BOLIVARIAN REPUBLIC OF VENEZUELA

1. General trends

The Venezuelan economy contracted by 1.4% in 2010, while inflation for the year stood at 27.2%. Stronger economic activity is expected for 2011, with real GDP projected to grow by 4.5%. The inflation rate is expected to remain high because of rising food and other commodity prices, and employment is likely to continue to stagnate.

2. Economic policy

(a) Fiscal policy

The central government's performance in 2010 was better than in 2009, as fiscal revenues outpaced spending in nominal terms. However, preliminary figures as at the third quarter of 2010 indicate that the narrowly defined public sector posted a larger deficit than in 2009. The central government's primary deficit was 2.3% of GDP in 2010, while the overall deficit was 3.8% of GDP (compared with 4% and 5.4% of GDP in 2009).

Central government non-oil revenue fell by 2.3 percentage points of GDP, while oil revenue rose by 0.4 points. Although both capital and current spending shrank as a percentage of GDP, the latter dropped more (2.3 percentage points of GDP), owing mainly to the cutback in transfers to other public bodies. Even so, the central government deployed a greater fiscal stimulus, as nominal spending exceeded inflows, especially non-oil revenue.

In 2010, nominal borrowings by the Bolivarian Republic of Venezuela rose, albeit slightly, as a percentage of GDP. Total debt crept up from 18.4% to 18.6% of GDP, with domestic debt increasing by 1.4% of GDP and external debt falling by 1.2% of GDP. The borrowings were used to finance the public deficit and secure funds for various public programmes. The official debt figures do not, however, include the country's borrowings from China, which are to be repaid in kind with oil.

The government saw its oil revenue grow following the jump in oil prices in the fourth quarter of 2010 and the first four months of 2011. With an eye to increasing the State's share in profits generated by oil exports, in April 2011 the government established a special levy on windfall prices in the international hydrocarbons market, specifically on exports of liquid hydrocarbons and derivatives. Under the decree-law, when oil prices exceed the price set in the Budget Act but are equal to or lower than US$ 70 per barrel, a 20% tax will be levied on the difference between the two prices. When prices are above US$ 70 per barrel but lower than US$ 90 per barrel, the State will collect 80% of the surplus. When prices are between US$ 90 and US$ 99 per barrel, the State will receive 90% of the surplus; and when prices are US$ 100 or above, the State's share of the surplus will be 95%. The revenue from this tax is channelled into the National Development Fund. In addition, the decree-law establishes a maximum price of US$ 70 per barrel for the purposes of calculating royalties and the extraction and export registration taxes, and it repeals the previous legislation concerning the special levy on windfall prices in the international hydrocarbons market, in force since April 2008.

In late December 2010, the government moved to invest in infrastructure and repair the damage caused by heavy rains by creating the Simón Bolívar Reconstruction Fund, which would be administered by the Ministry of People's Power for Energy and Petroleum and maintained outside the expenditure budget.

(b) Credit and monetary policy

The central bank pursued an expansionary monetary policy aimed at reviving the economy in 2010. Currency in circulation and, in particular, demand deposits topped the inflation rate (which stood at 27.2%), resulting in a nominal increase in M1 of 40% during the period. The sharp drop in term deposits (-61.5%), however, meant that M2 only rose by 24%, which was actually a slight contraction in real terms. In the first few months of 2011, M1 grew faster than during the same period in 2010, while term deposits returned to growth (8%) in the first quarter of 2011 after bottoming out in December 2010.

In the interest rate arena, monetary policy rates remained unchanged in 2010 and the central bank made no changes to the financial system's maximum and minimum lending and borrowing rates set the previous year. The lending rate ceiling remained at 24% while the maximum rate for credit cards held steady at 29%.

In an effort to boost bank lending, the central bank twice cut the marginal reserve rates for financial institutions in 2010, bringing those rates down from 23% to 17%. Prime lending rates were left unchanged for sectors regarded as strategic by the government, including agriculture, manufacturing and mortgage lending, while the prime rates for the tourism sector were pared back. In addition, the central bank maintained the minimum percentage (10% of gross portfolio as at March 2009) for credit that banks must grant to the industrial sector and to mortgage loans. Late in April 2011, the government launched a large-scale housing support initiative that entailed a 3 percentage point cut in the marginal banking reserve and a hike in the minimum portfolio percentage that banks must allocate to mortgages, from 10% to 12%.

(c) Exchange rate policy

In January 2010, the government established a two-tier exchange rate system comprising a rate of 2.6 bolívares fuertes (BsF) per dollar for selected items, chiefly food, medicine, educational materials, machinery and equipment,[1] and a rate of BsF 4.3 per dollar for other imports. In June 2010, the Transaction System for Foreign Currency Denominated Securities (SITME) was implemented, adopting an implicit exchange rate of BsF 5.3 per dollar for the year 2010. SITME allows the purchase of dollars for operations that are not eligible for currency authorized by the Foreign Exchange Administration Commission (CADIVI). In 2010, the central bank liquidated US$ 34.844 billion through CADIVI (equivalent to 7.9% more than in 2009), while US$ 5.08 billion was negotiated through SITME.

On 1 January 2011, the government harmonized the exchange rate at BsF 4.3 per dollar, abolishing the BsF 2.6 per dollar rate. The implicit rate of BsF 5.3 per dollar was maintained in SITME for operations not eligible for the BsF 4.3 per dollar rate authorized by CADIVI.

Despite the devaluation of the bolívar fuerte in January 2011, the country's persistently high inflation in the early months of 2011 caused the real effective exchange rate in March 2011 to be 27% lower (currency appreciation) than the average recorded between 1990 and 2009.

In 2010 the central bank transferred US$ 7 billion in international reserves to the National Development Fund, bringing those reserves down to US$ 29.5 billion, or 7.6% of GDP,[2] in December

[1] This exchange rate was also applied in this period to outward family remittances and some other transactions.

[2] Using the exchange rate of 2.6 bolívares fuertes per United States dollar to estimate GDP in dollars.

2010; that figure compared with US$ 35 billion, or 10.7% of GDP, in December 2009. Even though oil prices remained high, the central bank's international reserves continued to fall in the first quarter of 2011, leaving a balance of US$ 26.861 billion at the end of March 2011 subsequent to the central bank's transfer of US$ 2 billion to the National Development Fund in January and February of the year. In early February 2011, the government withdrew US$ 829 million from the Macroeconomic Stabilization Fund, leaving a balance of only US$ 3 million.

3. The main variables

(a) Economic activity

The downtrend in GDP that began in 2009 showed signs of slowing in the second quarter of 2010, with output expanding slightly in the last quarter of the year (by 0.6% compared with the same period in 2009). As a result, GDP fell by only 1.4% in 2010 compared with the previous year.

The decline was largely triggered by the sluggish activity in 2010 in the manufacturing (-3.4%), construction (-7.1%) and financial and insurance sectors (-4.9%), although the growth in communications (9.3%) and government goods and services (2.6%) helped to minimize the contraction in GDP. On the expenditure side, the dip in GDP was due mainly to weak performance in exports (-12.4%), private final consumption (-2.3%) and gross fixed capital formation (-4.4%); this last item had declined for three consecutive years and in 2010 stood 15.1% lower than in 2007. The contraction in exports at constant prices stemmed chiefly from the lower volume of hydrocarbon exports, although non-oil exports in both the public and private sectors also fell. Private consumption fell off as high inflation rates eroded public-sector revenue. The overall drop in imports (4.6% at constant prices) could be traced in great part to lower privatesector goods imports (-14.4%), while public sector imports grew by 28.8% and reflected the expanding share of the public sector in various economic sectors.

The electric power rationing introduced in the wake of the drought that significantly curtailed generating capacity at the Guri dam continued during the first half of 2010 but was suspended in June. As a result, production gradually resumed in the basic industries that had been subject to rationing during the first half of the year.

According to data from the Organization of the Petroleum Exporting Countries (OPEC), oil production by the Bolivarian Republic of Venezuela fell by 1.1% between 2009 and 2010. The second half of 2010 saw renewed investment in extraction activities in response to rising crude oil prices. According to the oilfield services company Baker Hughes, the number of oil drilling rigs in the country rose by an average of 11.2% between 2009 and 2010, while investment in the sector gathered pace in the last quarter of 2010 and the first quarter of 2011.

The recovery of the Venezuelan economy is expected to continue in 2011, with projected GDP growth of 4.5%. The sharp rise in oil prices, coupled with government measures to increase its share of oil revenue, is expected to spur public spending and more widespread availability of hard currency in the economy. This was already evident in the first quarter of 2011, when GDP grew by 4.5% compared with the same period in 2010, boosted by a 10.4%increase in public consumption. However, encouraging private investment in a context of uncertainty, high inflation and a lagging exchange rate poses an ongoing challenge, as indicated by sluggish growth of just 4.9% in gross fixed capital formation in the first quarter of 2011, despite that rate's already low levels in the first quarter of 2010.

(b) Prices, wages and employment

Between December 2009 and December 2010, the national consumer price index rose by 27.2%, outstripping the inflation rate of 25.1% posted in 2009. During the first three months of 2011, inflationary pressures continued, with prices up by 27.4% compared with March 2010 and cumulative inflation reaching 6%. Prices climbed the most in the food and beverage sectors, in particular for farm produce.

As economic activity contracted, the unemployment rate rose, climbing from an average of 7.9% in 2009 to 8.5% in 2010; unemployment was higher in every quarter of 2010 compared with the year-earlier periods. Informal employment also expanded slightly, from 44% in 2009 to 44.5% in 2010, while the average participation rate fell by half a percentage point. In the first quarter of 2011, the unemployment rate mirrored that of first-quarter 2010, but the activity rate dropped off slightly by 0.4 percentage points.

Wages increased by 20.5% in nominal terms between the fourth quarter of 2009 and the same quarter of 2010, but were down in real terms owing to high inflation (27.2%) over the period. The drop was most notable in the public sector, where wages rose by only 9.9% in nominal terms, compared with growth of 25.5% in the private sector. In April 2011, the government ordered a 25% hike in the minimum wage, broken down into an increase of 15% from 1 May and a further 10% from 1 September.

(c) The external sector

The current account surplus for 2010 stood at 3.7% of GDP, which reflected an improvement over the 2.6% surplus posted in 2009.

In terms of value, goods exports rose by 14.2% vis-à-vis 2009, but they shrank slightly in GDP terms, from 17.7% of GDP in 2009 to 17.1% in 2010. The increase in value terms was attributable entirely to higher export prices, particularly for Venezuelan crude, which shot up by 27.5% between 2009 and 2010. As noted earlier, export volumes fell significantly in 2010, both in the oil sector and in the rest of the economy. Goods imports grew by just 0.4% in value, with the drop in volume being partly offset by higher import prices.

The deficit on the capital and financial account widened slightly in 2010 to 4.9% of GDP (compared with 4.3% of GDP in 2009). This was due mainly to growth in the external assets held by both the private and public sectors, particularly private sector deposits abroad, the central bank transfer of US$ 7 billion to the National Development Fund and the expansion of the external assets of the State-owned oil company Petróleos de Venezuela S.A. (PDVSA). The negative balance of foreign direct investment in the country shrank from 1% of GDP in 2009 to 0.4% of GDP in 2010, while Venezuelan outward direct investment remained steady at 0.6% of GDP. Lastly, with respect to 2009, in 2010 the portfolio investment account recorded a smaller issuance of external debt and, accordingly, a smaller surplus (0.8% of GDP, compared with 2.7% in 2009). In 2010, both PDVSA and the central government placed bonds: the PDVSA 2017 bond and redeemable bond 2022 respectively.

The current account is expected to deteriorate in 2011 despite rising oil prices, owing to sluggish growth in the value of exports compared with imports in a setting of economic recovery. In the first quarter, for example, exports grew by 25.1% whereas imports grew by 27.4%.