Economic Research Department

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Venezuela

Economic Observatory

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Foreign accounts remain strong

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- **Balance of Payments shows surplus of $US 5,585 million.**
- **Record in current account (US$18,030 million) driven by oil exports.**
- **Imports affected by the first year-on-year contraction of foreign demand in the last 21 quarters (US$379 million).**
- **The financial buffer of exchange rate control protected the country against restructuring of the international portfolio.**

The Venezuelan Central Bank (BCV) presented its third-quarter foreign results, with a positive Balance of Payments of US$5,585 million, resulting from a current account surplus (US$18,030 million) and capital and financial account deficit (US$11,003 million).

Record results for current account

The third-quarter current account balance was largely determined by the balance of goods of US$19,201 million. Oil continued to account for almost the entirety of the Venezuelan export market (93.8%), reaching a record total of US$29,398 million. From the figures reported by the BCV, the increase in oil exports during this quarter was driven by the combined increase in both average price (59.9%, year-on-year) and production (210m barrels/day). For the second quarter in succession, non-oil exports (US$1,952 million) grew year-on-year (19.5%), thanks to the growth in sales of iron and steel products, chemicals and iron ore.

In imports (US$12,149 million), the economy suffered the first year-on-year contraction of foreign demand in the last 21 quarters (US$379 million).This negative trend is the result of two processes. First, in relation to government-imposed restrictions (quota) on imports of vehicles assembled in Colombia, the effects of which were seen in a drop of 10.6% (US$335 million) in imports of end-use goods by the private sector with respect to September 2007 levels. Second, the slowdown of the economy during the quarter, in particular the fall-off in investment (-1.3%), which reduced demand for capital goods and contributed to a year-on-year drop in imports for this sector of 19.6% (US$700 million).

Capital and financial accounts continue to show high deficits

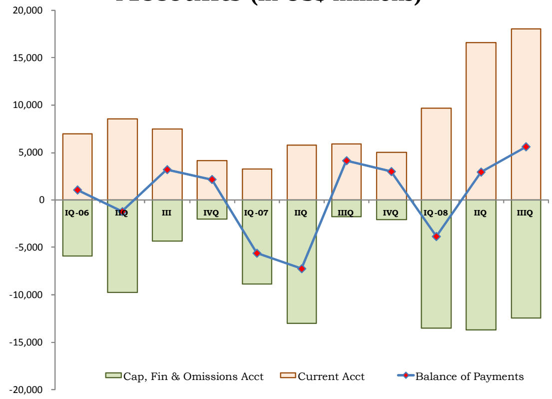
The total deficit for capital and financial accounts was US$11,003 million, which matches the approximate levels of the last seven years, resulting in this case from the significant deficit in other investments (US$9,815

Summary of Balance of Payments
(in US$ millions)

	(I+II+III) 2008	III Q 2008	III Q 2007	III Q 2006
Current account	44.325	18.030	5.898	7.499
Balance of goods	49.393	19.201	6.282	8.436
Export of goods	83.166	31,350	18.810	16.945
Oil	77.862	29.398	17.177	15.176
Non-oil	5.304	1.952	1.633	1.769
Import of goods	-33.773	-12.149	-12.528	-8.509
Oil	-3.279	-1.039	-1.349	-791
Non-oil	-30.494	-11.110	-11.179	-7.718
Balance of services	-4.492	-1.668	-1.531	-1.146
Balance of income	-158	567	1.264	215
Balance of goods, services and income	44.743	18.100	6.015	7.505
Current transfers	-418	-70	-117	-6
Capital and financial account	-36.514	-11.003	-1.599	-2.864
Direct investment	-3.129	-1.509	-52	854
Portfolio investment	-400	321	2.910	-1.446
Other investment	-32.985	-9.815	-4.457	-2.272
Errors and omissions	-3.150	-1.442	-182	-1.453
Balance in current and capital transfers	4.661	5.585	4.117	3.182
Reserves	-4.661	-5.585	-4.117	-3.182

Source: BCV

Current, Capital and Financial Accounts (in US$ millions)



Source:

million). This was accompanied by a negative balance in the direct investment account (US$1,509 million) and a slight surplus in the portfolio investment account (US$321 million). The positive portfolio investment account results were linked to a resolution passed by the national banking regulator requiring foreign currency structured notes to be removed from the investment portfolio in September. Taking into account the figures reported in the balance of payments, the total rose to US$2,278 million. The deficit in other investments was caused by an increase in foreign currency deposits held by the public sector and credits issued by the oil industry to international clients. Despite the negative balance of the capital and financial account and the uncharacteristically high value of net errors and omissions (US$-1,442 million), international reserves increased by US$5,585 million, reaching a record total value of US$39,589 million on September 29th.

Although records show a general upward trend, this behavior contrasts with the evolution of NIRs in other small, oil-dependent economies such as Libya and Algeria, whose respective stocks of foreign currency are 221.0% and 336.6% greater than those of Venezuela. This behavior can be explained by two factors: first, annual transfers of surplus government reserves, and second, the greater flexibility to establish public sector foreign currency funds. In combination, these factors limit the accumulation of international reserves. The Venezuela Central Bank report shows that until September the public sector (including NIRs) maintained a favorable net balance with the rest of the world of US$83,055 million, which is 70.4% greater than the figure for the previous year and 488.7% greater than the 2004 level.

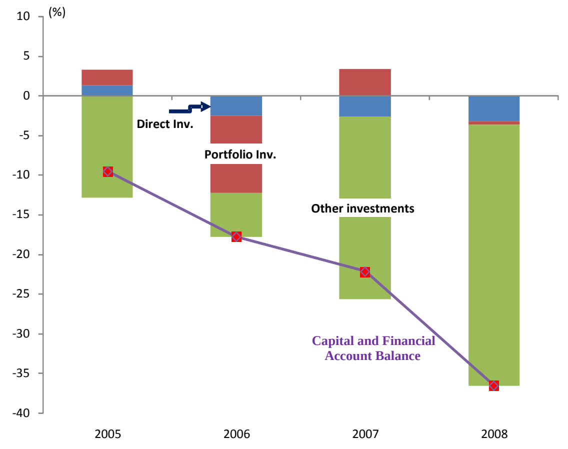
Appraisal and outlook.

As has been characteristic in recent years, the principal factor influencing the foreign trade balance was the price of oil, despite the fact that financial transactions are restricted to the mechanisms permitted by the currency administration system. As such, the high prices of crude oil during the quarter, including the historic high of US$126.5 per barrel for the Venezuelan basket in July, contributed to the positive balance of goods in exports and, by extension, the overall balance of the foreign sector.

However, the fluctuating hydrocarbon market in the weeks towards the end of the quarter showed a rapid reversal of this upward trend and a drop in the growth rate of domestic exports. Elsewhere, the effects of the financial turbulence on the country’s foreign accounts were fairly moderate. The financial buffer of exchange rate control protected the country against restructuring of the international portfolio and the resulting pressures on international reserves.

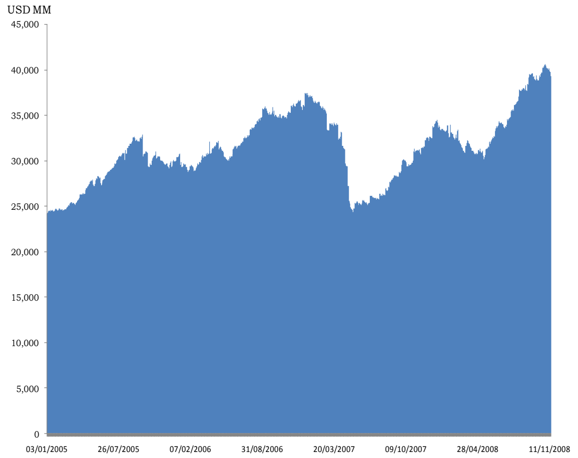
As such, the negative financial account balance continues to be linked to decisions on the accumulation of official sector foreign resources rather than foreign capital outflows. Forecasts for year end and 2009 indicate a significant moderation of foreign results, principally in the balance of goods. The unprecedented exports results of the last two years are expected to decline, although we do not anticipate as dramatic as change

Capital and Financial Account
(in US$ millions)



Source: BCV

Net International Reserves
(in US$ millions)



Source: BCV

as suggested by current oil prices. The value of crude should show an upward correction in the medium-term, to reach prices of around US$80 per barrel for reference crudes. Such a scenario will require a restructuring of foreign accounts to focus on fewer imports and less accumulation of foreign assets by the public sector. Expected total values for year close 2008 are approximately US$100,000 million for exports and US$47,000 million for imports.