



# ***The Venezuelan Reality: Current Situation and Outlook***

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## Socialism of the XXI Century

- Populism (populist spending programs)
- No autonomous democratic institutions (total control by the Executive Branch)
- Controlled economy by an authoritarian centralized government
  - Exchange controls
  - Price controls
  - Production and distribution controls
- Very high economic dependency of the oil rent
- Public spending plays a key role as the main economic stimulus
- Very hostile attitude against the private sector (expropriations)
- Rampant corruption
- Massive and high cost support to allied countries (Cuba, ALBA, Petrocaribe, etc.)



## Consequences: Economic Imbalances

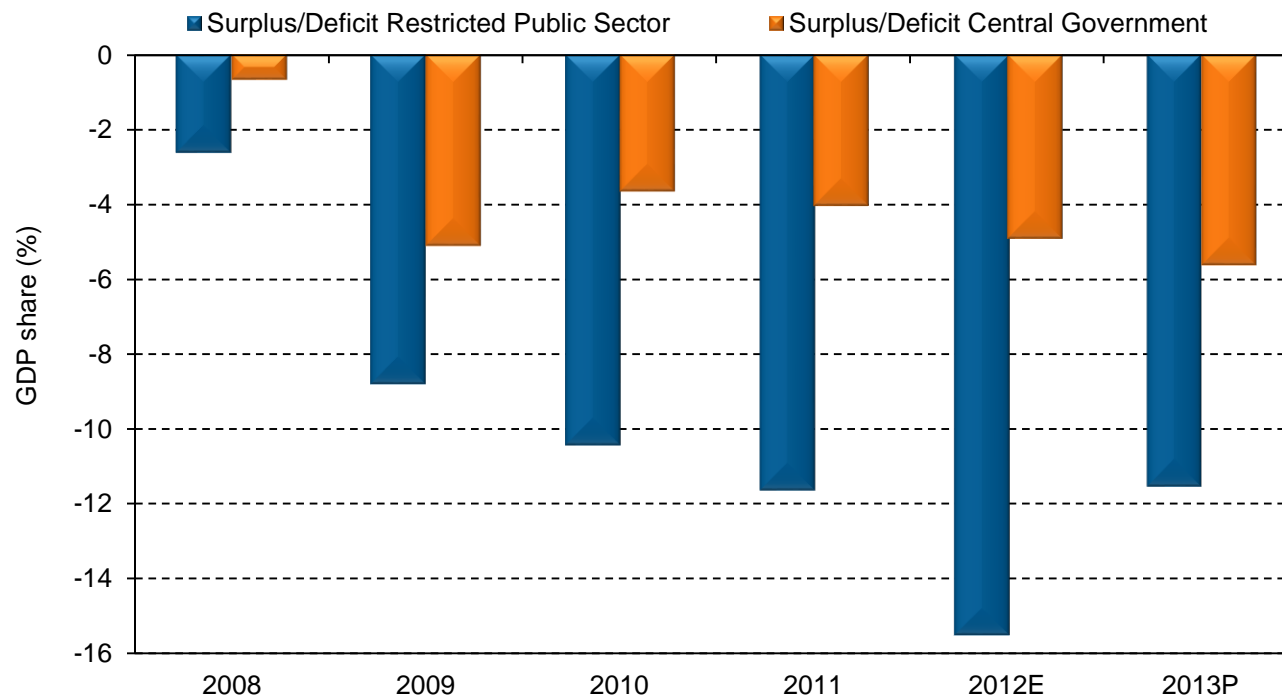
- Public finance imbalances
- Foreign exchange imbalance
- Monetary and financial imbalances
- Production and distribution (shortages) imbalances
- Imbalances between real supply and demand (high dependency on imports)
- Oil imbalances despite high international oil prices
- Political uncertainty
- Social unrest

Negative effects on the economy



# Public finance imbalances

## Restricted Public Sector's vs. Central Government's Fiscal Balance

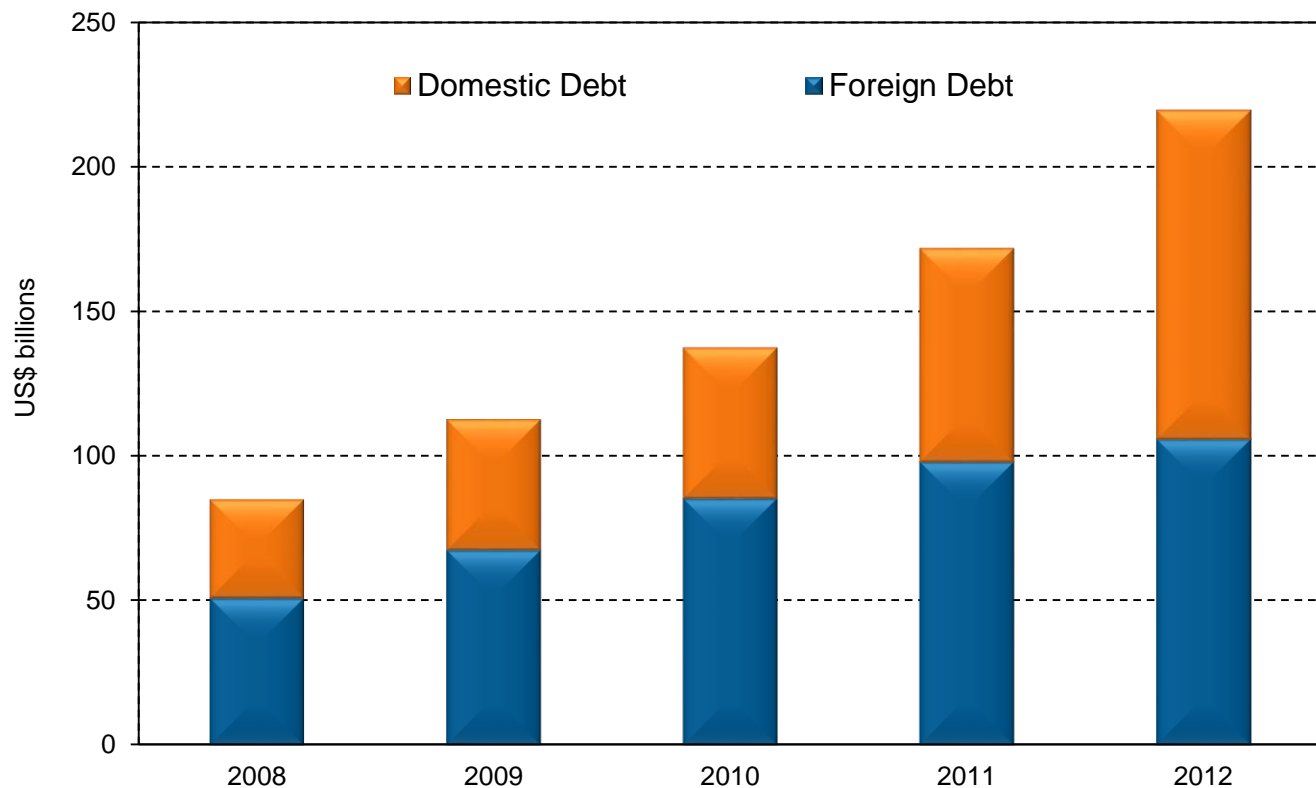


Sources: MPF and Ecoanalítica





## Public Sector Debt

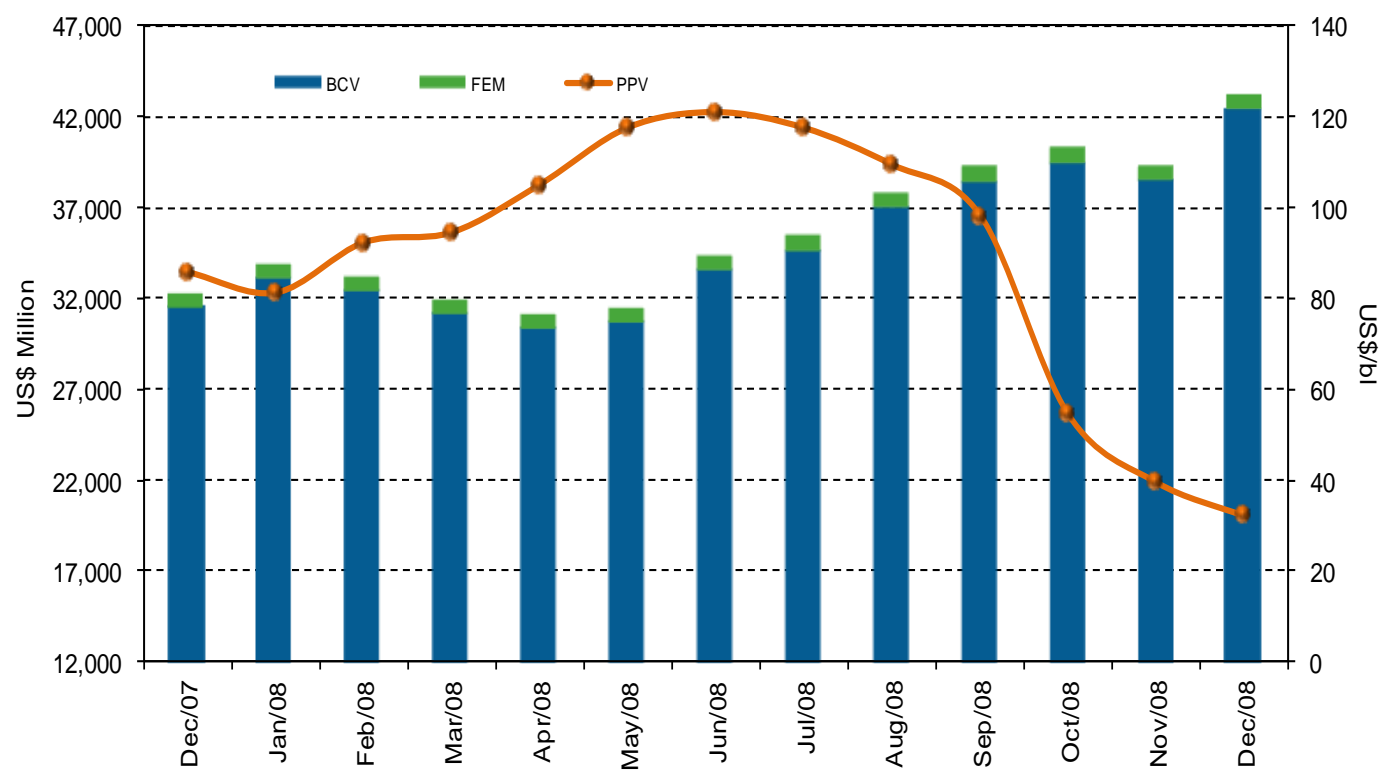


Sources: Pdvsa and Ecoanalítica

Note: the domestic debt only includes central government's and PDVSA's debt



# International Reserves and Oil Prices

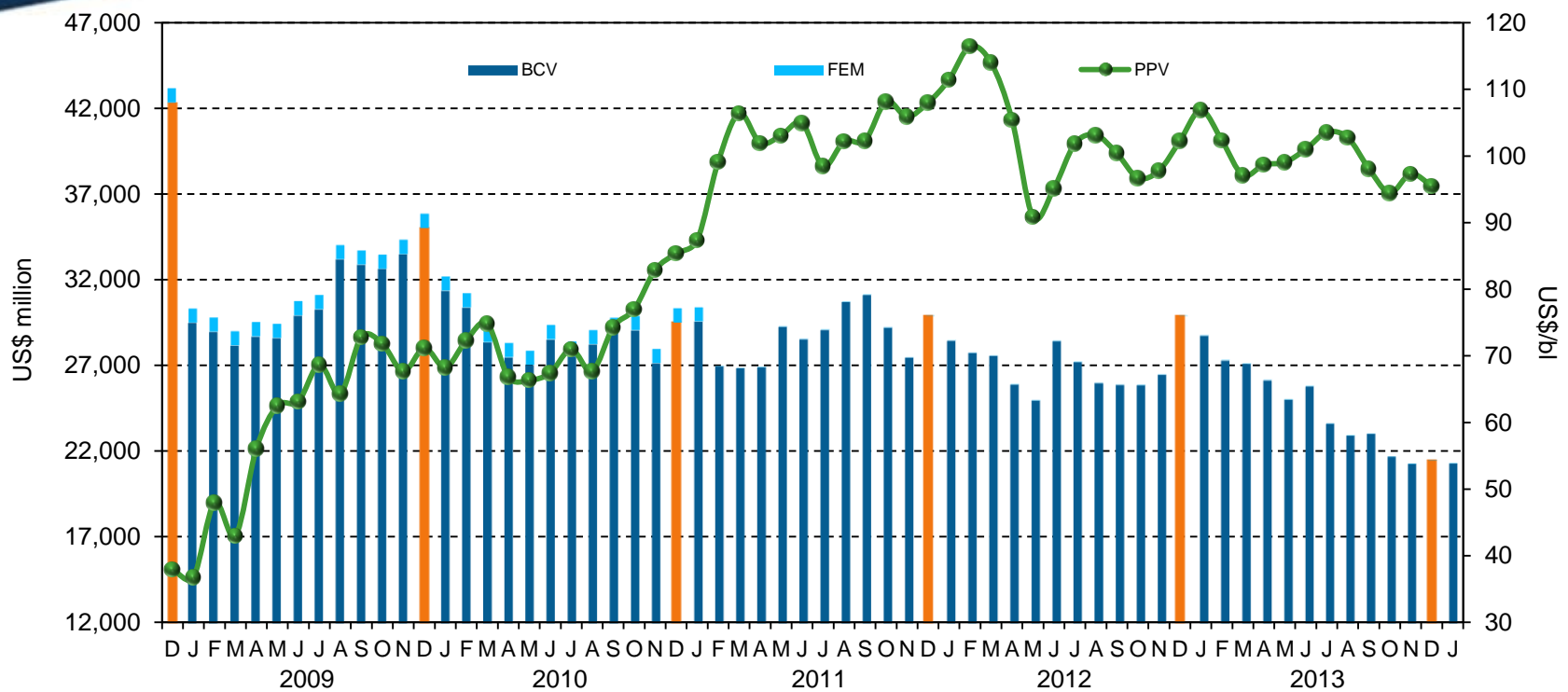


Sources: BCV, Ecoanalítica and Metroeconómica

|                                    | 2007   | 2008   |
|------------------------------------|--------|--------|
| International Reserves ( Dec 31st) | 34,286 | 43,127 |
| Oil Average Price                  | 64.4   | 86.49  |



# International Reserves and Oil Prices



Sources: BCV, MPPEP and Ecoanalítica

So far this year the average price for the Venezuelan oil basket is \$/b 96.63. During the week of March 3 – 7, 2014 the average oil price was \$/b 97.76. At the end of February 2014 the international reserves were \$ 21.713 MM, and on March 11 they were \$21,672 MM.

|                                       | 2009   | 2010   | 2011   | 2012   | 2013   |
|---------------------------------------|--------|--------|--------|--------|--------|
| International Reserves (Million US\$) | 35,830 | 30,332 | 29,902 | 29,890 | 21,485 |
| Average Oil Price (US\$/b)            | 57.0   | 72.7   | 101.0  | 103.42 | 99.49  |



## Oil Imbalance despite high international oil prices

- Crude oil production restrictions
- High levels of domestic consumption
- Fuel smuggling
- PDVSA plundering by the government
  - Financing of government's missions (social programs)
  - Massive transfers to Fonden (\$ 59.7 billion in 8 years)
  - Limited cash flow
    - ✓ Shipments to Cuba: 91.1 Mb/d in 2012
    - ✓ Shipments to Petrocaribe, ALBA and others: 175.6 Mb/d
    - ✓ Shipments to China: 451 Mb/d in 2012
- High financing needs (loans from BCV)

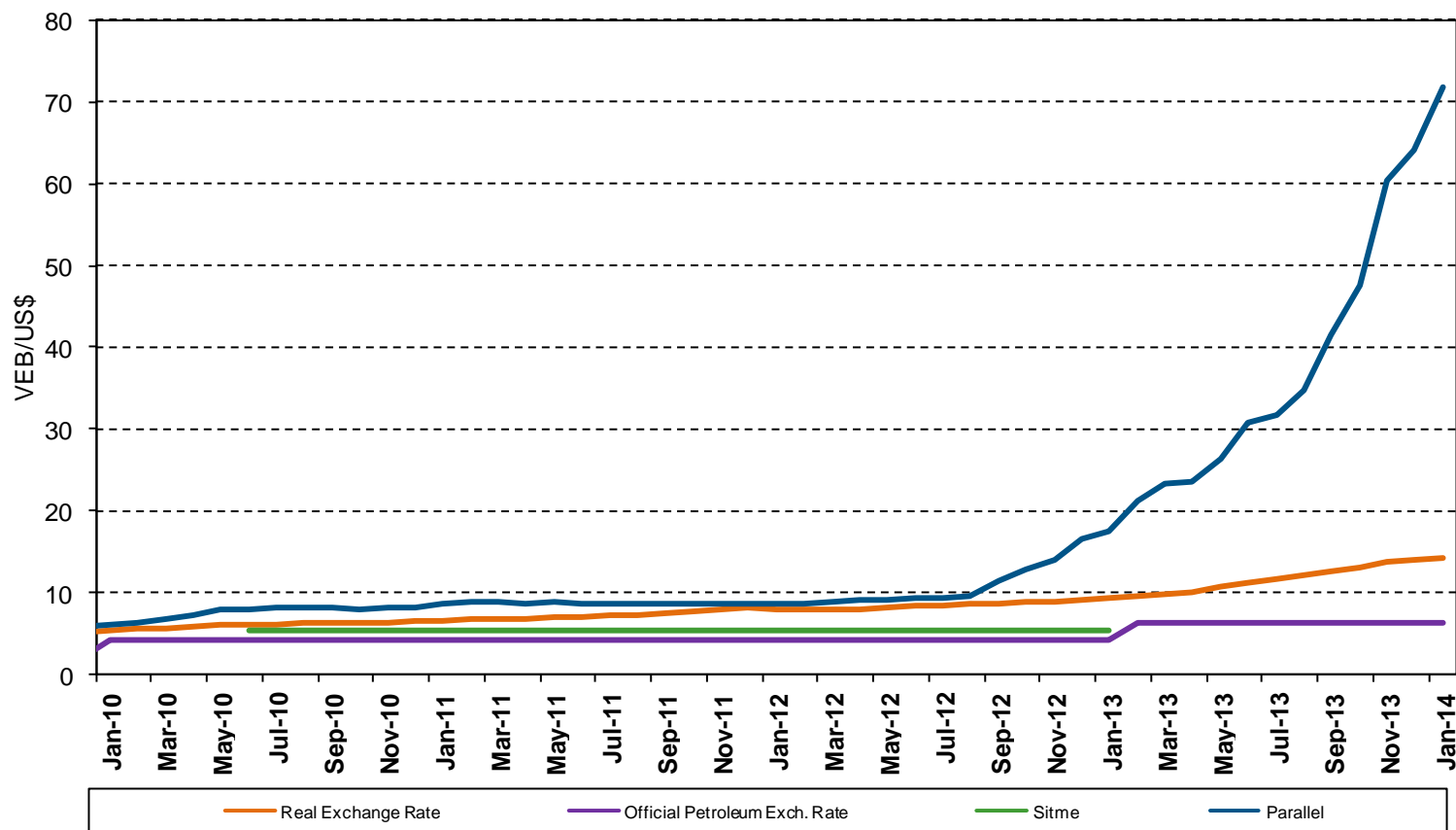
## Oil policy has to be reviewed

- Regularization of PDVSA's commitments to partners and suppliers
- Production increase (medium term)
- Relieving PDVSA from commitments alien to its core activities





# Exchange Rates



Sources: BCV and Ecoanalítica



## Monetary and Financial Imbalances

- High increase of money supply
  - Nominal liquidity ( $M_2$ ) growth in 2012: 60.9%
  - Real liquidity growth in 2012: 33.9%
  - Nominal liquidity growth between Mar. 2013 / Mar. 2014: 90.8%
- High level of banking excess reserves: Bs 124.6 billion as of March 12, 2014. The average during July 2012 was Bs 26.7 billion
- Deeply negative real interest rates
- No attractive financial assets ➡ Investments in real estate
- High BCV's financing to public entities which has been growing fast
  - PDVSA's net debt to BCV at the end of 2013: Bs 407.8 MMM. (\$ 64.7 MMM)
  - BCV's net loans to public sector firms at the end of 2013 were equivalent to 97% of the monetary base and to 35.6% of monetary liquidity ( $M_2$ )



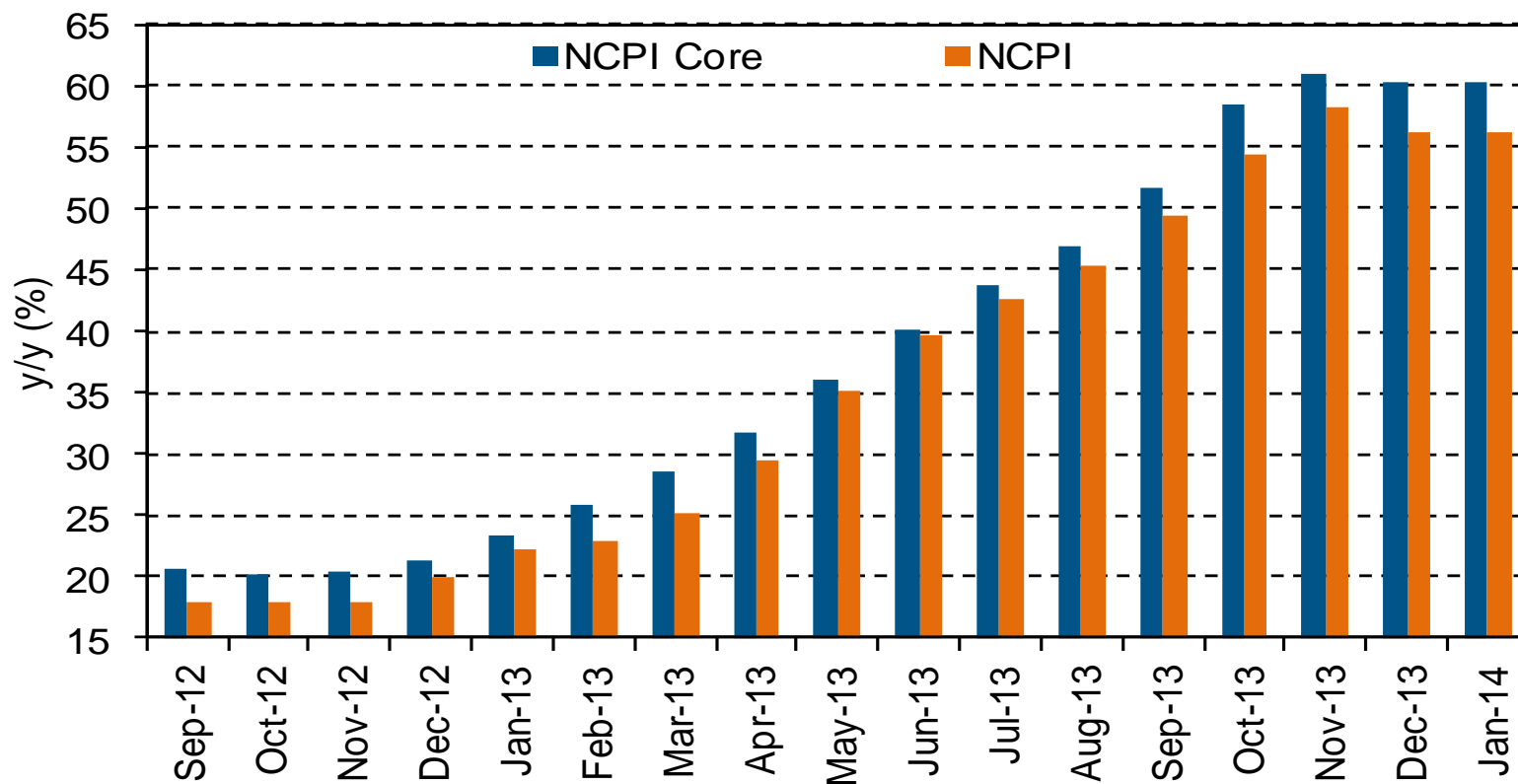
- Production of tradable goods has been severely affected
  - Loss of competitiveness due to a highly overvalued currency
  - Disproportionate price controls that have forced multiple produces to produce at losses
  - Production and distribution controls
  - Cumbersome requirements to obtain foreign currency
    - ✓ Non-domestic production certificate
    - ✓ Labor debt compliance certificate
  - Delays to obtain preferential dollars for imports
  - Increasing difficulties to obtain financing from foreign suppliers
  - Government harassment
    - ✓ Expropriation threats
    - ✓ Seizure of raw materials or products due to alleged hoarding
    - ✓ Law-decrees as part of the Enabling Law approved on Nov. 11<sup>th</sup>
- Deterioration of production capacity due to expropriations of companies

**The upshot: shortages and scarcity**



## High Inflation

### NCPI Core vs. NCPI



Sources: BCV and Ecoanalítica





## Corrective Measures have Consequences

- Inflation
  - Higher indirect taxes (VAT, Bank Debits Tax?)
  - Devaluation (more expensive imports)
  - Necessary price adjustments to avoid shortages
- Economic deceleration
  - Lower people's purchasing power
  - Private consumption deceleration
  - Exchange tax due to devaluation
- Deterioration of labor situation
  - Fewer jobs & high unemployment and underemployment
  - Deterioration of real wages

**Conclusion: Economic outlook is dim and uncertain**



Acompaña las buenas decisiones...

However, in the mid-term Venezuela will be a  
country of great opportunities



*Acompaña las buenas decisiones...*

THANK YOU



# ADDITIONAL SLIDES





## Answers to Public Finance Imbalances

- Spending rationalization
- Possible tax hikes
  - Income tax
  - VAT
- Possible new taxes such as the Bank Debits Tax
- Possible adjustments of public services tariffs and prices of public goods
- Adjustments to the official exchange rate (devaluation)
- Rationalization of domestic and foreign debt

*Recessive and inflationary effects*



## Answers to Foreign Exchange Imbalances

- Adjustments to the official exchange rates (announced on February 6<sup>th</sup> 2013)
  - Cadivi: from Bs/\$ 4.30 to Bs/\$ 6.30. (increased by 46.5%)
  - Elimination of Sitme and creation of Sicad
  - Bs/\$ 4.30 exchange rate reserved for some imports requested and authorized before Jan. 15, 2013
- More rational allocation of preferential dollars
  - Creation of the Higher Office for Optimization of the Exchange Control System
- Reduction of the exchange rates gap. We propose
  - Adjust the preferential exchange rate approaching it to the real effective exch. rate
  - Legalization of the parallel market, allowing Pdvsa to sell part of its dollars in it, the intervention of BCV, the selling of dollars of the non traditional exports, etc.
  - Modification of Sicad with the participation of BCV and Pdvsa
  - Elimination of transfers of BCV and Pdvsa to Fonden and other government funds

**Devaluation has effects on inflation and public finances**



Acompaña las buenas decisiones...

# Effects of Devaluation

|  |                   |
|--|-------------------|
| 2012 Current GDP   | Bs. 1.64 trillion |
| External Public Debt at the end of 2012                                    | \$ 105.78 billion |
| • Current GDP in \$ at the Bs/\$ 4.30 exchange rate                        | \$ 381.5 billion  |
| • Current GDP in \$ at the 2012 real average exchange rate (Bs/\$ 8.50)    | \$ 193.0 billion  |
| • Public External Debt at the end of 2012 / GDP 2012 (real Exch. Rate)     | 54.8%             |
| • Public External Debt at the end of 2012 / Export. of goods               | 108.7%            |
| • Public External Debt at the end of 2012 / Internat. Reserves at year end | 354%              |

## Effects on public revenues

- Increase in fiscal revenues due to devaluation: Bs. 85 billion (4.1% of GDP)
- Increase of Pdvsa's revenues because of devaluation
  - From sales of \$ to BCV at Bs/\$ 6.30: Bs. 90 billion ( $\$ 45 \text{ billion} \times 2 (6.30 - 4.30)$ )
- Dilution of Pdvsa's net debt to BCV in US\$ at the end of 2012
  - Bs 165.5 billion / 4.30 = \$ 38.37 billion
  - Bs 165.5 billion / 6.30 = \$ 26.19 billion
  - Dilution: \$ 12.18 billion (equivalent to a contraction of 31.7%)
- Dilution of Central Government domestic debt: \$ 18.83 billion (-31.7%)  
(nominal domestic debt of the Central Government at the end of 2012: Bs. 255 billion)



# Effects of Devaluation

## Positive effects for

- Exporters
- Public entities receiving revenues in \$
- Private debtors in bolivars who have \$
- PDVSA
  - Receives more bolivars for each dollar it sells
  - Its local debt is diluted
- Government (increased tax collection)

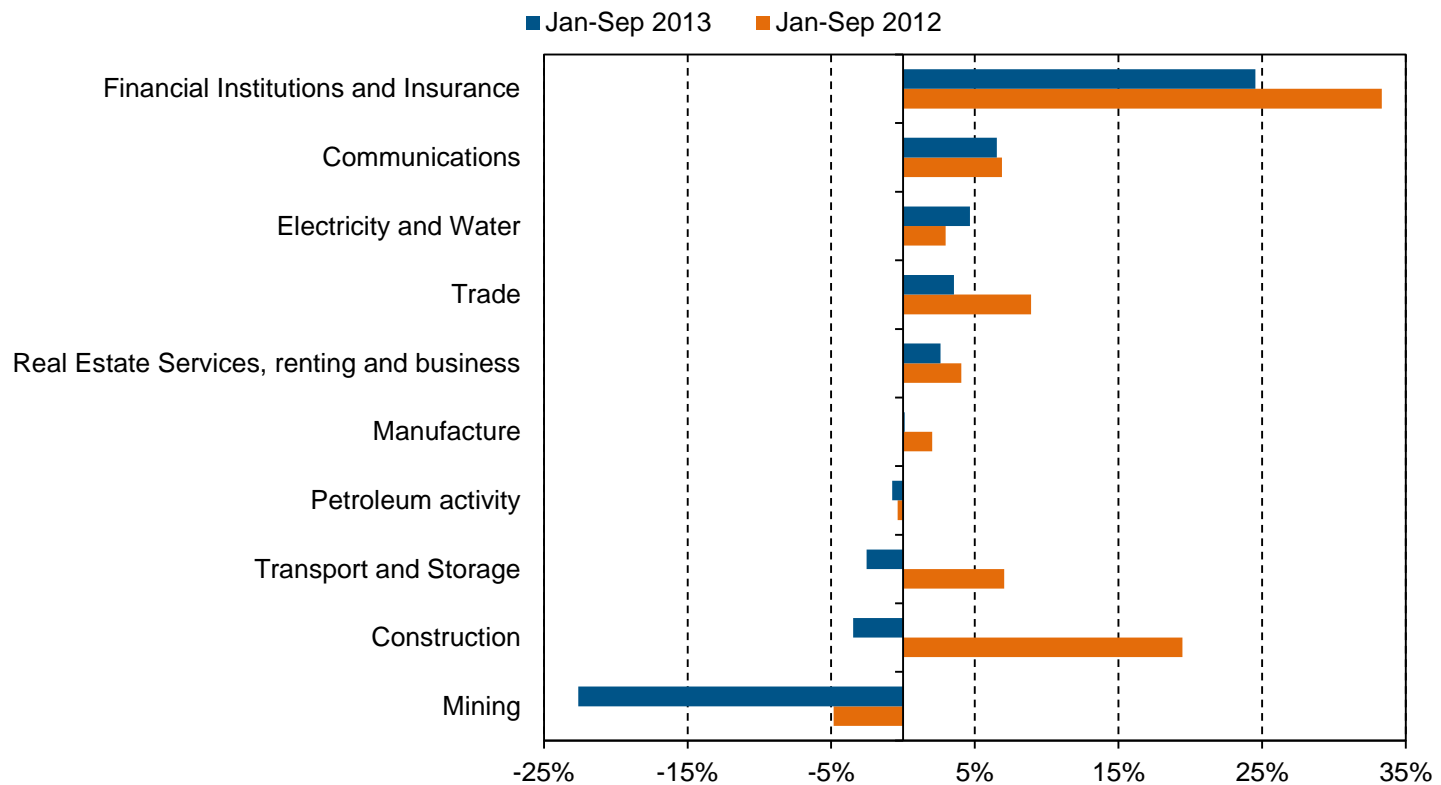
## Negative effects for

- Importers (exchange tax)
- Debtors in foreign currency
- Consumers (higher inflation, loss of purchasing power of their revenues and more expensive preferential dollars)
- Multinational corporations with retained dividends in Bs
- Former Sitme beneficiaries (individuals and firms)





## GDP Growth by Activity



Sources: BCV and Ecoanalítica



## Supply and Demand Imbalances

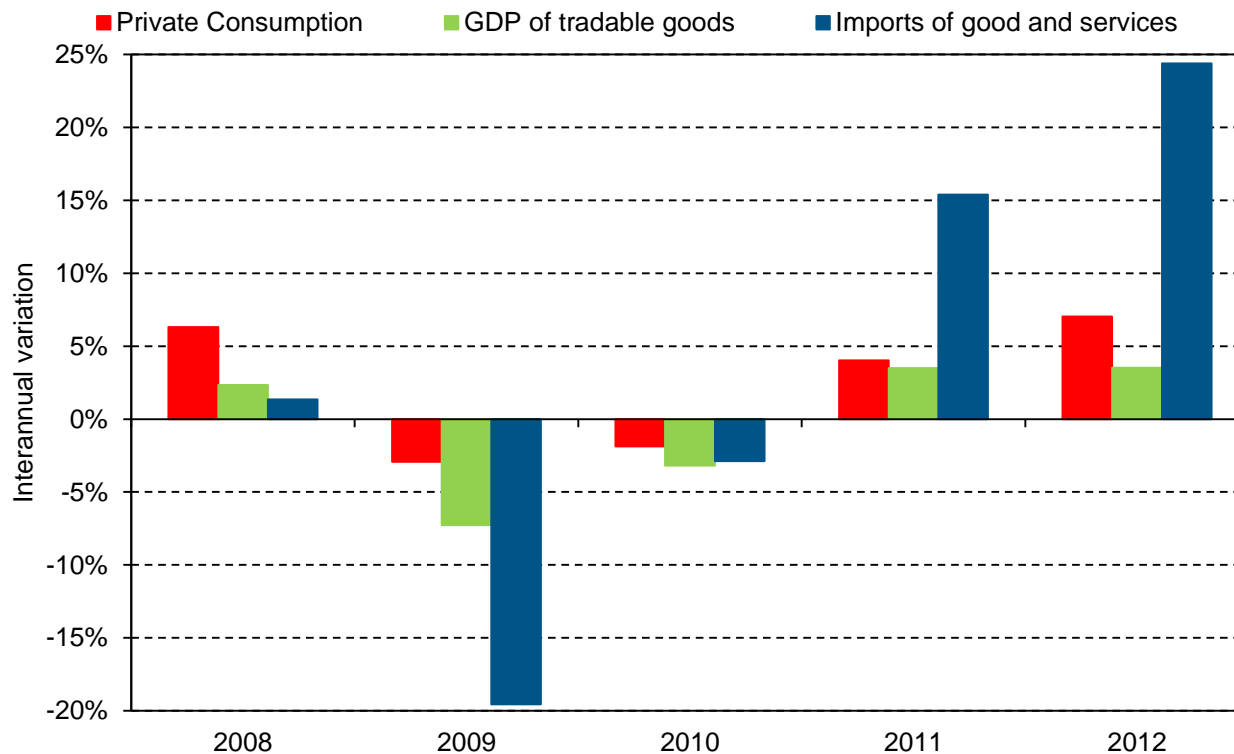
- Solid expansion of private consumption
  - Growth of money supply
  - Higher banks' lending capacity
  - Government's social programs (missions)
- Restriction of domestic production
- Growing dependence on imports

## Deregulation and promotion of private production activities

- Limitations of controls
- Investment promotion (higher production capacity and efficiency)



# Private Consumption, Imports and GDP of tradable goods

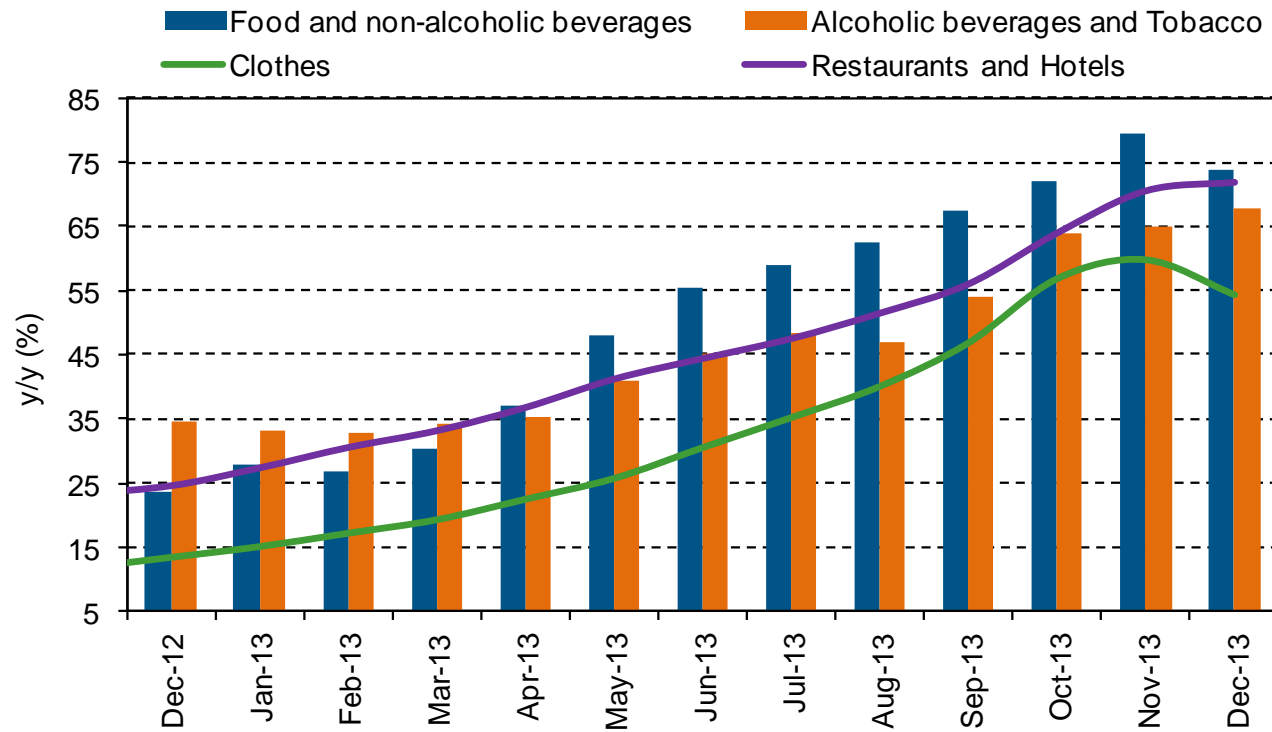


Sources: BCV and Ecoanalítica



# Inflation by Item

## Inflation by Item



Sources: BCV and Ecoanalítica