



Ecoanalítica

acompañando las buenas decisiones

PERSPECTIVE REPORT

Year 16, Number 2
Quarter II

Forbidden reproduction and/or distribution

The pandemic (and the collapse) reoccur

CONTENTS

Introduction.....	2
The Oil Sector: What black gold?	5
The Real Sector: A bad start.....	13
Fiscal and Monetary Policy: At the edge of the cliff	19
Prices and Foreign Exchange Policy: The Price of the Pandemic.....	26
External Sector: There's still a semester to go	36
Conclusion: The most fragile among Latin America	43
Tables	46

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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

Introduction

A new quarter of confinement because of COVID-19 brought with it a Venezuelan environment afflicted from greater limitations in local economic activity and private consumption, failures in the supply of car fuel, the resurgence of inflationary pressures and recurrent tensions in the foreign exchange market. Such aspects, together with the restrictions on international trade due to the pandemic and the international sanctions on Maduro's government and the decline in oil production in face of the vulnerability of the national industry, have forced a greater collapse of the state apparatus, which now has fewer and fewer options for dealing with the local economic crisis amplified by the rise of the new virus.

On local real sector, the country's commercial activities continued their development in a restricted manner during the containment approach taken by the Executive. Despite recent attempts at reopening, the government was forced to resume a more rigid quarantine scheme at the end of the quarter, in view of the growing number of positive cases of coronavirus and the almost exponential rate of growth in positive cases and deaths.

Paradoxically, the countermeasures undertaken by the Executive to mitigate the real costs of the pandemic in Venezuela have further damaged the performance of the private sector within this new context. Even though some of them constituted partial arrangements to avoid a massive collapse of private consumption (such as authorizing borrowers to renegotiate part of the bank debts, the payment of special direct transfers and the payment of salaries to a fraction of the private payroll by the Government), they did not address the vulnerabilities that the private supply of goods and services already showed before the arrival of COVID-19.

Indeed, the Government urged very few changes in the legal banking reserves and did not dismantle the current weekly tax scheme, although it did order the suspension of payments of private and commercial leases and the extension of the decree of labor immobility. These conditions implied significant adjustments in the cost structure of the business activity seriously affected by the pandemic; therefore, both informal workers and formal employees suffered reductions in their income, which decreased the population's incentives to comply with containment measures.

The measures taken by the Executive were closely linked to the few alternatives available to it to cover its minimum expenses (payroll and food and drug imports) in the midst of the pandemic. During this quarter, the State not only faced a reduction in taxes due to the

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contraction of local economic activity in this quarter, but also a large foreign exchange deficit due to limited income from oil exports, amidst a lower flow of remittances received by households. With an expected sale of only 584 kb/d of Venezuelan crude oil in international markets this year (on average), even in the most optimistic scenario, local basket prices would lead the government to face a foreign exchange deficit of close to USD 1,993 MM by the end of 2020.

Price tensions did not stop with quarantine. In spite of the stop of economic activity and the decrease in household spending, monthly prices grew up to 58.0% (according to **Ecoanalítica's** metrics) during the second quarter, a behavior partially supported by the recently official published figures (until 38.6% for the same period). Thus, domestic prices would return to monthly levels that place Venezuela once again on the path of official hyperinflation this quarter.

Once the first pressures on prices increases due to the uncertainty of the pandemic were overcome, the economic dynamic seemed to be affected by the adjustment in food and service prices. Several factors are responsible for making these items more expensive: the sharp rise in the cost of freight due to the shortage of local gasoline at the beginning of the quarter, the use of monetary financing by the executive branch as a mechanism to cover the absence of traditional revenues (although on a smaller scale than expected) and recurrent increases in the foreign exchange rate. Nevertheless, changes in household consumption patterns during the quarantine still played an important role in determining local inflation and distorting relative prices.

Similarly, the exchange rate dynamics were influenced by the reduced capacity of the private sector to generate a greater flow of foreign currency, by the irregularity in the supply of gasoline, by the still high legal reserve requirements for banks and by the reduced capacity of households and businesses to acquire foreign currency due to the decline in their income in the midst of the cessation of activities. Similarly, the collapse of oil prices at the beginning of the quarter also contributed to greater volatility of the score in that period and even affected price dynamics.

In the midst of such tensions, the Nicolás Maduro government showed new intentions to resume the policy of agreed (or regulated) prices, as a mechanism to "stop" the recent price increase. Although its effective implementation would eventually be abandoned, these actions revived old fears in households and private firms about the beginning of a new round of shortages (and reappearance of black markets) of essential goods, adding further uncertainty to the pricing process in Venezuela.

The quarter was also marked by the unprecedented change in the pattern of domestic gasoline sales, following the arrival of a shipment of refined products from Iran. The Executive implemented a new system that includes service stations that offer fuel at rates close to the international price and other stations that sell at a subsidized price (for a given allocation) with a preferential scheme for public transport. This adjustment was an official recognition of the State's lack of resources (and the high fiscal cost) and the inability of the national industry to refine what is necessary to supply the domestic market.

In view of recent events, we have updated our projections for the main economic indicators of the country at the end of the year. With the possibility of a longer official quarantine, we estimate a contraction in domestic production of close to 33.5%, influenced by a sharper than expected drop on domestic oil activity (not fully compensated by the recovery of global oil markers). Similarly, non-oil economic activity will continue to be marked by the persistence of social containment policies and the cessation of trade with the rest of the world and its effects on local import activity.

On the other hand, with the current cash injection scenarios, we project local inflation above 4,000% by year-end, which is below the initial estimate. In addition to the Executive's caution in managing its spending while the quarantine remains in place, we believe that the setting of local rates will be affected by the decline in private consumption, in the midst of a more widespread social containment policy, lower remittances and bank financing still limited by the legal reserve. In this sense, the exchange rate will continue to be the most visible adjustment variable of the events occurring in the fiscal, monetary, and real environments in Venezuela. These new challenges demand new private firms' strategies to bail out the new crisis, which are summed up on the conclusions of this report.

The Oil Sector: What black gold?

The second half of 2020 continued to be marked by an adverse environment in the global oil market due to the general fall in demand for crude oil as a result of the COVID-19 pandemic. The resulting economic paralysis drove oil prices in April to their lowest levels¹ since 2016; in response, OPEC and its allies have sought to recover oil prices by reducing production to 22,271 kb/d, i.e., to 1991 levels.

In this context, the Venezuelan oil industry is simultaneously hit by the interruption of trade flows, the intensification of international sanctions and the accelerated degradation of productive capacity, which shows few signs of recovery in the short term.

Back to the 30s

According to official sources, Venezuelan oil production was at 393 kb/d in June, which converges with the secondary sources reported to OPEC. This represents a fall of 86.4% since the end of 2013. According to Bloomberg reports², during the first half of June, the most pronounced contraction was concentrated in the Orinoco Belt with a 50% drop to 148 kb/d, while the Maracaibo Basin registered a 40% drop to 83 kb/d in that period. These overall levels leave production below the level recorded in the 2002-2003 oil strike³ and effectively fall back to 1934 levels⁴.

¹ Brent oil averaged UDS 27.6 per barrel and WTI May futures contracts reached negative prices.

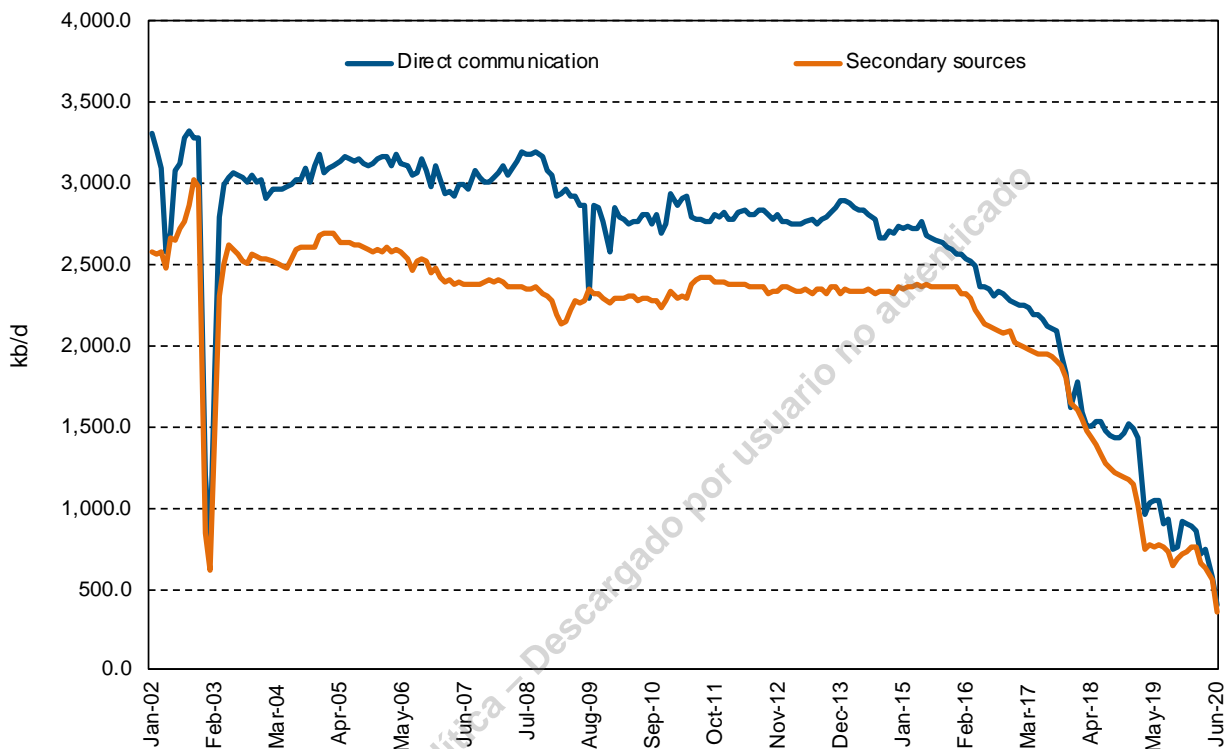
² [Bloomberg](#) (2020). *Venezuelan Crude Output Falls for Sixth Month, Deepening Crisis*.

³ 737 kb/d, according to official sources

⁴ Per capita production is set at 4.3 barrels a year, levels of 1924.

Year 16, Number 2
Quarter II

Venezuelan oil production



Sources: OPEC and Ecoanalítica.

The drop-in production is, in part, attributable to difficulties in locating oil on the international market, which depletes inventory capacities and forces the closure of well operations. Like other refining complexes, Indian refineries belonging to Nayara and Reliance have not placed new orders since March⁵ for fear of being subject to international sanctions for being linked to PDVSA. This meant that nearly 18.1 million barrels of crude⁶ remained in tankers with no destination for unloading and 38.2 million barrels were kept in inventory.

These restrictions on storage capacity are motivating PDVSA to slow down the pace of production. According to the firm Baker Hughes, only one gas drill was operating in Venezuela and none of the oil drills were operating by the end of June, a fall of 98.6% in the number of operational drills since December 2013.

⁵ With shipments delivered in May.

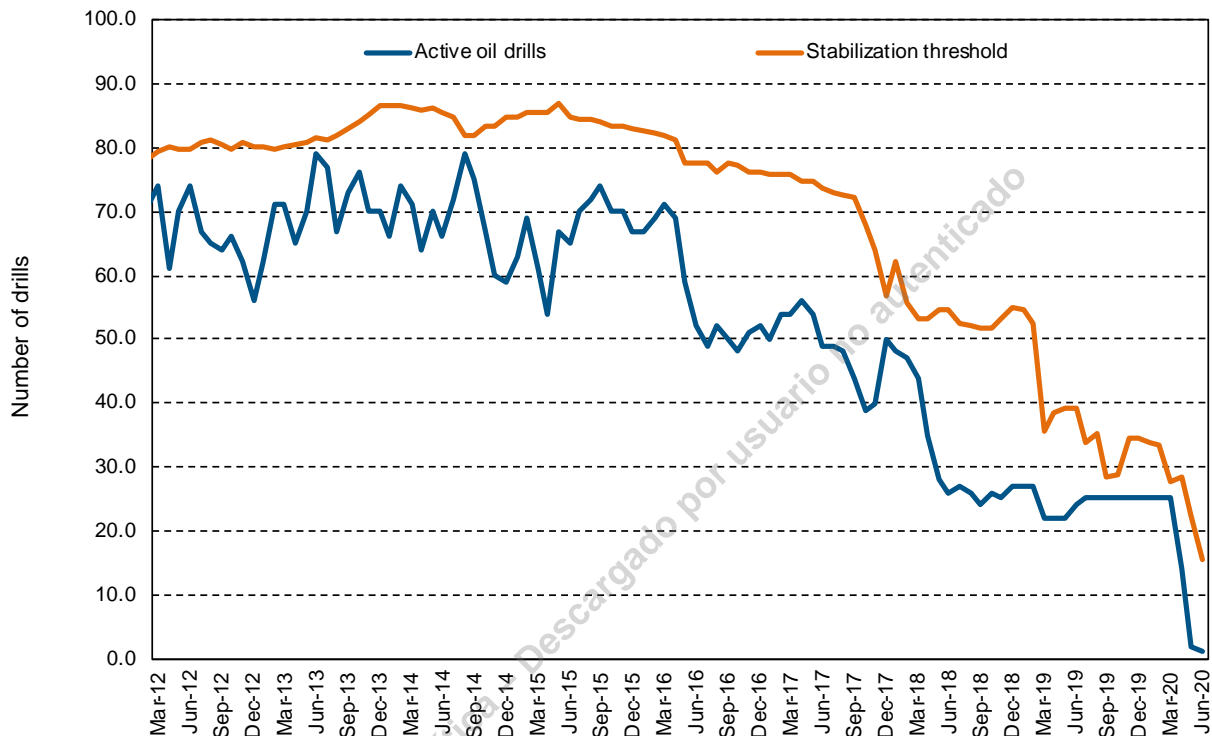
⁶ Equal to two months of production.

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Quarter II

Active oil drills and stabilization threshold



Sources: Baker Hughes and Ecoanalítica.

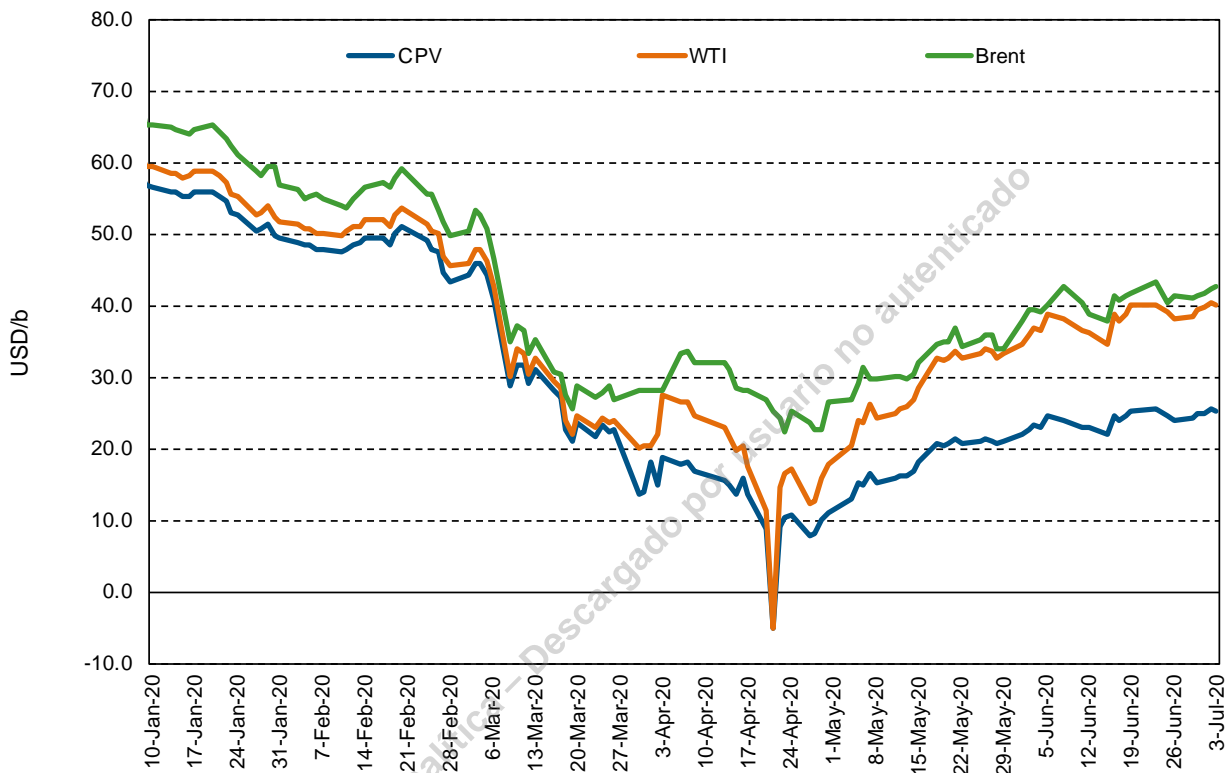
In this context, the greater accumulation of crude inventory in Venezuela, in addition to the collapse of the global crude oil markers on the eve of the expiration of the WTI oil contracts at the end of April, brought about an unprecedented decline in the price of the Venezuelan oil basket that caused it to reach levels below zero (- 5.1 UDS/b). Although recent stylized facts show the "transitory" nature of such adjustments, these limitations caused great damage to the Executive's capacity to generate income in foreign currency, tending to magnify, as we will see in the section on *External Sector: There's still a semester to go*, the State's needs to face a public budget already reduced in the rest of 2020.

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Year 16, Number 2
Quarter II

Oil prices per barrel



Source: Ecoanalítica.

Involuntary contributions

In April 2020, OPEC+ reached an agreement to cut production by 9,700 kb/d between May 1 and June 30, with subsequent adjustments until December 2020 and April 2022. Subscribing countries would reduce their production by 23% from October 2018 levels⁷. By the end of May, the global agreement had been fulfilled by 87%. Venezuela, along with Iran and Libya, is exempt from these cuts, but its cumulative fall until June (from baseline levels) would mean that it is contributing to an additional cut of 850 kb/d, or a compliance rate of 306.4% of the cuts it is not required to participate in.

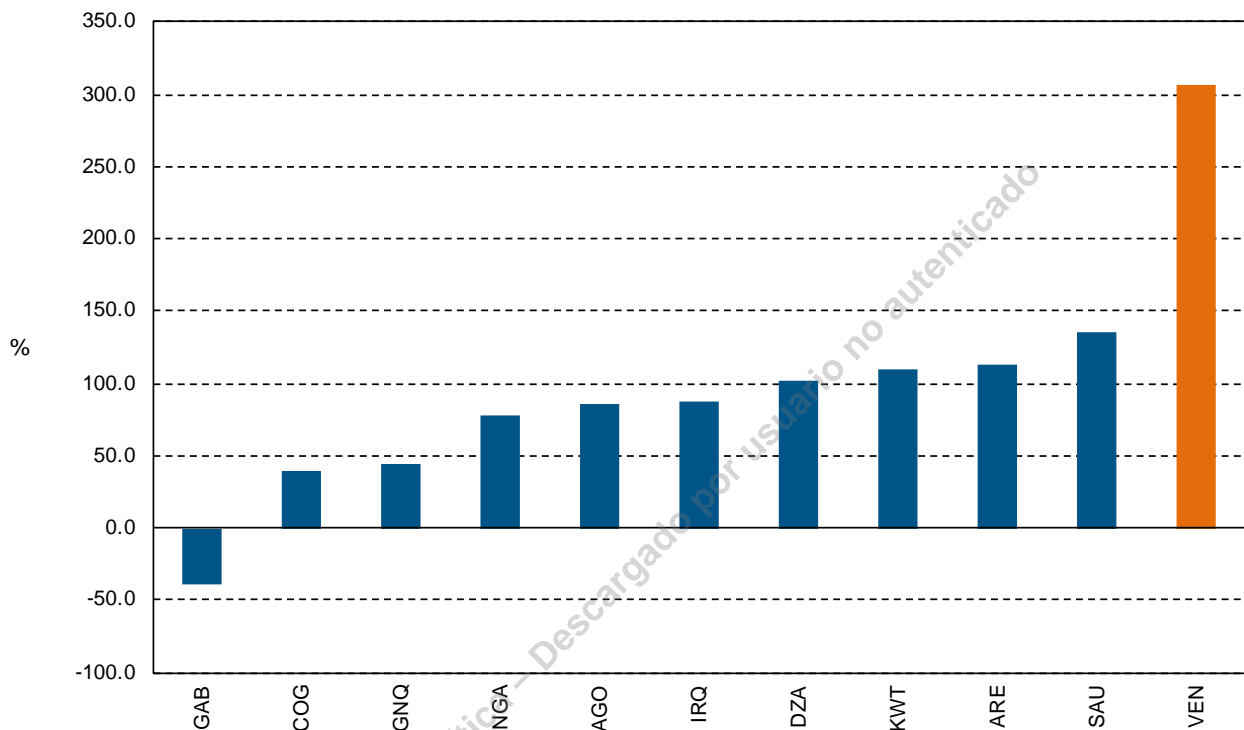
⁷ Except Saudi Arabia and Russia, where the reference level is 11,000 kb/d

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Year 16, Number 2
Quarter II

Compliance rate of OPEC cuts (June 2020)



Note: Compliance rate of reducing by 23% the production compared to reference levels of October 2018.
Sources: OPEC (secondary sources), S&P Platts and Ecoanalítica.

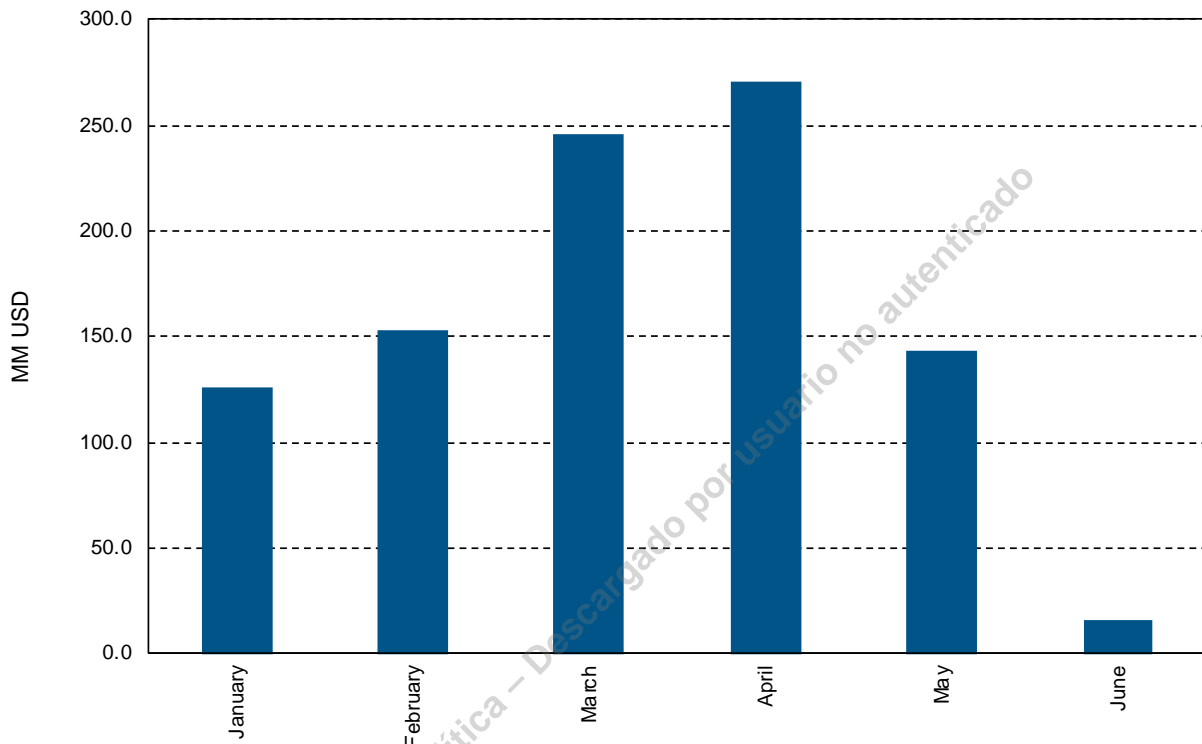
Incorrect instruments to solve a historical error

The second quarter of 2020 also saw substantial changes in the dynamics of the domestic fuel market, especially that of the price subsidy of fuel that had been frozen since 2016. Despite the fact that the quarantine had reduced domestic consumption to 67 kb/d, the chronic fuel shortage in the interior of the country during April is widespread enough for informal markets to record prices of USD 4.0 per liter. The shortcomings in fuel supply are leading to a reversal of smuggling from the border with Colombia to the domestic market, which reached USD 143 million in May.

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Internal fuel smuggling (2020)



Sources: Ecoanalítica.

In response, on May 30, the Executive announced an adjustment in the price of fuel as of June 1 and the implementation of a system of differentiated prices, which contemplates the "subsidized" rate of VES 5,000⁸, controlled through the system of national bonds and subject to monthly⁹ purchase limits, and an "international" rate of USD 0.5 per liter available in 200 authorized private gasoline stations. In addition, a 100% subsidy is established for public land transport.

At **Ecoanalítica**, we believe that this system of differentiated prices in a homogeneous goods market encourages internal fuel arbitrage with the subsidized price, to which the 73.2% of gasoline was sold. The preferential rate continues to represent the lowest price in the world within a market where there is a differential of 1,958.9% with the official international price and 16,371.0% with the upper limit registered in the parallel market.

⁸ Equivalent to USD 0.02 per liter when adjusted by the average monthly exchange rate of VES 213,905 /USD

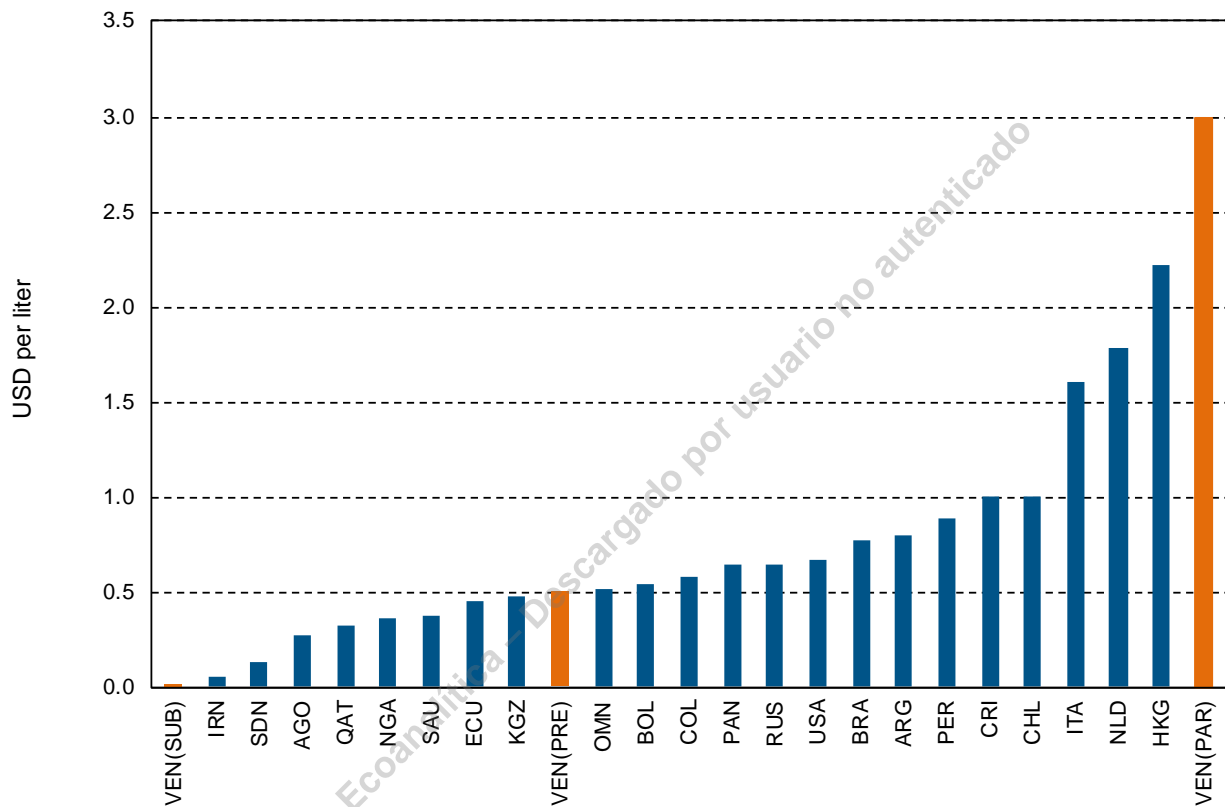
⁹ 120 liters per single vehicle and 60 liters for motorcycles.

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International gasoline prices



Note: VEN(SUB) corresponds to the "subsidized" price of VES 5,000/litre at a ER of VES 200,000/USD, VEN(PRE) is the international price of USD 0.5/litre, and VEN(PAR) is the parallel market of USD 3/litre.
Sources: GlobalPetrolPrices.com and Ecoanalítica.

The Fuel Odyssey

In June, average gasoline sales rose to 156 kb/d with the new supply scheme sustained mainly because of the 1.5 million barrels of fuel and diluents from Iran and the partial reactivation of local refining complexes, for dispatching 60 kb/d¹⁰.

The U.S. government proceeded to sanction¹¹ five Iranian tanker captains who disembarked in Venezuela and, subsequently, U.S. prosecutors introduced demands to

¹⁰ [Argus Media](#) (2020). PdV restarts gasoline output at Cardon refinery.

¹¹ [United States Treasury Department](#) (2020). Treasury Sanctions Five Iranian Captains Who Delivered Gasoline to the Maduro Regime in Venezuela.

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seize Iranian shipments of 1.1 million barrels headed for Venezuelan territory; however, the Tehran government maintained its position and said it would continue to negotiate fuel sales to Venezuela at current prices¹².

These geopolitical confrontations draw a scenario where fuel supply is at the mercy of vulnerable and potentially irregular supply chains, which could compromise the restitution of the service in Venezuela, to the extent that local refining capacity remains insufficient.

Views on the second semester

At **Ecoanalítica** we believe that the restitution of the rigidities that limit the range of maneuvering of the oil sector in terms of production, exports and imports will remain consistent in the next few months, so we consider that the most relevant elements for the rest of the year will be based on:

- Production levels around 510 kb/d, for the second half of the year. The complete resumption of operations will be subject to the emptying of inventories, a situation that has the effect of reducing the operational and capital costs with which the oil industry must operate.
- Prolonged inoperability of wells may raise reactivation costs above the expected profitability from the sale of Venezuelan oil, which would compromise recovery capacity in the medium term.
- Fuel supply dependent on irregular imports, with local refining capacity below domestic demand
- Unbalanced territorial distribution of gasoline, with an increase in the rationing of available fuel.
- Implicit rate of gasoline subsidies remains high, although the Executive shows signs of wanting to expand participation in international gasoline sales with the announcement of intervention of privately-run gas stations.
- The absence of major political upheaval from this first fuel price increase may motivate the Executive to make subsequent adjustments for fiscal reasons; however, internal pressure to maintain structures that facilitate arbitration may delay the elimination of distortions caused by differentiated prices.

¹² [S&P Global Platts](#) (2020). *Iran says it sold gasoline to Venezuela at current prices.*

The Real Sector: A bad start...

Among the activities of the real sector in Venezuela, one of the areas most affected during this quarter was manufacturing and commercial operations. With the official measures imposed to prevent a further spread of the virus among Venezuelans, both the manufacture of finished products and small and large service providers have seen their capacity to generate income and keep their business operational limited, in a context where teleworking represents an insufficient mechanism to compensate for the closure of on-site operations.

The local market has simultaneously suffered an adverse demand shock (marked by a drop in Venezuelans' income after the interruption of activities) and an adverse supply shock (limited by the effects of social containment and the absence of imports of inputs and finished goods). The maximum expression of this situation has been the lack of income generation by some companies and its effects in terms of job creation or compensation.

In this regard, leaders from various sectors in the country (such as Felipe Capozzolo from Consecomercio and Tanto Adán from Conindustria) have frequently mentioned the difficulties faced by companies in the context of the pandemic, resulting from the decrease in their cash flow due to the lack of activity and the absence of tax incentives. However, they clearly state that their operations suffered from multiple weaknesses before the official quarantine began, adding further drama to the expected collapse in the non-oil sector in Venezuela following the passage of COVID-19.

In this regard, in order to understand the true scope of the pandemic within our economy in the coming months, it is worthwhile to examine, in the first instance, the initial conditions in which the Venezuelan economic real environment was when the pandemic arrived to the country.

A virus before the virus

The Qualitative Industrial Survey¹³, conducted by Conindustria, offers a vision of the Venezuelan manufacturing industry for the first quarter of 2020. The aspects evaluated in this instrument reveal information on the capacity of such companies to face the paralysis of activities from the policy of social distancing, which can identify their potential vulnerabilities in the midst of the current pandemic.

¹³ [Conindustria](#) (2020). Qualitative Survey of the Industrial Situation I Quarter 2020.

In the first instance, the survey revealed how, despite the fact that 20.0% of the companies analyzed considered that the industrial sector was in better condition than the previous year, a high fraction of local entrepreneurs (39.0%) still thought that they would find themselves in a worse scenario than the first quarter of 2020. This lack of optimism is due to a series of elements that limit the manufacturing of their products and persist within their activities:

- Low national demand for nationally manufactured products.
- Uncertainty in the Venezuelan political and institutional scenario.
- Excessive fiscal or parafiscal taxes.
- Shortage of fuel for transport and other operations
- Precariousness of basic services (electricity, water, telephone and internet)

Is there a shortage of demand?

Low demand is a major problem for the sector, as even before the forced closure, a third of the total sample said they had no assured work for the next month. Likewise, 62.0% of the total stated that their sales volume had decreased, of which 82.2% mentioned that they had contracted significantly. Expectations for the next twelve months were not promising: 29.0% expected a decrease in their sales volume and 41.0% considered that they would remain constant.

Such results have undoubtedly affected the vision that entrepreneurs have of their own long-term survival in the local manufacturing market. At the time of answering the survey, 60.0% considered that they would not operate beyond next year given the present economic conditions (which did not include the containment policies that would be applied in the following weeks), of which one third of the companies (not necessarily the same third of the industry without orders to operate in the next month) claimed not to have the capacity to continue operating beyond the next six months.

Idle resources?

However, it is not all lack of demand. According to the respondents, prior to the pandemic, the local manufacturing industry was already presenting failures in the production and commercialization of its products, which end up affecting its income generation. In their view, such weaknesses were concentrated in the low level of sales, the difficulty of obtaining financing, production inefficiencies, high costs of production, poor quality of inputs and raw materials, and poorly qualified personnel. Thus, the presence of a new

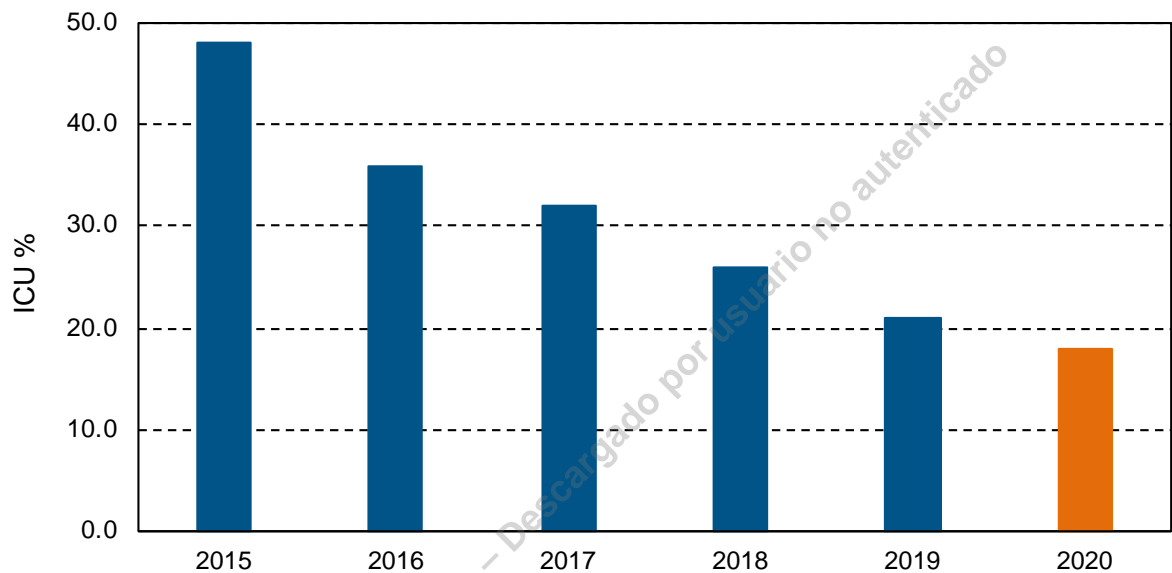
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event like COVID-19 only hurts the already affected source of income of the local businesses.

Installed capacity utilization (ICU) in Venezuela



Source: Conindustria.

Note: The comparison was made using the first quarter of each year.

The Installed Capacity Utilization (ICU) indicator was estimated at 18.1% at the end of the first quarter of the year. This shows a clear downward trend from an ICU of 48.0% five years ago. This value not only weakens when compared to our recent past, but also when compared to the indicator of other countries in the region such as Argentina, Brazil and Colombia, their ICU was 60.0%, 78.0% and 79.0%, respectively.

Half of those surveyed said that their company's operations would be affected by more than 50.0% because of the cessation of economic activity during quarantine. Half of the companies consulted agree that the main measure that should be taken to minimize the economic impact that COVID-19 would bring is to support the mobilization of personnel, products, inputs and raw materials, release of the legal reserve to allow greater circulation of credits and modification of the payment of the VAT and Income Tax.

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Trading with the virus

Like the industrial sector, the commercial sector was already experiencing difficulties at the end of the first quarter of this year, especially in the interior of the country. In the Economic Situation Survey, relative to the first quarter 2020, conducted by the Chamber of Commerce of Maracaibo (CCM), 93.0% of its respondents shared that their sales were reduced compared to the fourth quarter of 2019. In addition, 74.0% declared that their investments maintained a similar behavior. The main factors identified affecting their activities were weak demand, fuel shortages and political uncertainty.

As for the situation of the companies during the confinement, 74% said they were open or partially open and implementing actions to protect the health of their employees. However, they considered that the effect of COVID-19 will be negative for the economy. They also think that the measures implemented do not generate confidence, since 60.0% consider the increase in the minimum wage to be negative and 69.0% describe the price control policy as "not very appropriate".

However, one advantage of this sector is its ability to adapt to the constraints of quarantine. Therefore, 40.0% of those surveyed stated that they had implemented home delivery services for their products, 38.0% stated that they were considering the implementation of digital portfolios in foreign currencies to facilitate the transaction of their products and 69.0% and 64.0% stated that both suppliers and customers, respectively, had adopted digital strategies to offer or request their goods and services.

In addition, they have declared that they have carried out complementary measures, such as: reassigning projects, advancing holidays, charitable activities in vulnerable communities, advertising campaigns on social networks, payment of extraordinary bonuses, advances in salary payments and the halting of salary adjustments. This last measure stood out because 41.0% declared that they had implemented it. Despite these actions, those surveyed said they were aware that it could not guarantee the survival of their operation in the long term. 47.0% of businesses surveyed¹⁴ by the Maracaibo Chamber of Commerce considered that, if the quarantine were extended, they would not be able to remain operational beyond next month.

In terms of employment in both sectors, the Conindustria survey showed that, for the first quarter of 2020, 14% of companies on average lost some of their qualified personnel compared to the previous quarter. Most industries (44%) said their loss of skilled personnel was less than 10%. According to the agency, this represents a smaller

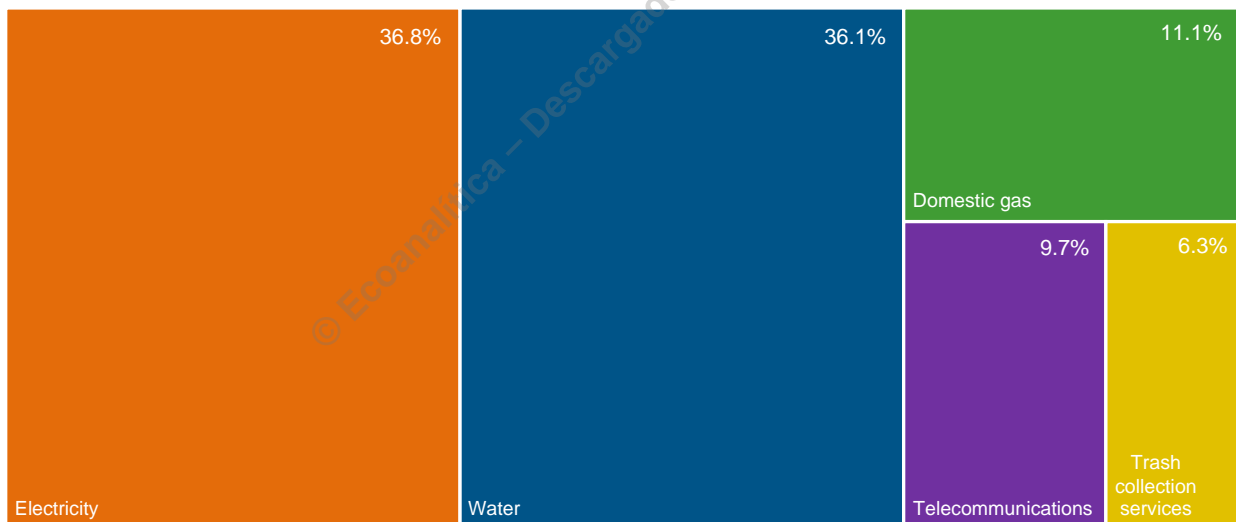
¹⁴ In May 2020.

decrease in personnel compared to previous months; however, several companies expressed plans to make personnel cuts.

Most notorious vulnerabilities

An additional dimension of the economic and social crisis currently facing the local market is public services. Similar to what has been described by the manufacturing and commercial areas, public services in Venezuela were in precarious situations before the arrival of the pandemic to the country. These deficiencies are becoming more evident with the crisis. The study by the Venezuelan Observatory of Public Services (OVSP)¹⁵ highlights that, by April and May, 64.7% of the inhabitants "do not have enough drinking water to apply the hygiene measures recommended by the World Health Organization (WHO) to deal with the effects of COVID-19.

Distribution of the reported services during quarantine



Sources: OVSP and Ecoanalítica.

In addition, 57.4% of those surveyed said they experienced blackouts and power outage in their residences, leading 70.0% of them to change their routine. The inconstancy of the electrical service has a direct impact on telecommunications. More than half of the users reported daily failures in their Internet connection and 53.9% of the users declared that

¹⁵ Held in the ten main cities of the country: Caracas, Valencia, Punto Fijo, Maracaibo, Barinas, San Cristobal, Ciudad Bolivar, Barcelona, Porlamar and Barquisimeto.

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the service was deficient. Continuing with work and school activities under these conditions is a challenge for Venezuelans.

Poor access and quality of services, in general, have forced a large number of Venezuelans to make adjustments to their routines using increasingly costly and occasionally inhumane mechanisms.

What poorly begins...

Clearly, the initial conditions under which the private sector in Venezuela was facing the new pandemic have led to the development of new and greater vulnerabilities on the supply side of local goods and services, as the spread of the new virus increases, leading to attempts by the Executive to slow its progress. Due to the fact that limitations on import activity will still persist in the short term, the lack of bank loans as a result of the legal reserve, an unchanged tax scheme, and the future extension of the official quarantine, lead us to our latest projections, that points to a contraction of manufacturing and the commercial sector of 36.5% and 42.1% this year.

Together with the austerity of the public sector forced by the fiscal consequences of the new virus (outlined in the fiscal/external section of this report), the deterioration of national oil production, and the restrictions on non-oil activity would lead to a fall in Venezuela's gross domestic product of no less than 33.5%, according to our estimates.

Furthermore, as local entrepreneurs themselves reveal, shortcomings on the producers' side end up translating into limitations on the purchasing power of their employees. This, together with the precarious conditions of informal work in the midst of the pandemic (including the persistence of the hyperinflationary environment) and the absence of bank credit as a compensatory mechanism, makes it possible to foresee a sharp contraction in private consumption. We therefore estimate a fall on this expenditure of no less than 32.5% by the end of 2020.

Fiscal and Monetary Policy: At the edge of the cliff

The Executive has been stumbling over the tightrope to counteract the negative effects of COVID-19. In advance, it has a weak position in terms of its income (oil and non-oil). Furthermore, knowing that any expansive monetary or fiscal measures to counteract the effects of the pandemic may cause a spike in inflation and the exchange rate, the Government has tried to be cautious in its decisions.

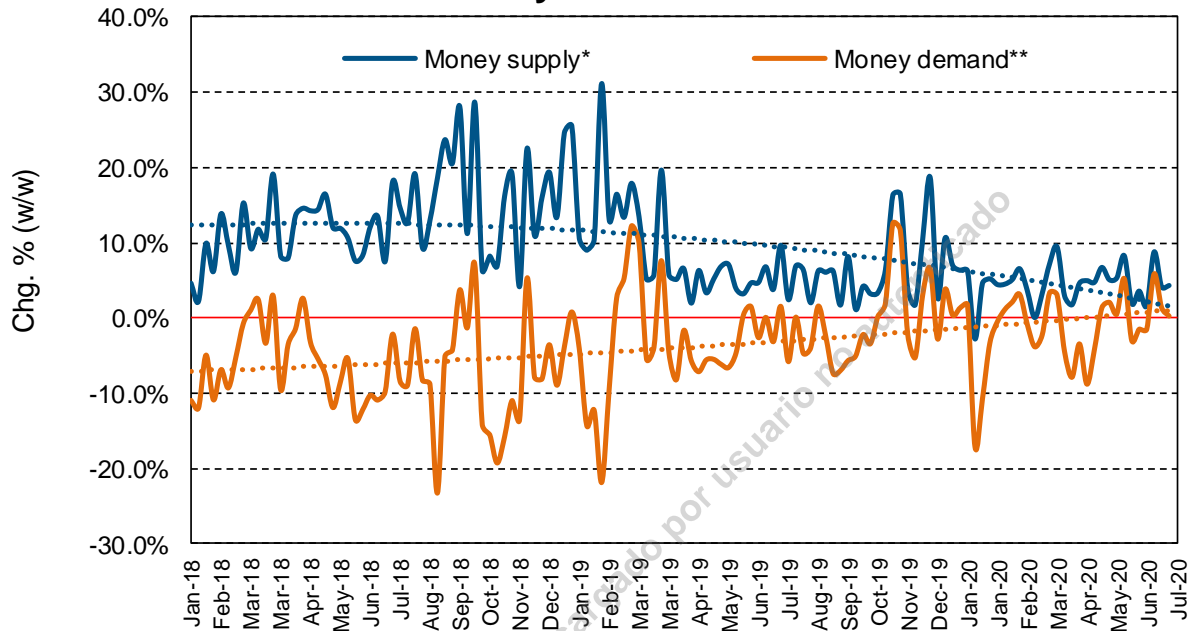
The Government has sought to adjust public spending, but its revenues continue to fall, so there remains a significant fiscal deficit that continues to be financed monetarily in the absence of other options. In the previous version of this report¹⁶, possible decisions taken by the official body were mentioned; for this edition, we will describe the implications of the main actions taken.

Bolivars that get in the way

Furthermore, as expected, transactional dollarization in Venezuela deepened in the midst of quarantine. Given the context of uncertainty, between policies of flexibilization and radicalization of containment measures, people began to demand more foreign currency for hedging and transactional reasons in order to be able to make payments in non-conventional channels. This translated into a new collapse in the demand for bolivars, which seemed to stabilize in the first months of the year, but then resumed its downward path, showing a cumulative contraction of 15.8% from March 13 to the second week of June.

¹⁶ Perspectives Report 1Q2020: *Overcome by the Invisible*, section on Fiscal and Monetary Policy: *Stumbling on the Tightrope*.

Money Market in 2018-20



Sources: BCV and Ecoanalítica.

*Accumulated change of nominal monetary liquidity (M2).

**Its impact is assumed as the accumulated change in M2 in real terms.

Additionally, in several reports¹⁷ we have pointed out the narrow field of maneuver that the Executive must take actions according to the crisis we are facing. In this sense, with the frantic increase in inflation, the Government opted for a policy of salary delays and the delivery of the bonds became increasingly opaque, coupled with strict legal reserve measures¹⁸.

Trying to compensate the blow to Venezuelans' income through public spending and the flexibilization of the lace have been the most popular options; the first at an international level and the second among different sector leaders who have proposed it as a solution. However, these actions would generate inflationary pressures¹⁹, something that the

¹⁷ Weekly Report N°9, 2020: *No one is immune to fear: Coronavirus Economic Effects*, N°10, 2020: *The bubble in quarantine: How will the COVID-19 Impact our economy?* N°11, 2020: *COVID-19 reloaded: Numbers in containment times*.

¹⁸ Before the modification of April 1 of this year, the financial entities were responsible for delivering 54% in the form of ordinary reserve, 100% as marginal reserve, in addition to the special reserve, referring to sanctions in case of presenting information of their requirements.

¹⁹ For a more extensive analysis of the possible measures that the Venezuelan Government will take during the COVID-19 pandemic, you can refer to our Weekly Report N°10, 2020: *The bubble in quarantine: How will the COVID-19 Impact our economy?*

government has sought to avoid since last year. Therefore, it has focused its efforts on restricting monetary issuance to levels that do not drive higher price growth.

Is it better in the legal lace?

Faced with the economic consequences of the pandemic, the Executive responded with modifications to the legal reserve²⁰, setting it at a level of 93% of bank deposits and repealing the concept of the marginal reserve. Although this, theoretically, would allow greater ease in the circulation of credit, thus reducing the fall in consumption in the short term, in reality, it continues to be a restrictive requirement for the Venezuelan banking system. In addition, the differentiated penalty scheme based on the size of each bank's legal reserve deficit is maintained, only with an initial reduction as of April 1²¹.

Therefore, in a still tight environment coupled with a lack of demand due to the economic downturn, it is not surprising that the banking system has not granted any new loans during the quarantine. In this period, loans have not yielded more than 13.7% of their deposits, which is less than in the last quarter of 2019. Similarly, lending by all sectors (except agriculture) contracted between 27.4% and 62.2% in April.

The policy of reduction

Compared to the previous quarter, the number of bond types issued increased. Apart from those that are issued at a fixed frequency²², the government announced eleven new bonuses, although their delivery has been not very transparent, as not all beneficiaries receive the total amount of each category and official entities do not disclose this number²³. Figures from the new Encovi²⁴ show that 52% of households received transfers through the Patria system in March and April, an increase of 27 percentage points (pp) over the period October to February. In addition, the average amount of these transactions was USD 5.

²⁰ Resolution 20.03.01 of the Official Gazette No. 41,850 of March 30, 2020.

²¹ For further details on the new socket measures, please refer to our Economic Note N°1, 2020: *New legal socket guidelines. More of the same?*

²² Bonuses such as "Hogares de la Patria", "José Gregorio Hernández", "Pueblo Libertador" and those related to maternity.

²³ The allocation of the type of bond, its amount and the beneficiary itself is at the discretion of the Executive.

²⁴ [Encovi](#) (2020). *Encuesta Encovi 2019-2020*.

Fatherland's Direct Transfers during Quarantine

Transfers	Dates ¹	Amount (VES)
Stay Home (March)	From March 24th	400,000
Family Economy	From March 29th	125,000
Stay Home (April)	All April	400,000
Easter	April 8th - 15th	350,000
Health and Life	April 22nd - 30th	350,000
Stay Home (May)	All May	400,000
Labor Day	May 2nd- 12th	450,000
Mother's Day	May 10th - 12th	450,000
Discipline and Conciousness	May 28th - June 4th	500,000
Special against the Economic War	Until June 6th	300,000
Relative Normalcy	June 12th - 19th	N.A. ²

Sources: Patria.org, official announcements and Ecoanalítica.

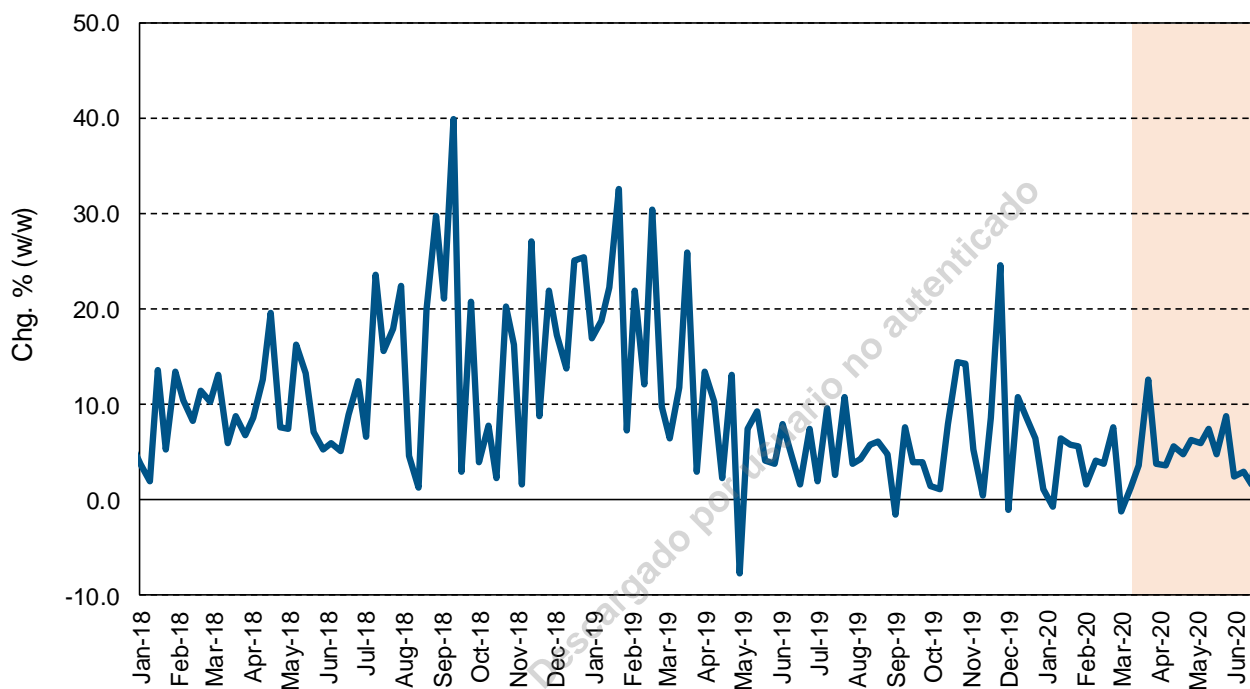
¹Date of the transfer, not its announcement.

²Not announced amount, the Executive established it will be known later.

It is striking that, with the number of bond issues and payroll payments that had to be executed, the average variation in the monetary base was only 5,6% each week during the confinement. Although it has had an upward trend in this period, further growth was expected. One explanation for this may be the decrease in the monetary impact of the private sector payroll, as 63% of the companies expressed that they would not use the local subsidy because of their distrust of the governing body²⁵.

²⁵ According to the PGA Group's April 24th Situation Report: *Coronavirus*.

Weekly chg. of Monetary Base



Note: The shadowed area refers to the period under confinement measures
Sources: BCV and Ecoanalítica.

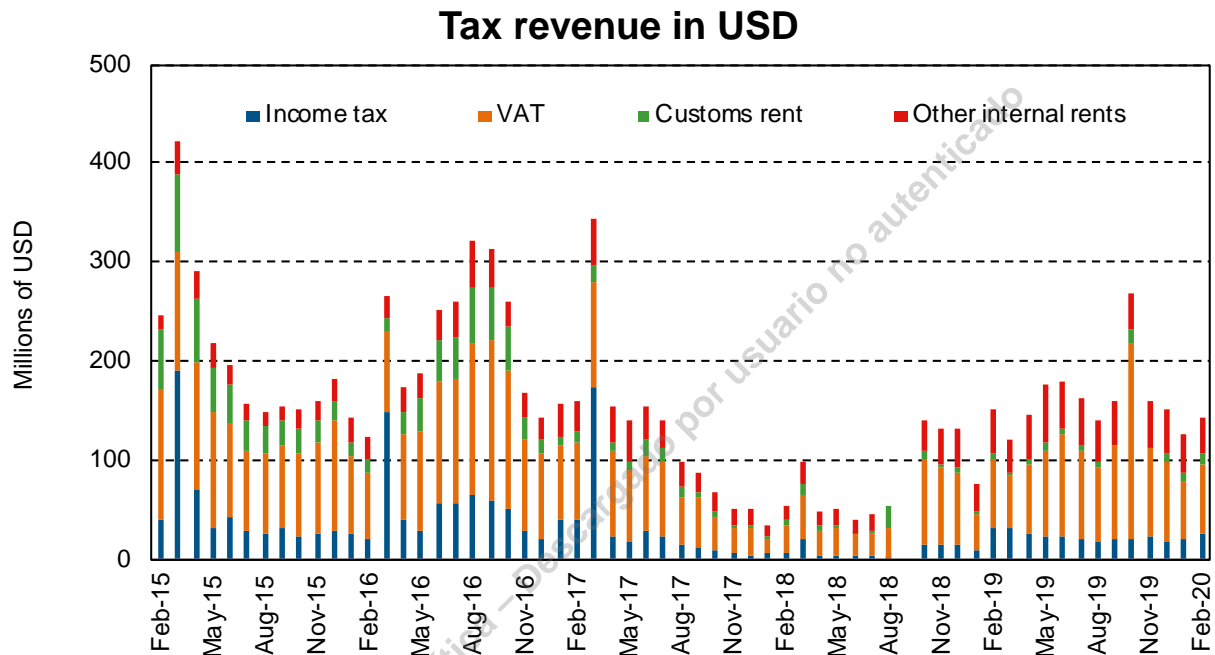
Another reason behind this may be the sterilization of the base through the positioning of securities by banks. These adjustments coincided with exchange rate increases and expansion of net non-monetary foreign currency liabilities. Thus, as a larger injection of bolivars translated into exchange rate increases, the expansion of BCV liabilities contracted the monetary base, thus offsetting the initial expansions of fiscal origin²⁶.

And the income?

The Executive's efforts to reduce public spending are hampered by the sharp drop in non-oil tax revenues. The SENIAT has not published figures for revenue since February; however, it has been declining in real terms for several months. The amount collected in the last month is equivalent to USD 142.1 million a yearly fall of 6.1%. A reduction of this magnitude in non-oil revenues implies difficulties in the Government's fiscal management, especially in the midst of the collapse of public income generation from oil exploitation.

²⁶ For a more detailed analysis on this subject, please refer to Weekly Report N°23, 2020: *A look at Venezuela's quarantined banking system*.

This was a persistent problem before the arrival of the COVID-19, so we do not expect the trend in taxes to change in the coming months.



Sources: Seniat, Local bitcoin and Ecoanalítica.

When detailing non-oil revenues, while value added tax (VAT) collection represents 56.2% of the total, income tax (ISLR) collection represents only 14.2%²⁷. The predominance of the former in non-oil taxes has been present for more than six years. This may reflect a decrease in the number of taxpayers, something that has been observed since the last decade²⁸, the drop in real wages of the population in a hyperinflationary context and the growing informality within the labor market²⁹. In particular, the latter aspect is expected to have been magnified in the midst of the pandemic by the search for other subsistence mechanisms, which in the future will mean that more Venezuelans will be more vulnerable with temporary or uncertain sources of income to cope with higher prices.

²⁷ From the collection of the period between March 2019 and February 2020.

²⁸ According to García G. & Salvato S. (2005). *Equity of the tax system and public expenditure in Venezuela*, the average number of taxpayers in the country during the period from 1986 to 1994 was 743,787 persons, while between 1995 and 2004 it was 544,460 persons.

²⁹ Vera, L. (2017). *Taxation in Venezuela: challenges with a sense of equity*. FES, Bogotá.

A forced austerity

As long as the problem of the lack of income is not solved, the State will be in a precarious general condition, where any false step around the monetary aggregates can trigger inflation and the exchange rate again. In this sense, the Government lacks the fiscal strength to curb hyperinflation or chronically high inflation. Without changes from this source, this structure will remain unworkable in the long term and the uncertainty and lack of trust of Venezuelans about official measures will grow even more.

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Prices and Foreign Exchange Policy: The Price of the Pandemic.

In our Outlook report last quarter³⁰, we foresaw the possibility that the Executive would again incur in monetary financing of public spending to meet the payroll of private sector employees and to be able to make current transfers to the population through the Patria system. All this as part of the measures announced to alleviate the effects of the pandemic³¹.

However, as we analyzed in the Fiscal and Monetary Policies section of this report, the Executive would maintain the strategy it took since the beginning of 2019: a restrictive fiscal adjustment, limiting its expenditures³² by means of delays in the minimum wage³³ and direct transfers through the Patria system; in other words, the Executive would prefer to assume the reputational costs of not incurring a large expenditure to reduce the consequences of the pandemic so as not to encourage an even more acute hyperinflationary environment again.

Without this stimulus, according to our estimates, the average monthly inflation in 2Q2020 was 33.6%, 14.1 percentage points (pp) lower than the one observed in the same period of 2019; however, the evolution of prices is not only due to what the government has done; therefore, in this section, we will review in detail the behavior of prices and the exchange rate and will offer our projections on both indicators for the end of 2020.

A strong start and a deflated continuation.

Local prices showed a rather volatile evolution throughout the quarter, starting with a notable increase in April (58.0%), followed by decelerations in their variations for May and June of 22.9% and 19.9%, respectively³⁴.

³⁰ Outlook Report 1Q2020: *Defeated by the Invisible*.

³¹ Reviewed in: [El Nacional](#) (2020). *Las ocho medidas económicas que anunció Tareck el Aissami para enfrentar el covid-19*. And those that we initially analyzed in the Weekly Report N°11, 2020: *COVID-19 reloaded: Numbers in containment times*.

³² And consequent financing through the expansion of the monetary base.

³³ Although wages increased 77.8% in May, the accumulated inflation between that increase and the previous one was 185.6%, according to data from the BCV.

³⁴ According to our estimates.

The behavior in April was closely linked to upward pressures on the exchange rate³⁵, in addition to the fuel shortage that forced local agents to resort to unofficial markets with prices above any international marker³⁶, which would eventually have repercussions on price formation for transport services.

On the other hand, the prevailing uncertainty in the business world about its ability to continue to generate income in the short term would cause some companies to make the decision to advance payments that would then be used by their employees to purchase basic necessities. Such income shocks ended up reinforcing the changes in the spending pattern of local households, which favored the acquisition of such goods since the arrival of the pandemic in Venezuela therefore generating, the rise in the price of such goods due to increased demand.

Later on, even with the elimination of the gasoline subsidy (and its impact on the price level³⁷) and the attempts to implement a new price control (and its repercussion on the potential shortage of some products³⁸), a deceleration of the inflation rate would be observed in the following two months. This would be due, in part, to the considerable discontinuance of private activity due to confinement, which would affect companies' cash flow and, therefore, compensation for their employees. Such a contraction of income would reduce the possibilities of consumption and therefore its demand for goods and services.

In this sense, weekly inflation illustrates these points: this quarter's average was 5.9%, a clear deceleration if we compare it with the same indicator observed in the previous quarter (6.8%) and in 2Q2019 (9.8%). In addition, the inflation of the week from June 26th to July 3rd stood out (2.7%), the second lowest of the whole series³⁹.

³⁵ Discussed later in this section.

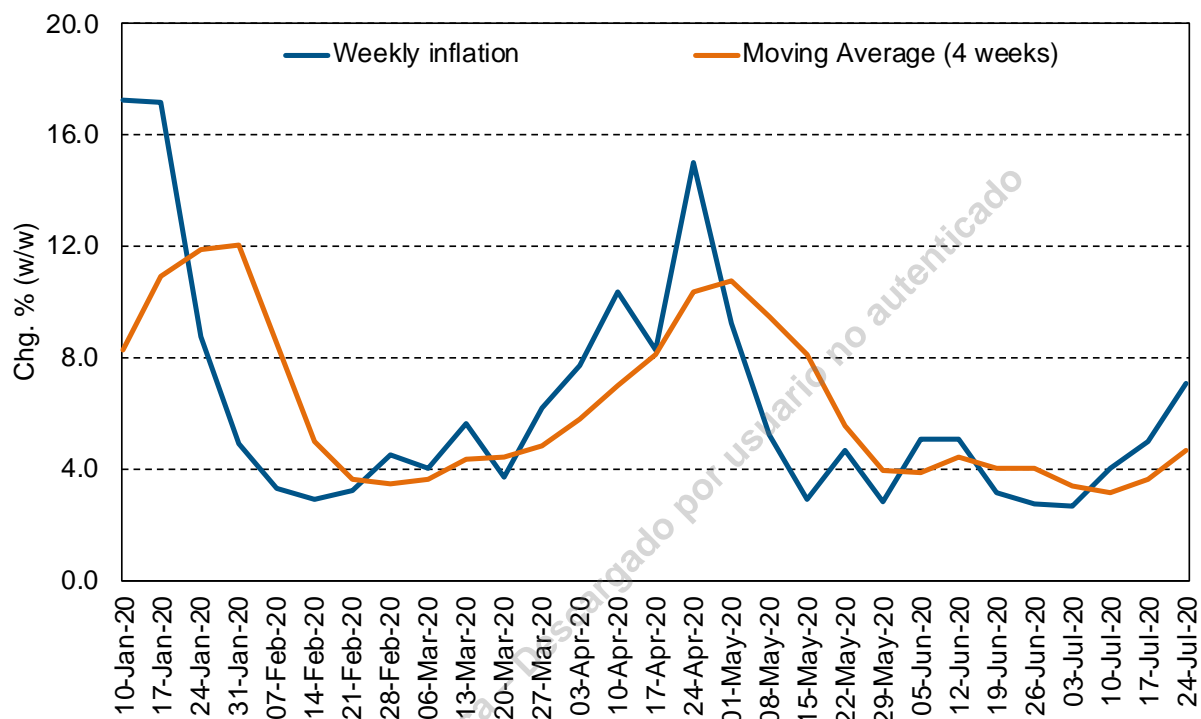
³⁶ [Reuters](#) (2020). *Venezuela's gasoline goes from world's cheapest to steepest*

³⁷ On May 31st, the Executive announced a modification of the price of gasoline and the incorporation of a dual pricing scheme: one "subsidized" to VES 5000/L and another released to USD 0.5/L. For more information, check our Oil Environment section and the Weekly Report N°20, 2020: *12 questions about the rising petrol prices (I)*.

³⁸ For a more detailed review, see our Weekly Report N°15, 2020. *The perfect storm: Price controls in quarantine*.

³⁹ Ecoanalítica has been monitoring prices at a national level on a weekly basis since January 2018. For more information, consult our product Inflation Monitor.

Weekly Inflation 2020



Source: Ecoanalítica

Preferences under quarantine

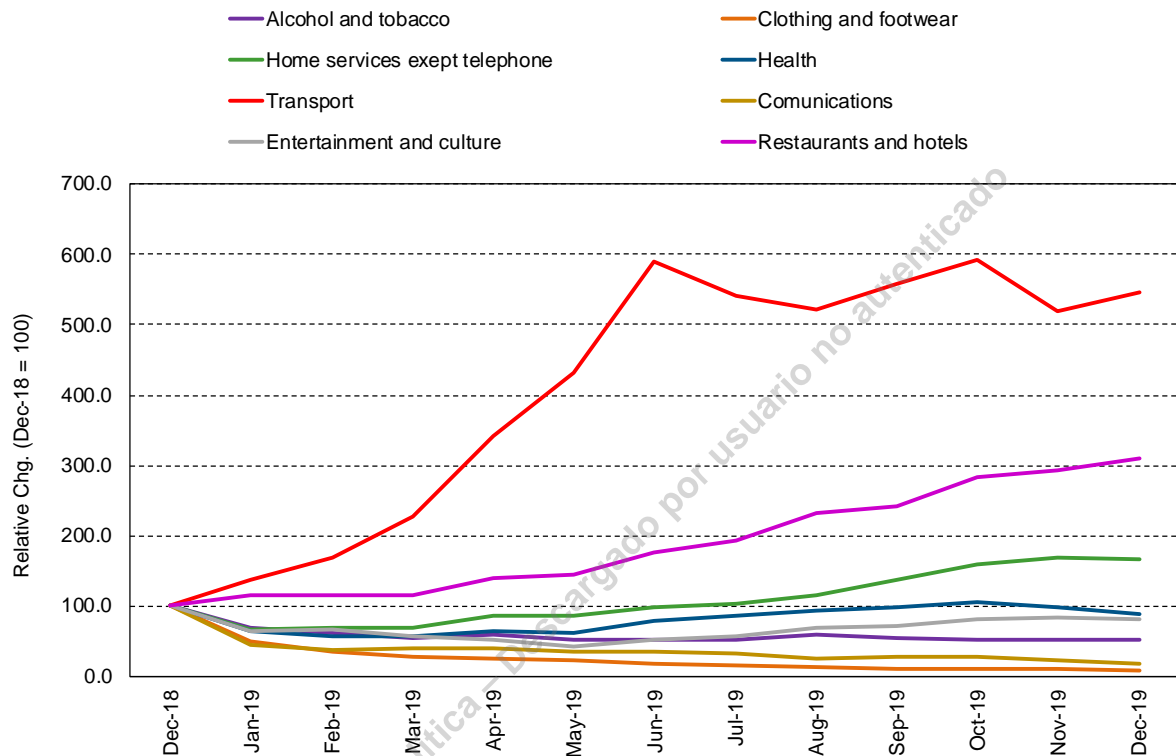
It should be considered that the items that make up the Venezuelan consumer basket do not evolve symmetrically, each of its price indicators are due to particulars that affect their supply and demand, so that these differences between their markets cause a different price formation process and, consequently, different growth rates. These differences may be due, for example, to the fact that an item is affected by price controls and subsidies - whether the presence of these or the observation of an adjustment process resulting from the release of tariffs- or to the preferences of the agents.

Already in 2019, the process of liberating certain subsidies had led to a significant increase in the price of "Transportation" (407.6%) compared to "Food and non-alcoholic beverages", while "Health" showed a similar increase in its prices.

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Relative Prices to Foodstuff (Ecoanalítica)



Source: Ecoanalítica

Then, in the first half of 2020, it was observed that the Food category presented a greater increase in prices, compared to the rest of the categories that make up the basket of goods representative of Venezuelans; however, some behaviors have been observed throughout the year that are worth noting. Firstly, the change in the trend of the relationship between the Food and the Basic Services category that is observed since the beginning of quarantine in March⁴⁰ and in the relationship between Food and Transportation, where in the first three months a relative increase of the first over the second was observed and then a contrary relationship, which also coincides with the beginning of quarantine and the fluctuations in the price of gasoline (both officially and unofficially).

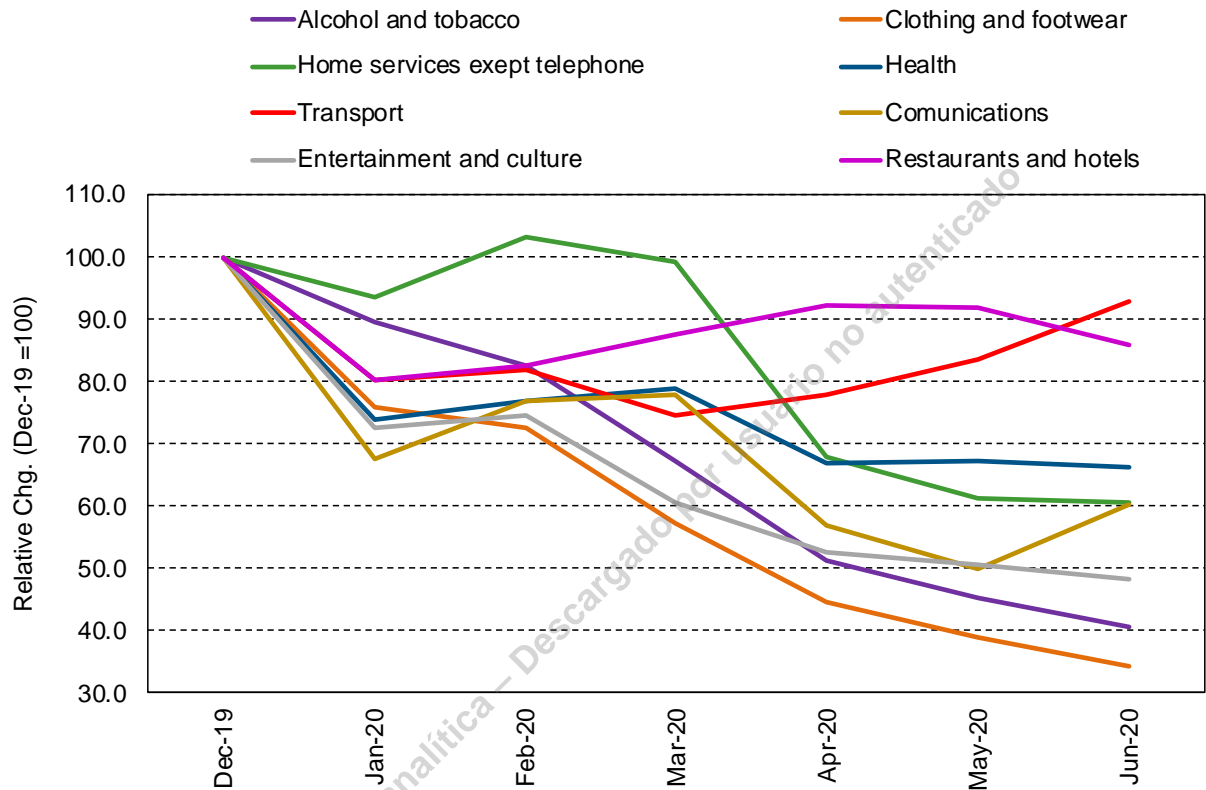
⁴⁰ Before the start of the containment measures, an adjustment of the subsidized prices related to the cost of basic services was taking place. Reviewed in: [Reuters](#) (2020). *Venezuela aumenta tarifas de servicios públicos en medio de crisis e impacto por coronavirus.*

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Relative Prices to Foodstuff (Ecoanalítica)



Source: Ecoanalítica.

It should also be noted how lower priority or "luxury" goods such as "Clothing and Footwear" or "Entertainment and culture" and "Alcohol and Tobacco" show less growth than the rest of the more essential goods such as "Food and Non-Alcoholic Beverages" and "Health". Therefore, it could be said that the arrival of the pandemic, with its consequent income limitations for consumers, has affected the consumption decisions of Venezuelans, who give greater priority to more essential items.

The change of confinement

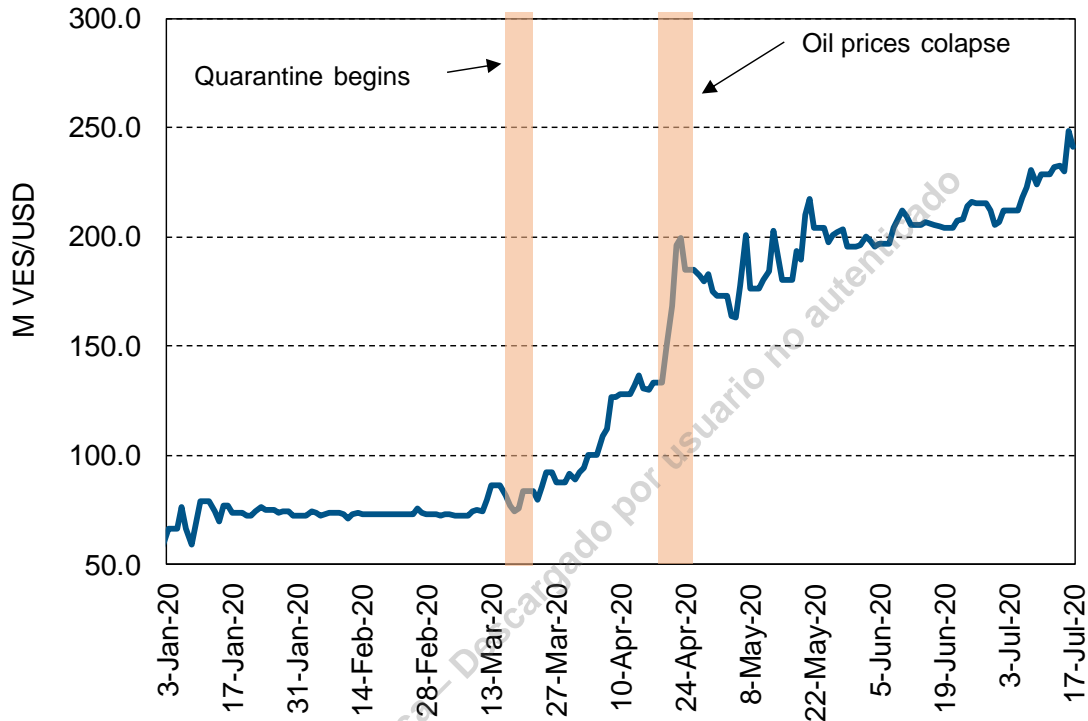
During the first weeks of quarantine, a clear acceleration of the rate of change was observed. In April, the retail exchange rate indicator would increase by 96.4% (depreciation of 49.1%), this is equivalent to the highest monthly increase since January 2019.

This initial increase could be due to two reasons: 1) the (previously exposed) decision of many companies to advance payments as a compensation measure, since they presumably foresaw a shortage of basic necessities or a sudden acceleration of prices due to the pandemic; and 2) the reaction of agents to the fall in international oil price indicators; the week in which the value of WTI crude fell to negative levels, the retail exchange rate increased 38.3%.

Both factors made the agents, in order to anticipate the limitations in fiscal matters that the Executive had to face, demand a greater amount of foreign currency in search of protection, driving up the exchange rate indicators.

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Retail exchange rate evolution on 2020



Sources: LocalBitcoin and Ecoanalítica

After April, the change in the exchange rate was 11.7% in May and 5.1% in June (depreciations of 10.4% and 4.8%, respectively). In this period, the specified release and "dollarization" of the price of gasoline should be highlighted. At the time the new dual scheme was introduced (a "subsidized" price at VES 5,000 per liter and another at USD 0.5 per liter⁴¹), service stations did not have an electronic payment mechanism and there was little availability of local currency in circulation⁴²; consequently, the alternative payment that would present greater ease would be the use of foreign currencies in cash.

This could have two effects. In principle, the transaction value that the currencies acquire would increase their demand, driving up their value against the local currency. However,

⁴¹ Or its equivalent in sovereign bolivars calculated at the official rate.

⁴² Whose higher-denomination presentation would only suffice for 20 liters of fuel under the subsidized scheme (or, approximately, for less than one liter under the released scheme).

the constant collection and future circulation of foreign currency by national⁴³ banks from service stations could slow down the increase in exchange rate indicators⁴⁴.

In addition, the collapse of private income must be considered. The price of foreign currency also acts and is governed by particular supply and demand mechanisms; therefore, in view of the reduced income of the agents, they prioritize the acquisition of goods of more priority use (consumption) to the detriment of the demand for foreign currency for hedging purposes. Certainly, this mechanism could not operate in basic need categories, which are marketed exclusively in foreign currency (in which case, the demand for foreign currency for consumption could be exacerbated and, with it, the rise in the exchange marker).

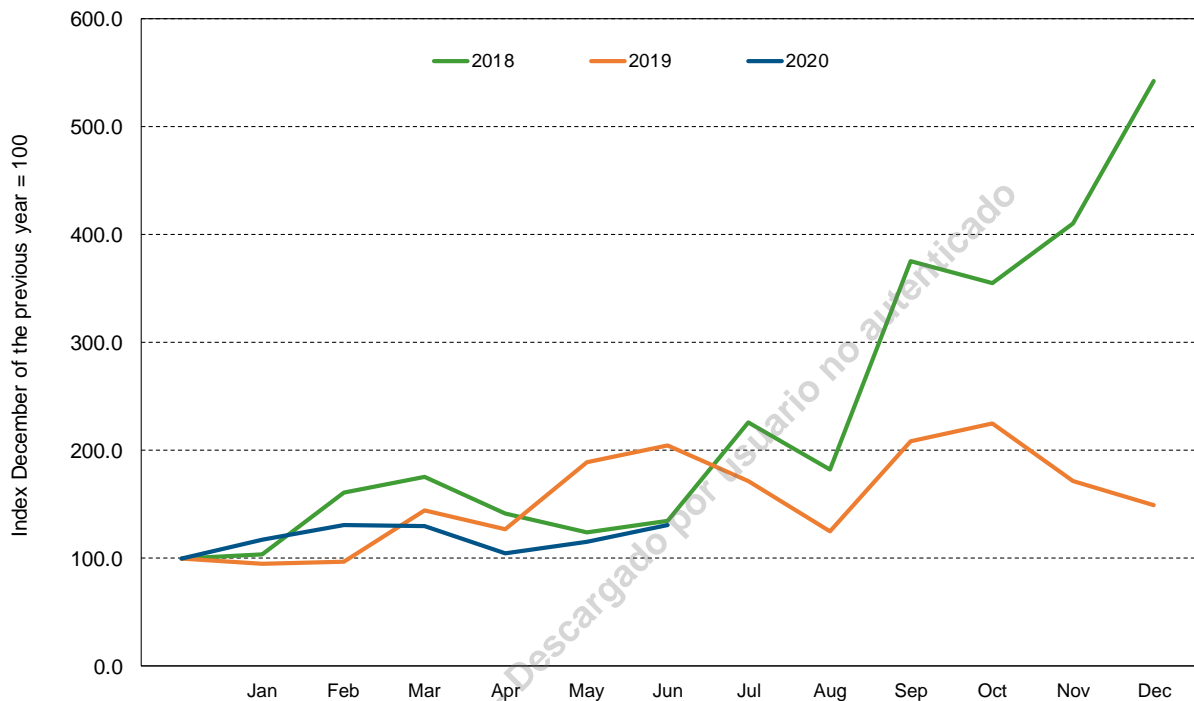
Similar to 2019 (for now).

After the first half of 2020, the NCPI and the unofficial exchange rate showed a cumulative variation of 387.7% and 272.3%, respectively. At first glance, it can be seen that price growth has been higher than that of the exchange rate indicator, which would give rise to phenomena that we have mentioned in different reports: "the loss of purchasing power of the dollar", "the rise in the price of life in dollars" and "the real appreciation of the exchange rate".

⁴³ By imposition of the Executive, national banks must sell the foreign currency obtained from the sale of fuel. Reviewed at: [Reuters](#) (2020). *Venezuela orders banks to sell dollars from fuel sales to forex market.*

⁴⁴ It should be recalled that the government had employed the strategy of selling euros in cash to the domestic bank for subsequent sale to the public in order to increase the supply of foreign currency and try to stabilize the exchange rate; however, this strategy of injecting foreign currency would gradually diminish. According to our estimates, the average monthly sale of euros to banks between January and April was 73.6% less than that estimated for the same period in 2019. Reviewed in: [Reuters](#) (2020). *Banco Central venezolano obliga a bancos a vender millones de euros en efectivo.*

Rising Cost of Living in Dollars



Note: the series indicate the amount required to maintain the purchasing power of USD 100 at the beginning of the year
Sources: Localbitcoin and Ecoanalítica

The value of the dollar would show an actual loss of 23.7% during 1H2020, which would represent a significant difference with the loss observed in the same period last year (-51.1%). Thus, at the end of June, USD 131 was needed to buy the same goods that were bought with USD 100 at the beginning of this year.

At **Ecoanalítica** we had mentioned that this appreciation would persist in 2020, although we indicated that it would be observed less aggressively as the evolution of both indicators converged due to the pressure that the fiscal and external imbalances exerted on the exchange rate.

Now, beyond the deterioration that has already been accumulated in the local economy in the real sphere for 7 years, both the pandemic and official actions for its mitigation constitute additional factors to exacerbate or limit such increase. In the first case, when monetary imbalances and uncertainty weigh more heavily in determining the exchange rate with respect to prices; and in the second case, if the real costs of confinement limit

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the spending capacity of Venezuelans, forcing them to demand less foreign currency (more than other goods) to "smooth" the fall in their consumption.

2020, another turbulent year.

At **Ecoanalítica** we project that the average monthly inflation by 2020 will be 37.3%, a reduction of 14.7 percentage points (pp) with respect to our estimated average of 2019 (52.0%). Nevertheless, this would mean still a price variation for the whole year of 4,013.6%. At the same time, we project that the exchange rate will close this year between VES 978,238 /USD and VES 2,128,724 /USD, which would represent an increase (at least) of 1,671.8% with respect to the 2019 closing value (depreciation of 94.4%). As a result, we expect a loss on US dollar's power purchasing (in Venezuela) of at least 6.3% at the end of 2020.

The evolution of these indicators during the rest of the year will be closely linked to the behavior of COVID-19 and the response of the Executive to this health crisis. For the time being, in June, a significant daily increase in the number of infected people was observed and, at the same time, the announcement of the "radicalization of quarantine" in certain areas where there was a big focus of cases at the same time as the relaxation scheme. This occurs while the risk of importing fuel increases with threats from the United States to confiscate gasoline sent from Iran to Venezuela, which, if it materializes, would again enter a scenario of gasoline shortage and sale on the black market. We will have to see what scenario will emerge in the country in the next six months and how this is reflected in the information gathering traditional mechanism: prices.

External Sector: There's still a semester to go

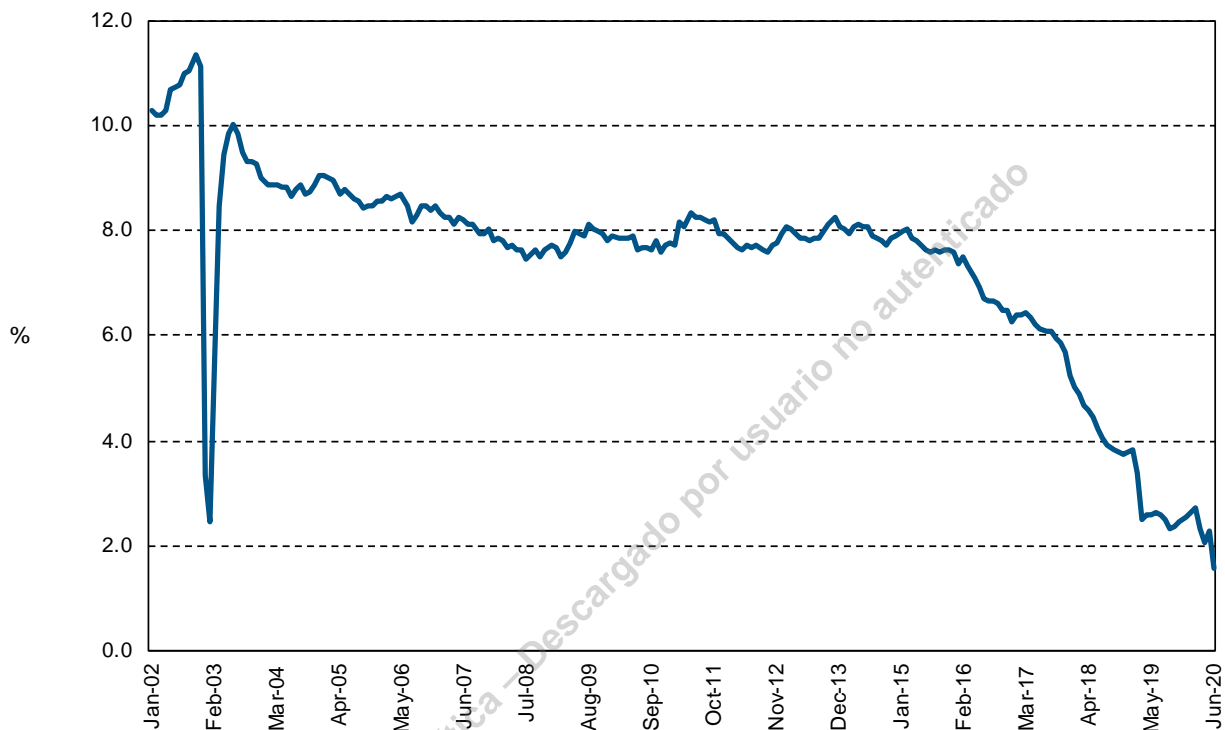
The second half of 2020 continued to be marked by the worsening of external conditions for the Venezuelan economy due to the COVID-19 pandemic and the intensification of international sanctions. With the fall in oil production, the difficulties in exporting it and the collapse of international oil prices, the foreign currency revenues that the Executive can capture are severely compromised; this is compounded by the decline to historic lows in the amounts of international reserves and extra-budgetary resources of the State.

As a result, the Executive's space for imports is tighter than in 2019, with particular weaknesses in maintaining a continuous supply of fuel in the face of delays in the reactivation of national refineries and the prioritization of food imports. This dynamic leaves a diminished private sector with the burden of filling gaps in the domestic market through trade with other countries.

Oil industry between disappearance and irrelevance

As we stated in the section *Oil Sector: What black gold?* As we stated in the section *Oil Sector: What Black Gold?* Venezuelan oil production has fallen to its lowest levels in 85 years, with 66 of the 99 last months presenting monthly drops, which translates into an accumulated fall of 86.4% since the end of 2013. The disintegration of Venezuela's productive capacity exceeds the voluntary cuts implemented by other OPEC members to stabilize oil prices, leaving Venezuela with a diminished role within the organization. By the end of the second quarter of 2020, Venezuelan production represents only 1.6% of total OPEC production, a drop of 6.5 percentage points from what was registered in December 2013.

Venezuelan production as a proportion of OPEC's total



Sources: OPEC (secondary sources), EIA and Ecoanalítica.

With the international market effectively flooded with oil due to lower demand and with the U.S. Treasury Department trying to sanction more than 50 tankers that shipped or transferred Venezuelan oil⁴⁵, PDVSA must offer its oil at considerable discounts to get buyers. During the second quarter, the price of Merey crude⁴⁶ averaged 52.7% below the Brent marker and reached a discount of up to 73.3% in April, the historical maximum.

⁴⁵ [S&P Global Platts](#) (2020). *US sanctions threat over tankers going to Venezuela unsettles market.*

⁴⁶ Shipments to Eni and Repsol for payment of debts and swaps are allowed in the exceptions to the sanctions.

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Year 16, Number 2
Quarter II

Merey crude oil discount vs. the market



Sources: OPEC and Ecoanalítica.

Lost Tanker Hunters

The relatively low price of Venezuelan oil does not necessarily translate into cash. According to information from Reuters⁴⁷, in June, the main destinations for Venezuelan oil were China, Cuba, Italy and Spain to settle debts or be exchanged for diesel, gas oil and other distillates⁴⁸ in operations that do not generate much new cash flow; which is calculated at an average of USD 640 million for the second half of the year.

Operations with China are conducted under high levels of opacity. Despite the fact that the Chinese state oil company CNPC stopped loading oil directly into Venezuela since September 2019 and Chinese customs statistics reflect a decline in imports during the second half of the year, imports from Malaysia, which are mainly crude oil, grew significantly in the same period. According to a Reuters report⁴⁹ containing data from

⁴⁷ Reuters (2020). *Russia says Venezuela will increase debt repayment five-fold from 2023.*

⁴⁸ A mode that is technically allowed by US sanctions.

⁴⁹ Reuters (2020). *Special Report: How China got shipments of Venezuelan oil despite U.S. sanctions.*

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Quarter II

Refinitiv Eikon, a significant portion of Venezuelan crude oil destined for Asia is transferred offshore in the Malacca Strait⁵⁰ to then head to China without properly identifying its origin.

This opacity makes it difficult to properly track the barrels that actually leave Venezuela. According to information from the firm Tanker Trackers, the distribution of Venezuelan oil destinations in June was: Unknown (37%), Spain (31%), Italy (25%) and Cuba (7%).

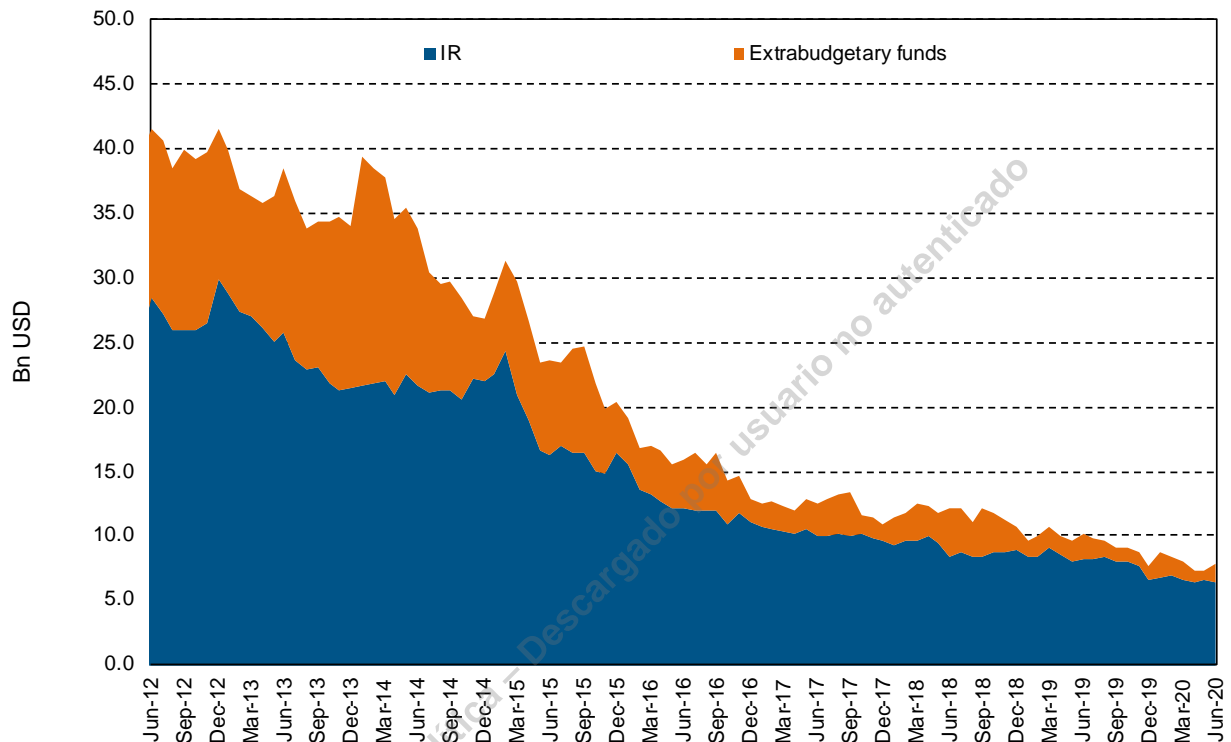
The well empties

With the reduction of income from oil activity, the resource alternatives available to the Executive evaporate. By the end of June, the international reserves had fallen to USD 6.48 billion⁵¹, while the extra-budgetary funds stood at USD 1.4 billion, representing a fall of 69.8% and 88.9% since the end of 2013, respectively. Additionally, in April, the international reserves reached their minimum since January 1989.

⁵⁰ Operations provided by Rosneft's marketing arm.

⁵¹ With the added restriction on approximately USD 1.0 billion in gold reserves deposited with the Bank of England that are frozen due to disputes over recognition of national authorities by the British government.

State's funds in foreign currency



Sources: BCV and Ecoanalítica.

Customized restructuring of the Kremlin

During the first semester of 2020, the Executive incurred in the default of USD 3.41 billion corresponding to financial debt⁵² of the Republic and PDVSA, which extends the chain of creditor claims for which an orderly debt restructuring process is still far away. On the other geopolitical front, on June 30, the details of the restructuring agreement for bilateral debt with Russia for USD 3.15 billion, planned for 2017 and signed in 2018, came to light. According to the agreement⁵³, Venezuela would make annual payments of USD 133 million until 2022, amounts that go up to USD 684 million until 2026. The payments remain at their "minimum" levels in 2020; however, they represent about half a month of oil exports, with high risks of non-payment in the future once the five-fold tranche starts.

⁵² Both coupon and principal payments.

⁵³ Different from the oil payment with Rosneft which was completed in the first quarter of 2020.

Year 16, Number 2
Quarter II

A look at the next semester

At **Ecoanalítica** we foresee that the external income received by the Executive could reach USD 4.76 billion which, contrasted with potential expenditures of USD 6.52 billion if imports remain constant, would result in a gap of USD 1.99 billion. Although the executive faces fewer outflows because of the costs associated with lower oil production, the adjustment variable continues to be non-oil imports, which the executive seems to want to shift to private hands. This would explain the extension of the exemption of taxes and rates on imports of 3,289 tariff codes or products until December 31.

Foreign currency cashflow						
Item	2019	1Q2020	2Q2020	3Q2020	4Q2020	2020
Income						
Oil Exports (mb/d)	1.0	0.8	0.5	0.4	0.7	0.6
Energy Agreements (mb/d)	0.1	0.1	0.1	0.1	0.1	0.1
Oil Imports (mb/d)	0.2	0.1	0.1	0.1	0.1	0.1
Effective Oil Exports (mb/d) ¹	1.1	0.7	0.4	0.3	0.6	0.5
Oil Income (Billion USD)	24.5	2.6	0.6	0.5	1.0	4.8
Oil imports (Billion USD)	-3.7	-0.7	-0.2	-0.2	-0.4	-1.5
Oil Imports (Diluents and Supply)	-1.1	-0.3	-0.2	-0.1	-0.2	-0.7
Other Oil Imports	19.7	1.6	0.2	0.2	0.4	2.5
Non-Oil Income (Billion USD)	5.4	0.4	0.4	0.7	0.7	2.2
Total income	25.1	2.0	0.6	1.0	1.2	4.8
Expenditure						
Other imports (Billion USD) ²	6.6	0.8	0.7	0.5	0.4	2.3
Net services	6.3	0.8	0.9	0.8	1.0	3.5
Net rents	7.3	1.1	0.2	0.1	0.1	1.5
Current Transfers	-3.5	-0.5	-0.4	-0.3	-0.4	-1.5
External Debt Service (Billion USD)	4.2	0.1	0.0	0.1	0.1	0.3
Private Capitals Outflow (Net)	-1.1	0.1	0.1	0.2	0.1	0.5
Total Expenditure	19.8	2.4	1.4	1.3	1.4	6.5

Sources: BCV, Menpet, Pdvsa and Ecoanalítica

* Considers a 90 day lag due to the internal dynamics of the oil market

¹ We take into account the reexported imports

² Considers non-oil imports and other imports from the oil sector

Under these conditions, we consider that the external environment will be marked by the following actions of the Executive to close its gap:

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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

- Identifiable oil exports will correspond to those of *swaps*, with Reliance from India resuming shipments tacitly allowed by the sanctions in early July.
- Cash-generating exports will be in the unobserved range⁵⁴, or with an unknown destination, as the opacity with which PDVSA negotiates to avoid U.S. sanctions grows.
- Oil production will be conditioned by the speed with which crude inventories can be emptied, which requires an increase in demand for heavy oil; therefore, PDVSA must find buyers.
- Private sector imports will continue to be encouraged by exchange rate appreciation and lower tariff rules, although they will hardly be able to cover the drop in local agro-industrial sector production due to the effect of economic paralysis caused by COVID-19.
- Even in an environment of more advanced dollarization, the private sector's capacity to generate foreign exchange is diminished by the decline in local commercial activity in the same way that the availability of foreign exchange for households is limited by the 55.8% year-on-year contraction in remittance flows.
- The lack of information regarding the commercialization of gold (officially and unofficially), together with the different political conflicts faced by Maduro's management in the search for access to non-oil external assets, deepens the uncertainty regarding the quantification of the options available to the Executive in this area. We therefore rule out the possibility that the government could improve its foreign currency deficit by taking advantage of the recent international revaluation of this asset⁵⁵, in which overall non-oil exports would be annually reduced 58.6% by the end of 2020.

⁵⁴ At least in official records.

⁵⁵ For now, the BCV's balances reveal a decumulation of monetary gold close to 8.5 tons between January and May.

Conclusion: The most fragile among Latin America

The visions presented in our quarterly report show the conditions that have exposed our economy even more to the costs of the pandemic than other countries in the region.

As the country enters a new phase in the spread of COVID-19, expectations for the rest of the year in economic and social matters are worsening. On the one hand, if the limitations on the placement of local crude oil over international markets continue, it is expected that gross crude oil exports will fall below 584 mb/d by 2020, which would lead to a contraction of at least 80.6% of public oil revenues, even with an optimistic view on the value of the oil basket (once the *low-zero* price range is exceeded) over 24.32 USD/b.

Within this scenario, in addition to the decline in remittances and even with the planned adjustments in imports, the Executive will still have to face a deficit of USD 1,993.0, according to our latest calculations.

With regard to the national environment, alterations in the flow of foreign currency, limitations in the supply of local goods due to the paralysis of activities, the weight of taxes and the lack of financing will lead to a general economic contraction of 33.5%, with a reduction of 34.2% in the non-oil sector (driven by the deterioration of commercial and manufacturing activity). In this area, the interruption of global trade plays a key role. In this regard, it is estimated that imports of goods are being restricted by close to 66.3%, becoming a new historical minimum (if this prevision occurs) since 1997.

With the limitations at the external level, the comeback of the ghost of the gasoline shortages is foreseeable and, with it, a new limitation (or increase in price) of the commercialization of goods and services in Venezuela.

Private consumption will continue to be affected by the pandemic (with a decline of 32.5% estimated for 2020), which, in the context of credit activity limited by the reserve requirement policy and with increasingly dollarized transactions, will limit the aggressiveness of the price and exchange rate increases estimated in previous reports. However, given the monetary imbalances caused by the Executive and the exchange rate instability resulting from the persistence of the pandemic, the economy would close the year with an annual inflation rate of close to 4,013.6%, thus culminating its third year under the specter of hyperinflation.

In the face of new vulnerabilities, there are several actions that the local private sector can take to preserve the operability of its business:

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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

- **More attention to balance sheets and financial statements:** efficient inventory management (for companies that produce or trade goods), as well as cash flow management under the assumption of mid-term persistence of the hyperinflationary environment and exchange rate tensions will be fundamental in the face of the commercial limitations imposed by the pandemic. In particular, it is recommended that strategies be established to preserve the inventory for a given time horizon (without neglecting its rotation), also giving greater preference to immediate payment transactions or, failing that, with very short-term credit and indexed by inflation or exchange rate metrics.
- **Don't neglect hedging:** Pending greater volatility in the exchange rate environment during the official quarantine, savings in foreign currency (or in final or intermediate goods, depending on the dynamics of inflation - rising exchange rates) remain the basis for safeguarding your business cash flow, especially if you are still subject to income and expenditure in local currency. This type of strategy should deprive your full-dollarized cash flow scheme, considering that the increase in the price of local goods measured in foreign currency may persist in some months to come.
- **Detection of new vulnerabilities:** It is imperative that companies develop risk maps to identify the threats that their business will face in the context of the pandemic. Some notions are based, for example, on the exposure of their operations to failures in the supply of gasoline (impacts on the cost of freight), or in the supply chains (dependence on low inventory or import intensive suppliers); or the limitation in the mobilization of personnel due to official quarantine.
- **Attention to supplier networks:** In relation to the above, you should try to strengthen communication with all the sectors that make up your company's supply chain. Actions such as renegotiating payments and delivery times of merchandise, redefining the type of services to be acquired, or employing alternative gasoline supply schemes, will give the business sufficient operational flexibility to face the limitations derived from new extensions to the official quarantine or in the face of new scenarios of gasoline shortage for the local market.
- **Preserving the health and stability of its employees:** The conditions of the jobs and working hours must be adapted to prevent further contagion. On the other hand, it is recommended to establish a communication policy among its employees that allows them to know and understand the vulnerabilities of the companies during the current context. This could minimize the costs or frictions associated with changes in salary policy that each company must make during the pandemic,

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always in the search to balance the stability of its workforce with the viability of the business.

- **Exploiting the advantages of the home economy:** In particular, the use of home delivery mechanisms, online or self-service marketing channels are the lowest cost strategies available to many companies to ensure the supply of their services or the placement of their products in the midst of (and even after) a widespread policy of isolation.
- **Identify new consumer habits:** Companies can use increased marketing of that portfolio of their highly desired (or preferred) products during the pandemic: medical supplies, non-perishable or semi-processed foods, leisure goods or services, among others. This strategy may involve changes towards more affordable presentations of their products, especially in items subject to frequent price adjustments.

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Year 16, Number 2
Quarter II

Tables

Variables	2018	2019 (*)	2020 (*)	2021 (*)	2022 (*)	2023 (*)
Output indicators (Annual changes on %) ^{1/}						
Gross Domestic Product (GDP)	-19.6	-39.8	-33.5	-1.5	5.5	11.7
Domestic Aggregate Demand	-21.3	-39.8	-35.4	-7.3	5.9	12.3
Total Consumption	-17.3	-38.2	-31.8	-7.5	3.0	11.9
Public consumption	-9.1	-25.0	-30.6	-19.8	0.4	9.0
Private consumption	-20.1	-43.2	-32.5	-1.2	4.0	13.1
Gross fixed capital formation	-37.5	-36.0	-31.7	1.5	4.9	4.1
Public gross capital formation	n/a	-32.6	-35.0	0.0	2.0	2.0
Private gross capital formation	n/a	-42.2	-25.0	4.2	10.0	7.5
Total exports	-10.8	-23.0	-48.3	20.1	5.5	6.6
Oil exports	n/a	-26.0	-45.1	18.1	4.2	7.2
Non-Oil exports	n/a	12.0	-56.5	31.1	6.2	7.6
Exports of services	n/a	-10.4	-48.8	11.9	13.2	0.8
Total imports	0.3	-22.8	-56.6	-12.2	8.3	7.1
Imports of goods	n/a	-22.8	-60.4	-18.2	2.2	6.7
Imports of services	n/a	-22.9	-44.0	1.8	19.8	7.7
Real results by sectors (Annual changes on %) ^{1/}						
Per capita GDP	-23.0	-40.5	-34.2	-2.5	4.5	10.6
Oil GDP	-24.1	-19.9	-32.3	4.0	5.9	10.7
Non-Oil GDP	-18.9	-42.7	-34.2	-2.9	4.2	13.1
Prices indicators (Annual changes on %)						
NCPI-based inflation, eop (2007 = 100)	130,060	9,584	4,013.6	3,007.0	156.2	66.4
NCPI-based inflation, aop (2007 = 100)	65,374	19,906	3,140.4	3,586.0	455.3	91.8
CPI-based inflation, eop (2007 = 100)	176,298	10,095	4,585.6	3,479.5	164.6	66.7
CPI-based inflation, aop (2007 = 100)	117,446	20,026	3,640.0	4,137.1	484.0	94.2
WPI-based inflation, eop (2007 = 100)	357,207	8,772	4,480.1	3,262.8	165.1	73.1
WPI-based inflation, aop (2007 = 100)	251,668	21,364	5,931.6	3,449.8	523.0	92.2
Official exchange rate, eop (VES/USD)	638.2	46,621	2,022,288	68,081,985	194,333,909	344,918,027
Official exchange rate, aop (VES/USD)	86.9	15,897	533,264	22,574,087	133,115,004	270,356,229
Non-Official exchange rate, eop (VES/USD)	739.7	55,212	2,128,724	69,827,677	197,293,308	345,263,290
Non-Official exchange rate, aop (VES/USD)	115.1	16,504	548,271	23,278,024	134,542,636	270,626,856
Official exchange rate, eop (VES/USD) ^{2/}	638.2	46,621	929,326	30,817,225	86,645,525	151,478,040
Non-Official exchange rate, eop (VES/USD) ^{2/}	739.7	55,212	978,238	31,607,411	87,965,000	151,629,669

^{1/} All data refer to eop figures (in real terms, 1997 prices). Otherwise, it is indicate.

^{2/} "Optimistic" scenario, by assuming additional eop inflation forecasts (by end-2020).

(*) Forecasts. Additional projections are available upon request to atencionalcliente@ecoanalitica.net, or to luish@ecoanalitica.net

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Av. Blandín, C.C. Mata de Coco, piso 5, oficina 5-E, La Castellana, Caracas, 1060, Venezuela.

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46

Year 16, Number 2 Quarter II

Variables	2018	2019 (*)	2020 (*)	2021 (*)	2022 (*)	2023 (*)
Money market (Annual changes on %)						
Monetary aggregates						
Money Base (BM)	43,949.9	7,172.4	1,435.4	1,407.9	222.5	72.0
Money (M1)	63,384.9	4,951.4	1,484.7	1,570.3	285.1	77.5
Broad money (M2)	63,257.3	4,945.6	1,485.6	1,594.4	290.6	72.5
Monetary multiplier (M2/BM)	1.8	1.3	1.3	1.5	1.8	1.8
Interest rates (levels, %)						
Bank lending rate (average)	21.9	29.3	35.9	37.8	31.3	26.8
Time- deposit rate (average)	12.5	20.3	24.5	31.3	26.3	22.8
External sector (Annual changes on %)						
Balance of payments						
Export of goods (USD MM)	33,677	25,124	6,378	10,090	13,088	15,109
Export of goods	-1.0	-25.4	-74.6	58.2	29.7	15.4
Oil exports (USD MM)	29,810	19,724	4,144	7,125	9,931	11,704
Oil exports	-5.4	-33.8	-79.0	71.9	39.4	17.9
Total imports (USD MM)	12,782	9,551	3,221	2,731	2,872	3,080
Total imports	6.3	-25.3	-66.3	-15.2	5.2	7.2
Trade balance (USD MM)	20,895	15,573	3,157	7,359	10,216	12,029
Trade balance (USD MM)	-6,260	-6,303	-3,473	-3,552	-4,306	-4,650
Rents and transfers (USD MM)	-6,022	-3,385	576	-1,347	-969	-2,352
Current account balance (USD MM)	8,613	5,885	251	2,460	4,942	5,026
Current account and financial balance (USD MM)	-3,765	-4,583	-1,301	-545	-1,689	-2,886
Balancing item (USD MM)	-3,893	-3,265	-490	-1,061	-1,167	-1,401
BOP balance (USD MM)	955	-1,964	-1,540	853	2,085	740
Gross International Reserves (USD MM)	8,837	6,621	5,081	5,935	8,020	8,760
Operative International Reserves (USD MM)	3,117	1,371	231	1,084	3,170	3,909
Oil sector						
Oil crude production (PDVSA's definition, mb/d)	1,517	1,022	603	657	661	744
Precio Cesta petrolera Venezolana (USD/b)	63.7	57.0	24.3	33.3	37.9	41.7
Demographics and labor indicators (Annual change, %)						
Population						
Total Population (thousand)	32,370	32,769	33,100	33,430	33,765	34,102
Labour force (thousand)	12,441	10,786	9,851	10,062	9,878	9,946
Labour						
Unemployment (% of labor force)	15.2	27.3	42.7	38.3	36.2	32.6
Minimum wage (thousands of VES)	4,500	150,000	3,900,000	77,000,000	185,120,000	295,520,000
Minimum wage (%)	253,411.1	3,233.3	2,506.3	1,877.7	140.4	59.7

1/ All data refer to eop figures (in real terms, 1997 prices). Otherwise, it is indicate.

(*) Forecasts. Additional projections are available upon request to atencionalcliente@ecoanalitica.net, or to luisb@ecoanalitica.net

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47

**Year 16, Number 2
Quarter II**

Variables	2018	2019 (*)	2020 (*)	2021 (*)	2022 (*)	2023 (*)
Real output indicators (Annual changes on %) ^{1/}						
Gross Domestic Product (GDP), by sectors						
Agriculture	-16.3	-25.0	-27.5	3.0	6.3	13.0
Minig	0.3	-22.1	-20.0	-10.6	5.1	12.0
Manufacturing	-39.3	-48.5	-36.5	-2.0	2.9	16.4
Construction	-52.2	-38.0	-38.7	-6.2	3.0	11.3
Water and electricity	-14.6	-36.1	-39.2	-5.3	3.0	7.5
Commercial sector and remediation services	-34.7	-47.5	-42.1	-4.6	8.4	12.9
Transport and storage	-28.4	-59.8	-52.4	-6.6	3.5	11.8
Communications	-5.8	-37.2	-21.6	1.6	4.9	5.5
Financial institutions and insurance companies	-45.5	-51.1	-52.1	0.7	9.7	17.4
Government services	-6.7	-40.6	-37.0	-12.1	1.1	13.5
Other services	-10.5	-69.1	-8.1	4.9	6.0	22.4
Non-oil goods	-40.8	-37.6	-33.8	-1.3	4.3	13.1
Non-oil services	-12.7	-44.1	-34.4	-3.4	4.2	13.1

1/ All data refer to eop figures (in real terms, 1997 prices). Otherwise, it will be indicate.

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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'S TEAM

Asdrúbal Oliveros / Director

asdrubalo@ecoanalitica.net / @aroliveros

Pedro Palma / Director

pedrop@ecoanalitica.net / @palmapedroa

Cristina Rodríguez / Director

crystinar@ecoanalitica.net

Luis Arturo Bárcenas / Senior Economist

luisb@ecoanalitica.net / @barcenasluis

Giorgio Cunto / Economist

giorgioc@ecoanalitica.net / @giorgiocunto

Corina Fung / Economist

corinaf@ecoanalitica.net / @corinafung7

Jhoan F. Castellano / Economist

jhoanc@ecoanalitica.net / @castellanojhoan

RESEARCH ASSISTANTS

Diego Santana

Carmen Pelay

Manuel Pérez-Luna

Ricardo Picón

CONTACT US

Venezuela: (+58-212) 266 9080/ Fax:

(+58-212) 266 5119

Estados Unidos: +1 (212) 994.1850

Ventas@ecoanalitica.net

www.ecoanalitica.com

@ecoanalitica