

**Sovereigns
Venezuela
Credit Analysis**

Bolivarian Republic of Venezuela

Ratings

Security Class	Current Ratings
Foreign Currency	
Long-Term IDR	B+
Short-Term IDR	B
Local Currency	
Long-Term Local Currency	B+
Country ceiling	B+

Outlook

Sovereign Foreign Long-Term IDR	Stable
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Financial Data

Venezuela	
USDbn	2007
GDP	228.1
GDP per head (USD, thousands)	8.2
Population (mns)	27.7
International Reserves	32.2
Net External Debt (% GDP)	-47.9
Central Government Total Debt (% GDP)	17.4
CG Foreign Currency Debt	28.6
CG Domestically Issued Debt (LCU bn)	36

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Related Research

- [Sovereign Rating Methodology](#)
- [Bank-Systemic Risk Report](#)
- [Global Economic Outlook](#)
- [Sovereign Review](#)

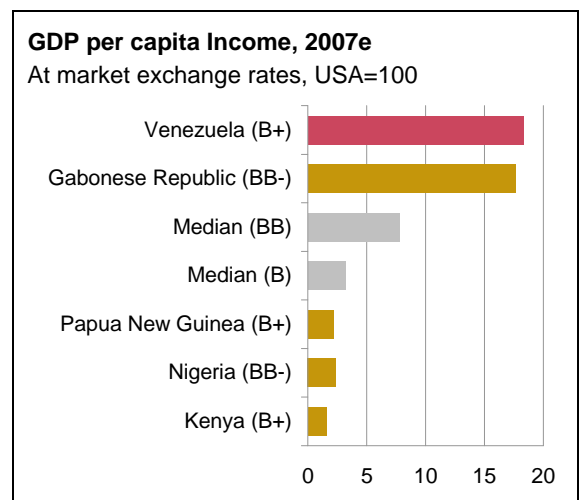
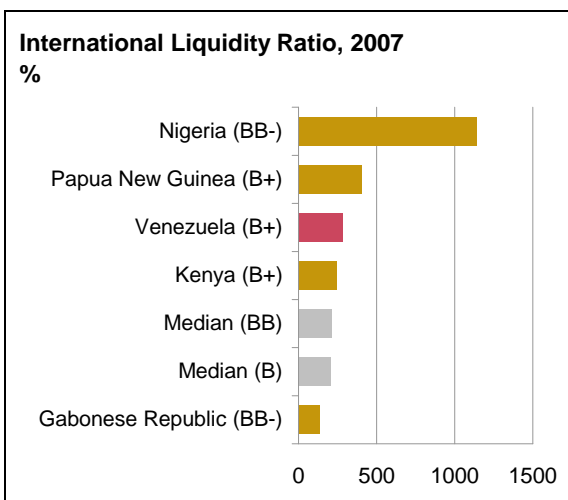
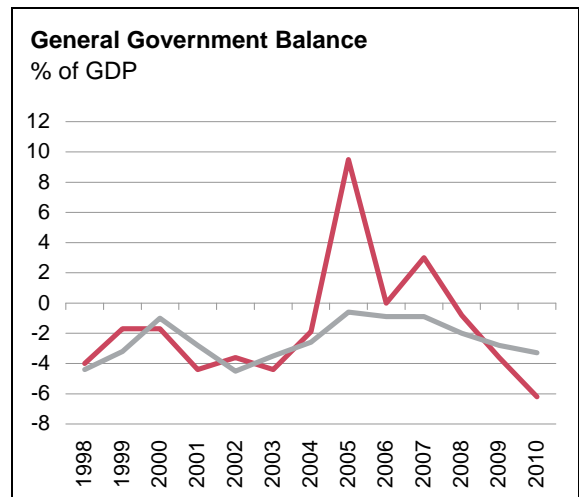
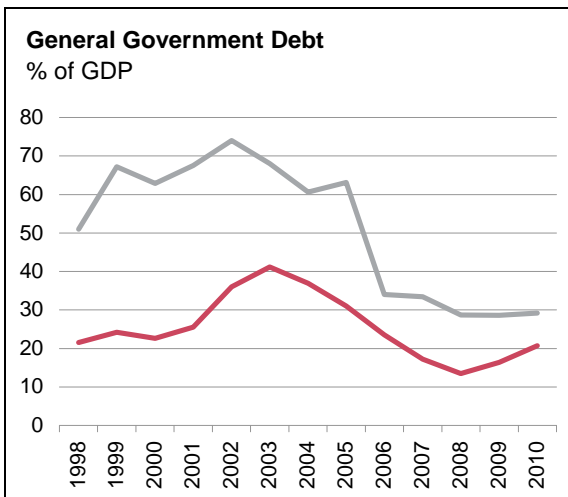
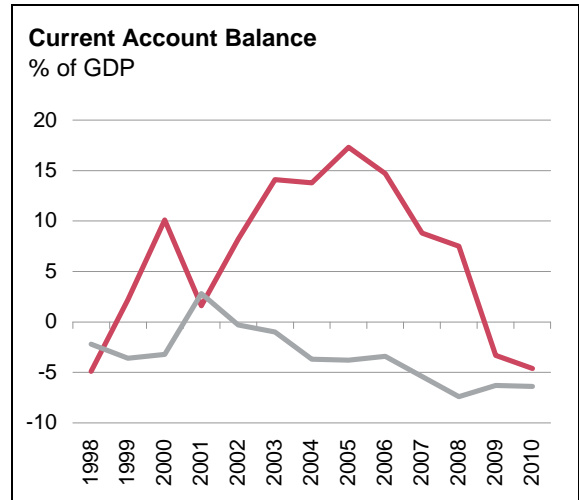
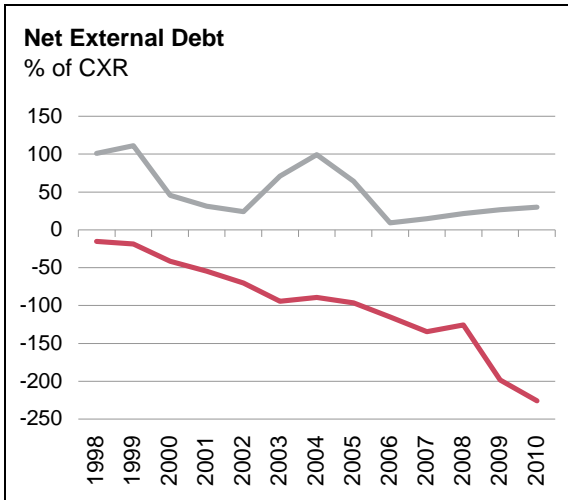
Rating Rationale

- Comparatively low government debt and financing needs combined with a considerable financial asset position constitute credit strengths for Venezuela. Moreover, the sovereign has demonstrated its willingness to service its debt obligations during times of stress in the past.
- Nevertheless, the Bolivarian Republic's tenuous macroeconomic policy framework has increased the vulnerability of the economy and public finances to external shocks, particularly lower oil prices, which constitutes a key credit weakness. The country's narrow economy and export base combined with the inconsistency of a marked fiscal expansion, price controls and a fixed exchange rate regime have resulted in a much higher level of volatility in terms of GDP growth, inflation and the real effective exchange rate relative to non-investment grade peers, thus, reducing policy options for an orderly adjustment and increasing the risk of financial and economic crises.
- An unprecedented fiscal stimulus, both directly through central government and quasi-fiscally through PDVSA, has fuelled fast paced economic expansion in recent years. On average, central government spending grew by 38% over the past five years, and quasi-fiscal spending through PDVSA (apart from taxes, royalties and dividends) reached an average of 6.1% of GDP over the last three years, which leaves little room to implement counter-cyclical policies under a low oil price scenario.
- In recent years, Venezuela's external position has been bolstered by historically high oil prices (oil accounts for 94% of exports and 84% of total current external receipts (CXR)), an overvalued fixed exchange rate and extensive capital controls. Nevertheless, the collapse of oil prices, the increased inelasticity of imports to cover shortages of basic products and the transfer of reserves to discretionary and opaque funds could lead to a rapid deterioration of external solvency and liquidity indicators over our forecast horizon.
- In spite of a tightening of monetary policy since H207, inflation, which is forecast to reach 31% by year-end 2008, is the highest among non-investment grade sovereigns. Inflation combined with the spread between the official and parallel market exchange rates, further erode sustainable growth prospects and limit policy options for the government to cope with a low oil price environment.

Key Rating Drivers

- Venezuela's creditworthiness could improve if a sustainable and coherent policy response were implemented to reduce its vulnerability to oil price fluctuations and thus the volatility of overall macroeconomic performance.
- Conversely, mounting macroeconomic pressures, underpinned by the rapid decline in oil prices, high inflation and an overvalued official exchange rate, if not addressed, could result in a severe and disorderly economic adjustment. In this scenario, the sovereign's capacity to service its debt could be adversely affected.
- Additionally, a greater than anticipated deterioration of the country's fiscal and balance of payments position could also put downward pressure on Venezuela's ratings.

Peer Comparison



— Venezuela

— Medians

Peer Group

Rating	Country
BB-	Gabonese Republic
	Lesotho, Kingdom of
	Nigeria
	Serbia
	Turkey
	Uruguay
	Vietnam
B+	Venezuela
	Cape Verde
	Georgia
	Ghana
	Kenya
	Mongolia
	Papua New Guinea
	Sri Lanka
	Ukraine
B	Benin
	Cameroon
	Dominican Republic
	Jamaica
	Mozambique
	Suriname
	Uganda

Rating History

Date	Long-Term Foreign Currency	Long-Term Local Currency
15 DEC 2008	B+	B+
18 OCT 2007	BB-	BB-
16 NOV 2006	BB-	BB-
14 NOV 2005	BB-	BB-
20 SEP 2004	B+	B+
23 JUN 2003	B-	B-
10 JAN 2003	CCC+	CCC
28 JUN 2002	B	B-
06 FEB 2002	B+	B
18 DEC 2001	BB-	B+
02 JUL 2001	BB-	B+
21 SEP 2000	BB-	B+

Rating Factors

Summary: Strengths and Weakness

Rating Factor	Macroeconomic	Public Finances	External Finances	Structural Issues
Status	Weakness	Neutral	Neutral	Weakness
Trend	Negative	Negative	Negative	Negative

Note: relative to 'B' category

Strengths

- Venezuela has the second largest oil reserves in the Western Hemisphere as well as other abundant natural resources.
- Venezuela's comparatively low government debt burden and manageable government debt maturity profile, as well as its high level of accumulated financial assets, could provide short-term cushion to lower oil prices. At 2% of GDP in 2008, government debt maturities are comparable to the 'B' rating category median of 2.1%, and are forecast to decline to less than 1% of GDP over our forecast horizon.

Weaknesses

- Years of inconsistent macroeconomic policy choices combined with a narrow, commodity-based economy underpin Venezuela's historically volatile output growth and inflation performance.
- Venezuela's oil dependency increases its vulnerability to the recent collapse in oil prices. Oil accounts for approximately 94% of total exports and over 50% of central government revenues.
- An overvalued, fixed official exchange rate and capital controls flatter many of Venezuela's key credit metrics, and have accentuated macroeconomic distortions by fuelling import growth and increasing inflationary pressures in the economy.
- Inflation is the highest and most volatile in the hemisphere as well as among non-investment grade sovereigns. In Fitch's view, inflation is not only a monetary phenomenon, but also a result of the government's heterodox anti-inflationary policy response, low investment in productive capacity and the spread between the official and parallel market exchange rate.
- Comparatively weak political and civil institutions detract credibility from the policy framework. Continued electoral processes also limit the government's flexibility to rationalize economic policy to address increasing macroeconomic imbalances and to adjust to a low oil price environment.

Local Currency Rating

Fitch maintains the same Long-term local and foreign currency Issuer Default Ratings (IDR) because it perceives as similar the expected ability and willingness of the sovereign to service each category of debt. Furthermore, the government has employed market-based exchange mechanisms to refinance large near-term domestic maturities in recent years, but more coercive approaches cannot be ruled out.

Country Ceiling

Fitch equates Venezuela's country ceiling and long-term IDR due to the extensive use of capital controls since 2002. In spite of modifications, the efficiency of the system's administration through CADIVI results in delays in the access of the private sector to foreign exchange.

Outlook and Key Issues

Although Venezuela has amassed a significant level of financial assets and has a comparatively manageable amortization profile in the forecast period, policy choices during the recent commodity boom have increased the vulnerability of the economy and public finances to swings in oil prices. Fitch believes that macroeconomic imbalances built over years of an inconsistent policy framework and short-term political objectives are likely to increase the challenges for authorities to engineer an orderly adjustment to a low oil price environment.

Fiscal health, external balances and economic growth in Venezuela have been traditionally tied to oil prices. This dependence has deepened in recent years as oil currently accounts for 94% of exports and 52% of central government revenues, compared to 68% and 33%, respectively, in 1999. Nevertheless, these figures underestimate the importance of oil, since oil revenues traditionally have an important multiplier effect, which has increased in recent years due to greater credit availability and the omnipresence of state in the economy ranging from nationalizations in strategic sectors to fulfilling food shortages. In addition, PDVSA has been a key player in meeting the government's policy goals, as it has directed an average of 6.1% of GDP to social programs and government funds during the last three years.

Favoured by historically high international oil prices, the government has more than tripled fiscal and quasi-fiscal expenditure since 2004, making fiscal sustainability completely reliant on the performance of the oil sector and considerably reducing the room for counter-cyclical fiscal measures. Furthermore, the government's dependence on oil-related revenues has resulted in one of the most volatile revenue to GDP ratios among all Fitch-rated sovereigns suggesting the potential for significant fiscal slippage and a limited tolerance to sustain a higher debt burden. Although the government has indicated its intentions to rationalize central government spending, by reducing expenditure growth and its discretionary character (through the incorporation of social spending into the budget and a higher oil price budget assumption), the government has also over-executed budgeted expenditure by 30% on average in the past three years. Political incentives increase the likelihood for over-execution to continue in 2009.

Public Finances: Sources and Uses (% GDP)

	2007	2008 ^f	2009 ^f	2010 ^f
Uses	0.0	2.8	4.3	6.9
Budget balance	3.0	-0.8	-3.5	-6.1
Amortisation (by place of issue)	3.0	2.0	0.8	0.8
Domestic	2.0	1.3	0.5	0.2
Foreign	1.0	0.7	0.2	0.6
Sources	0.0	2.8	4.3	6.9
Gross borrowing (by place of issue)	0.0	2.8	4.3	6.9
Domestic	-1.0	2.1	4.1	6.3
Foreign	1.0	0.7	0.2	0.6

Source: Fitch Ratings

Under Fitch's forecast of an average WTI price USD60 in 2009 and assuming an average differential of USD8.5 with the Venezuelan basket, the central government deficit could rise to 5.8% of GDP next year in the absence of a devaluation. The government could reduce the expected fiscal gap through the use of "off balance sheet" funds and ultimately an official devaluation. An official devaluation, though, could be politically costly due to the already high levels of inflation hurting Venezuelan's real incomes. Moreover, an official devaluation in the absence of broader policy adjustments is also likely to perpetuate or even increase the spread between the official and parallel exchange rates with its consequent negative impact on inflation. In the absence of an official devaluation, Fitch estimates that the average price per barrel for the Venezuelan blend would have to equal USD71

to balance fiscal accounts in 2009.

Although external accounts benefited from an unprecedented rise in oil prices in H108, the authorities need to address various structural weaknesses. First, Venezuela's external position remains cushioned by capital controls, which have not been completely successful in preventing private sector capital flight. Moreover, the economy's mismatch between domestic demand growth and domestic productive capacity has increased the inelasticity of imports, especially basic products, needed to avoid domestic shortages. Finally, the government has transferred international reserves to opaque and highly discretionary funds, which has eroded the sovereign's liquidity and external position.

Under Fitch's base case scenario for oil prices in 2009, exports could drop by 38%, and the current account surplus would revert to a deficit of 2% of GDP. Fitch estimates that the average price of the Venezuelan basket would need to reach USD68 to keep the current account in balance next year. In addition, Venezuela faces constraints to increase production levels to cope with lower prices due to its commitments to uphold its quota limit as a member of the Organization of Petroleum Exporting Countries (OPEC), and Petroleos de Venezuela S.A. (PDVSA) own difficulties to increase production levels even during the recent years of high oil prices. Hence, further cuts under Venezuela's OPEC quota could accentuate the deterioration in exports and the current account. In the absence of higher oil prices and/or an appropriate policy response, the sovereign could turn into a net external debtor in 2009, and external liquidity could drop to 133% by the beginning of 2010, below the forecasted median of 160% for 'BB' rated sovereigns and 198% for 'B' rated sovereigns. Continued transfers of reserves to the National Development Fund (FONDEN) are likely to further deteriorate external solvency and liquidity indicators. Given Venezuela's oil dependency, which causes an elevated degree of balance of payments volatility relative to peers, Fitch expects higher levels of external solvency and liquidity to support creditworthiness.

External Finances: Sources and Uses (USDbn)

	2007	2008 ^f	2009 ^f	2010 ^f
Uses	-13.5	-17.8	14.6	20.7
Current account balance	-20.0	-26.4	6.9	12.0
MLT amortisation	6.5	8.6	7.7	8.8
Sovereign	2.2	2.2	0.8	2.2
Non-sovereign	4.3	6.4	7.0	6.6
Sources	-19	-14.5	5.0	9.2
Gross MLT borrowing	15.2	16.0	10.2	12.1
Net FDI	-1.6	-3.2	-1.6	0.0
Net portfolio debt	-	-	-	-
Net portfolio equity	0.1	0.0	0.0	0.0
Other credit flows nes	-30	-27	-4	-3
Net E&O	-3	-	-	-
Change in fx reserves	-5.4	3.3	-9.6	-12.7

Source: Fitch Ratings

While economic cycles and fiscal conditions in Venezuela have traditionally been linked to oil prices, the structural changes undergone by the Venezuelan economy in recent years as a result of government policies have deepened macroeconomic imbalances. Although the government attempted to rationalize economic policy through a deceleration of fiscal spending in 2007 and a variety of measures to reduce liquidity in the local economy, including issuances of USD-denominated instruments in the local market, inflation remains the highest in the hemisphere. Moreover, the continued use of heterodox policies such as price controls, subsidies and financial repression have not only failed to control inflationary pressures but backfired by creating shortages of basic consumption items, which has further fuelled inflationary pressures.

Capital controls, in place since 2003, and the parallel exchange market reduce the

government policy options for an orderly adjustment to lower oil prices. The parallel exchange rate already trades with a premium over 100% in spite of the government's supply of USD-denominated bonds and other securities such as structured notes in the domestic market. Further tightening of capital controls and/or reduced FX provision by CADIVI to the private sector would increase the pressure on the parallel exchange rate resulting in higher inflation, since the parallel exchange is used as reference for price formation. As mentioned above, a formal devaluation in the absence of substantial policy adjustments is likely further fuel inflationary pressures in the economy. Moreover, given the structure of the Venezuelan economy, a devaluation is also likely to shave off growth, since the competitiveness gains of the limited non-oil export base would be outweighed by a more expensive import bill, especially given Venezuela's increased dependence on imports to cover the mismatch between domestic supply and demand.

The government's confrontational relations with the private sector, increased participation of the state in the economy and uncertainty about the direction of economic policy have reduced the economy's resilience to a commodity price shock, thus, increasing the potential volatility of the country's GDP growth. Even under exceptionally favourable external conditions for Venezuela's main export, growth in Q108 declined to 4.9% y-o-y, down from 8.8% in Q107 and 10.3% in Q106 due to decelerating private consumption and a sharp decline in investment. Moreover, manufacturing growth continued to decline this year reaching 0.3% in Q308, down from 7.6% and 8.9% in Q307 and Q306, respectively. Figures on private investment are not publicly available. Nevertheless, non-oil capital imports by the private sector fell to 17% of total imports in Q308 from 21% in Q307 and 24% in Q306, suggesting a decline in private sector investment is also underway. Going forward, the government's ability to spend will be reduced in light of lower fiscal revenues, while the impact of fiscal stimuli on economic growth is likely to be less effective due to continued low private investment and high inflation. Low growth or a contraction of the Venezuelan economy could in turn further weaken the sovereign's fiscal position and increase government financing needs.

Even though prospects for growth, external and fiscal performance are weak, the government is in a better position to withstand an oil price shock relative to previous periods. External financing needs could rise to 40% of official reserves in 2009, not only comparing favourably to the 'B' median of 63%, but also to Venezuela's 1998 needs at 78% of reserves slightly lower than 2001 at 44%. Moreover, the public sector accumulated USD18bn in liquid foreign currency financial assets (about 5.4% of GDP) apart from international reserves by September 2008. Although these assets may not necessarily be available for debt service due to countervailing political pressures, Fitch expects that some portion of these assets could be freed up to meet financial obligations, if necessary. On the fiscal front, financing needs could increase to 4.3% and 6.9% of GDP in 2009 and 2010, respectively, a noticeable deterioration compared with 2008. However, this level is still less burdensome than financing needs of 11% of GDP in 1998 or 11.2% in 2001. Finally, the Bolivarian republic has a recent record of fulfilling its debt service obligations even in periods of high revenue stress such as the 2003 oil strike, though macroeconomic imbalances and spending on key patronage programs have increased since then.

Fitch notes that the authorities' potential policy response to the imminent adjustment due to the collapse in oil prices remains a concern. The government's strong asset position and manageable financing needs could alleviate the impact of lower export and fiscal revenues, though a disorderly economic adjustment that results in a financial crisis could more than outweigh this strength. Furthermore, the heavy electoral calendar in recent years has provided incentives for policy makers to concentrate on short-term gains rather than medium-term objectives. The defeat of the President Chavez' constituent reform proposal in 2007, the gains by opposition candidates in regional and mayoral elections in 2008 and the

Venezuela FX Liquid Financial Assets

(Million, End of September 2009)

Reserves	39206
Non-Reserve Assets	
Fonden	9367
Bandes	750
Treasury Deposits	5900
China-Venezuela Fund	2000
Sub-Total	18017
TOTAL	57223

Source: Fitch Estimates and Official Sources.

intention to hold a referendum to allow President Chavez to run for consecutive indefinite terms are likely to delay any adjustment of economic policies to a low oil price environment, which would continue to increase the distortions of the domestic economy and accelerate the deterioration of external and fiscal accounts. The government has indicated that it intends to maintain its policy focus of supporting high rates of economic growth. As we indicated above, it is not likely that fiscal stimulus alone could sustain growth, and this attempt could further weaken the fiscal and external position of the sovereign, thus increasing pressures on the sovereign's ratings.

Forecast Summary

	2004	2005	2006	2007	2008 ^f	2009 ^f	2010 ^f
Macroeconomic Indicators and Policy							
Real GDP Growth (%)	18.6	10.3	10.3	8.4	5.1	0.9	-2.8
Consumer Prices (Annual Average % Change)	21.8	16.0	13.7	18.7	27.0	32.7	31.5
Short-Term Interest Rate (%) ⁽¹⁾	4.4	2.6	5.3	8.7	8.1	9.0	9.3
General Government Balance (% of GDP)	-1.9	9.5	0.0	3.0	-0.8	-3.6	-6.2
General Government Debt (% of GDP)	36.9	31.0	23.5	17.2	13.5	16.6	20.8
LC per USD (Annual Average)	1.9	2.1	2.1	2.1	2.1	2.5	3.3
Real Effective Exchange Rate (2000=100)	70.1	69.0	73.4	81.2	104.6	102.7	100.3
External Finance							
Current Account Balance (USDbn)	15.5	25.1	27.1	20.0	26.4	-7.2	-12.4
Current Account Balance (% of GDP)	13.8	17.3	14.7	8.8	8.0	-2.0	-3.4
Current Account Balance plus Net FDI (% of GDP)	14.6	18.2	13.3	8.1	7.0	-3.4	-3.7
Net External Debt (USDbn)	-38.5	-59.2	-86.5	-109.2	-110.8	-109.4	-106.9
Net External Debt (% of GDP)	-34.2	-40.7	-46.9	-47.9	-33.6	-30.1	-29.5
Net External Debt (% of CXR)	-89.3	-96.5	-115.3	-134.4	-111.3	-174.9	-200.7
Official International Reserves Including Gold (USDbn)	23.1	29.0	36.4	32.2	37.7	26.8	12.6
Official International Reserves in Months of CXP Cover	10.1	9.6	9.1	6.3	6.2	4.6	2.3
External Interest Service (% of CXR)	4.8	3.9	3.4	3.0	3.6	8.1	9.9
Gross external financing requirement (% int. reserves)	-14.4	-73.4	-66.4	-37.2	-55.2	39.8	78.9
Memo: Global Forecast Summary							
Real GDP growth (%)							
US	3.6	2.9	2.8	2.0	1.4	-1.2	1.2
Japan	2.7	1.9	2.5	2.1	0.5	0.4	1.4
Euro Area	3.6	2.9	2.8	2.0	1.2	-0.6	0.9
World	3.9	3.3	3.9	3.6	2.5	2.9	3.1
Commodities							
Oil, USD/barrel	38.3	54.4	65.4	72.6	100.0	60.0	50.0

⁽¹⁾ Money Market Rate (annual average).
Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

Venezuela

	2007						
	Gabonese Republic BB-	Nigeria BB-	Kenya B+	Papua New Guinea B+	Venezuela B+	B Median	BB Median
Real GDP, 5yr average % change	2.7	7.9	5.3	3.5	7.9	5.9	5.9
Volatility of GDP (10yr rolling SD)	3.2	5.4	2.3	2.6	9.0	2.9	3.4
Consumer Prices, 5yr average	1.5	12.1	11.2	4.4	20.2	9.6	7.0
Volatility of CPI (10yr rolling SD)	2.0	4.8	3.6	6.2	7.5	4.0	3.2
Years since double digit inflation	13.0	2.0	1.0	4.0	0.0	n.a.	n.a.
Unemployment rate	n.a.	n.a.	n.a.	n.a.	7.5	8.0	8.0
Type of exchange rate regime	Monetary Union	Managed Float	Managed Float	Managed Float	Fixed	n.a.	n.a.
Dollarisation ratio	0.0	0.1	15.2	-	0.0	33.0	38.4
REER volatility (10yr rolling SD)	3.6	18.5	7.2	7.6	13.1	7.4	9.0

Source: IMF and Fitch

Strengths

- As a result of the oil windfall, Venezuela’s five-year GDP growth average will reach 10.5% in 2008, one of the highest average growth rates among non-investment grade sovereigns. This recovery since the severe recession of 2002/2003 has resulted in a steady decline in unemployment rates (to 8% in 2008 from 15.3% in 2004) and a notable reduction in poverty (to 27.5% in 2007 from 54.0% in 2003).

Weaknesses

- Historically, inflation control has been problematic in Venezuela, as reflected by a higher level of inflation volatility relative to both the ‘BB’ and ‘B’ medians.
- Venezuela’s inconsistent policy framework and its narrow, oil-based economy have resulted in one of the highest levels of growth volatility among peers and render the economy vulnerable to shocks.
- An overvalued-fixed exchange rate, last adjusted in 2005, as well as widespread capital controls, has deepened macroeconomic distortions and flatter many of the sovereign’s key credit metrics.

Commentary

While Venezuela’s accelerated growth has reached “Asian” levels in recent years, its impetus is likely to wane in the absence of a strong fiscal stimulus, falling private consumption due to high inflation and credit deceleration, and minimal private investment as a result of an unfavourable business environment.

Furthermore, an artificially strong VEF has reduced the competitiveness of non-oil exports and made imports comparatively cheaper, which has begun to weigh on economic growth and the external balance. If oil prices continue at present levels, thus hurting fiscal revenues, the pressure to devalue to close the fiscal gap could increase in 2009. However, in light of already high inflation and slowing economy this would be a difficult policy choice.

The government has tried to address the demand side of the inflation problem by draining liquidity out of the system through higher consumer interest rates and VEF absorption operations. However, inflation has a structural character due to low investment, over-dependence on imports and the wide spread between the parallel market and the official exchange rate. Moreover, in spite of recent adjustments, real interest rates remain negative, as they did not kept pace with higher inflation and the acceleration in government spending ahead of regional elections.

Comparative Analysis: Structural Features

Venezuela

	2007						
	Gabonese Republic BB-	Nigeria BB-	Kenya B+	Papua New Guinea B+	Venezuela B+	B Median	BB Median
GNI per capita PPP (USD, latest)	13,080	1,770	1,540	2,060	11,920	2,935	6,450
GDP per capita (USD, mkt exchange rates)	7,943	1,100	718	998	8,247	1,370	3,521
Human Development Index, percentile (latest)	33.7	11.6	17.1	18.7	59.1	35.4	47.5
Ease of Doing Business, percentile (latest)	21.0	39.6	54.3	54.9	8.5	34.5	46.4
Trade Openness	56.6	48.9	35.7	87.1	31.2	n.a.	n.a.
Gross domestic savings, % GDP	56.2	29.2	6.5	31.1	34.3	9.3	20.8
Gross national savings, % GNP	46.0	24.6	14.7	47.8	35.3	17.9	19.7
Gross domestic investment, % GDP	23.3	9.3	18.6	40.6	28.0	26.8	23.1
Private credit, % GDP	12.0	22.6	27.2	21.2	23.0	24.1	34.5
BSR Indicators	n.a.	D/2	n.a.	n.a.	D/2	n.a.	n.a.
Bank system CAR	32.0	20.9	16.7	n.a.	12.9	n.a.	n.a.
Foreign bank ownership (% of assets)	65.0	11.8	40.0	n.a.	26.3	n.a.	n.a.
Public bank ownership (% of assets)	30.0	5.0	15.0	n.a.	10.9	15.0	24.3
Default record (year cured)	2005	n.a.	2002	n.a.	1999	n.a.	n.a.

Source: Fitch and World Bank

Strengths

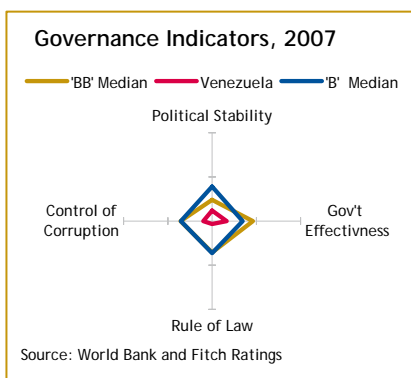
- Venezuela is estimated to have the second largest oil reserves in the Western Hemisphere at 99 billion barrels. The Bolivarian Republic’s reserves could be boosted further, as PDVSA is moving ahead with a certification process of heavy crude reserves. If certified, this could potentially move Venezuela up to second place in the world in terms of reserves volume.
- Venezuela’s GDP per capita at market exchange rates is more than five times the “B” median, while its social indicators, based on the United Nations Human Development Index, are better than non-investment grade peer medians.

Weaknesses

- According to the World Bank, Venezuela’s governance indicators compare unfavourably to both the ‘BB’ and ‘B’ medians. Highly centralized decision making in the executive branch weakens the ability and credibility of institutions to effectively implement policy.
- A 5-year average expansion of 69% in credit to the private sector, the VEF’s fast paced real appreciation combined with financial repression through mandatory credit allocations and interest rate ceilings/floors increase the banking system’s vulnerability to an economic downturn.
- At -1.0% of GDP, Venezuela’s net FDI flows are the second lowest among non-investment grade credits. This reflects nationalizations of foreign owned companies as well as the country’s poor business environment, best illustrated by Venezuela’s low ranking on the World Bank’s Ease of Doing Business survey.

Commentary

In spite of PDVSA’s ambitious capital expenditure program designed to increase production and refining capacity, Fitch is concerned that the government could increase the company’s quasi-fiscal responsibilities to cover the potential fiscal shortfall resulting from a lower oil price environment, thus hurting investment and production prospects. Private sector investment, even in the oil sector, is unlikely to recover due to low oil prices, the government’s growing intervention in the economy and the increasingly aggressive stance by the government to take control of economic sectors such as cement, steel and banking.



Comparative Analysis: External Finances

Venezuela

	2007					Last 10 years	
	Gabonese Republic BB-	Nigeria BB-	Kenya B+	Papua New Guinea B+	Venezuela B+	B Median	BB Median
GXD, % CXR	60.9	9.0	81.2	26.1	67.7	121.6	114.2
GXD, % GDP	39.3	5.0	27.4	23.0	24.1	58.2	44.4
NXD, % CXR	22.8	-56.1	31.1	-19.9	-134.4	40.9	25.0
NXD, % GDP	14.7	-31.0	10.5	-17.5	-47.9	23.5	11.3
GSXD, % GXD	94.9	44.2	75.9	75.2	42.0	63.1	50.3
NSXD, % CXR	34.8	-52.5	24.7	-18.1	-12.2	43.7	16.4
NSXD, % GDP	22.5	-29.1	8.3	-15.9	-4.3	19.8	6.5
SNFA, USD (USDbn)	-2.6	n.a.	-2.2	1.0	16.9	-1.2	-2.6
SNFA, % GDP	-22.5	n.a.	-8.3	15.9	7.4	-12.9	-6.7
Ext. debt service ratio, % CXR	10.2	1.4	8.2	4.0	10.9	13.4	16.6
Ext. interest service ratio, % of CXR	3.2	0.5	1.4	1.0	3.0	4.1	5.5
Liquidity ratio (latest)	134.9	1141.0	243.7	406.3	283.6	130.9	115.3
Current account balance, % GDP	15.9	13.0	-4.1	1.8	8.8	-3.2	-2.7
CAB plus net FDI, % GDP	18.0	20.5	-1.5	3.2	8.1	0.3	1.4
Commodity dependence (% of CXR, latest)	89.1	82.1	37.7	75.0	82.2	37.6	30.8
Sovereign net FX debt, % of GDP	26.6	-28.0	33.7	-15.9	-1.8	n.a.	n.a.

Source: Fitch

Strengths

- Venezuela's total gross and net external debt, relative to both GDP and CXR, are considerably below the 'B' median. While international reserves have almost doubled since 2004, the improvement in the country's net external debt ratios can be attributed to the accumulation of off-balance sheet public sector external assets, but more importantly to that of the non-bank private sector due to public sector USD-denominated issuances to absorb VEF-liquidity and capital flight.

Weaknesses

- Venezuela's high level of commodity dependence makes it more vulnerable to a terms-of-trade shock relative to peers. In the absence of capital inflows, external finances are completely dependent on the performance of oil exports.
- External solvency and liquidity indicators are expected to deteriorate over the rating horizon, even with the prevalence of capital controls. The sovereign is expected to turn into a net external debtor in 2009. The transfer of international reserves to discretionary and opaque government funds erodes the external liquidity of the sovereign which is expected to decline to 133% by 2010, below the 164% peer median.

Commentary

Although the combination of international reserves (USD 37.7bn by year-end 2008) and foreign exchange denominated assets accumulated in government funds could provide some cushion to an oil price shock, the government will have to make choices in terms of how best to use these resources. An adjustment of the government's policy framework with respect to nationalization plans, capital contributions to bi-national funds and regional institutions, as well as grants to allied governments, (all of these to be potentially covered by the FONDEN) may be necessary to stem future deterioration of the sovereign's external liquidity and solvency ratios. Moreover, yearly transfers of "excess reserves" to FONDEN (estimated between USD6.5 and USD7bn for 2009) would also weaken the sovereign's external position, since FONDEN funds are not counted as "official reserves" as these funds are earmarked for investment projects.

Comparative Analysis: Public Finances

Venezuela

	2007					Last 10 years	
	Gabonese Republic BB-	Nigeria BB-	Kenya B+	Papua New Guinea B+	Venezuela B+	B Median	BB Median
Budget balance, % GDP	8.5	0.9	-2.6	2.5	3.0	-1.8	-2.6
Primary balance, % GDP	10.6	1.1	-0.1	4.5	4.5	1.4	0.7
Revenues and grants, % of GDP	29.5	23.5	22.2	37.6	28.9	29.4	23.8
Volatility of revenues/GDP ratio	6.0	14.5	10.0	12.6	23.7	9.4	7.1
Interest payments % revenue	7.3	6.1	11.1	5.3	5.2	10.3	12.4
Debt, % revenue	134.0	53.1	203.9	91.1	59.5	204.7	194.2
Debt, % GDP	39.6	12.5	45.3	34.2	17.2	57.7	45.2
Net debt, % GDP	0.0	-8.8	42.5	182.0	10.6	56.3	38.9
FC debt % of total debt	79.7	26.6	100.0	50.5	66.1	70.6	63.7
CG debt maturities, % GDP	5.9	3.2	6.1	16.9	3.0	6.5	6.0
Average duration of CG debt	n.a.	n.a.	n.a.	n.a.	n.a.	8.9	2.1

* GG if not otherwise specified

Source: Fitch

Strengths

- Venezuela's gross and net government debt as a proportion of GDP and government revenues are low relative to peers. Government debt is expected to decline to 13.5% of GDP by the end of this year, the fourth lowest level among its peers. Moreover, debt measured in terms of revenues, estimated to decline to 54% by year-end 2008, considerably below the 102% 'B' median.
- Similarly, a low government debt burden translates into a manageable debt service profile. Debt service as a proportion of GDP and revenues is low relative to peers.

Weaknesses

- Venezuela's volatility of fiscal revenues stands out among peers due to the government's dependency on oil-related revenues (53% of the total). Moreover, revenue volatility is higher even when compared to oil-exporters such as Azerbaijan and Nigeria. Non-oil revenue is directly related to economic activity, which in turn is dependent on the performance of the oil sector.
- The government's high level of foreign currency denominated debt (69%) relative to peers suggests higher exchange rate risk.
- Weak fiscal management has rendered public finances vulnerable to adverse shocks. Budgets have not accurately reflected actual levels of spending. On average, over-execution has remained 30% above budgeted spending in the last three years. The government has also relied on PDVSA as a quasi-fiscal agent to fund social programs and transfer resources to the FONDEN.

Commentary

Although the oil price assumption for the 2009 budget, at an average of USD60 per barrel, reduces the discretionary character of spending, the change also responds to the need to accommodate new legal commitments of the central government in terms of the institutionalization of the Misiones and transfers to community councils. Under a low oil price environment the government faces the choice to increase the use of extra-budgetary funds, rationalize spending or devalue. A formal devaluation and/or spending reductions have a political cost; hence, the government is likely to maintain the current pace of spending in order to achieve immediate political objectives.

Fiscal Accounts Summary

% of GDP	2005	2006	2007	2008 ^f	2009 ^f	2010 ^f
General government						
Revenue	35.4	29.6	28.9	24.9	17.9	14.1
Expenditure	25.9	29.6	25.8	25.7	21.7	20.3
o/w interest payments	2.9	2.1	1.5	1.4	1.1	1.6
Primary balance	12.4	2.1	4.5	0.6	-2.5	-4.6
Overall balance	9.5	0.0	3.0	-0.8	-3.6	-6.2
General government debt	31.0	23.5	17.2	13.5	16.4	20.7
% of General government revenue	87.7	79.3	59.5	54.3	91.6	147.2
General government deposits	4.9	5.0	6.6	4.4	3.9	3.9
Net general government debt	25.3	18.5	10.6	9.1	12.5	16.8
Central government						
Revenue	35.4	29.6	28.9	24.9	17.9	14.1
o/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure & net lending	25.9	29.6	25.8	25.7	21.4	20.3
o/w current expenditure & transfers	19.0	21.8	19.6	20.0	17.0	16.7
- interest	2.9	2.1	1.5	1.4	1.1	1.6
o/w capital expenditure	5.8	6.7	5.8	5.0	4.0	3.0
Current balance	16.4	7.8	9.3	3.4	-0.5	-4.0
Primary balance	12.4	2.1	4.5	0.6	-2.5	-4.6
Overall balance	9.5	0.0	3.0	-0.8	-3.6	-6.2
Central government debt	31.0	23.5	17.2	13.5	16.4	20.7
% of Central government revenues	87.7	79.3	59.5	54.3	91.6	147.2
Central government debt (LC bn)	94.4	93.0	84.1	95.6	151.2	248.3
By residency of holder						
Domestic	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Foreign	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
By place of issue						
Domestic	33.7	36.2	36.0	39.7	63.7	118.7
Foreign	60.7	56.8	48.1	55.9	87.5	129.6
By currency denomination						
Local currency	32.5	33.4	28.6	29.9	44.5	83.0
Foreign currency	61.8	59.6	55.6	65.8	106.6	165.3
in USD equivalent (eop exchange rate)	28.8	27.7	25.9	30.6	37.2	44.4
By maturity						
Less than 12 months (residual maturity)	6.5	6.6	2.0	1.3	9.6	22.0
Average maturity (years)	5.2	4.7	5.7	6.9	n.a.	n.a.
Average duration (years)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Memo:	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Non-financial public sector balance (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Net non-financial public sector debt (% of GDP)	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Nominal GDP (LC bn)	304.1	396.1	489.7	708.7	933.1	1222.4

Source: Ministry of Finance and Fitch estimates and forecasts

External Debt and Assets

(USDbn)	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007
Gross external debt	40.9	44.7	45.3	46.1	46.8	51.3	51.9	53.4	48.1	55.0
% of GDP	44.8	45.7	38.7	37.5	50.4	61.5	46.1	36.7	26.1	24.1
% of CXR	187.7	180.4	119.2	148.8	158.4	170.6	120.5	87.1	64.2	67.7
By maturity										
Medium- and long-term	35.3	39.9	40.2	41.4	42.2	47.2	47.4	48.7	42.8	46.5
Short -term	5.6	4.8	5.1	4.7	4.6	4.2	4.5	4.7	5.3	8.5
% of total debt	13.7	10.8	11.2	10.3	9.9	8.1	8.6	8.8	11.1	15.4
By debtor										
Monetary Authorities	1.5	0.9	0.4	0.2	0.1	0.1	0.4	0.3	0.3	0.7
General Government	16.0	17.1	15.8	15.4	16.3	19.7	25.7	28.6	26.7	23.1
o/w Central Government	-	-	-	-	-	-	-	-	-	-
Banks	0.3	0.2	0.4	0.5	0.3	0.1	0.2	0.2	0.6	0.7
Other sectors	24.6	27.4	29.1	30.1	30.2	31.5	26.0	24.6	20.9	31.2
Gross external assets (non-equity)	44.2	49.3	61.1	63.0	67.6	79.8	90.4	112.7	134.6	164.2
International reserves, incl. gold	14.8	15.0	15.9	12.2	11.8	20.2	23.1	29.0	36.4	32.2
Other Sovereign assets nes	0.9	0.9	5.5	7.1	3.8	1.2	1.1	6.6	9.0	7.8
Deposit money banks' foreign assets	0.5	0.9	1.0	0.7	0.7	0.8	1.4	2.6	4.0	5.5
Other sector foreign assets	28.0	32.5	38.7	43.0	51.3	57.5	64.8	74.5	85.3	118.6
Net external debt	-3.4	-4.6	-15.8	-16.9	-20.7	-28.5	-38.5	-59.2	-86.5	-109.2
% of GDP	-3.7	-4.7	-13.5	-13.7	-22.3	-34.1	-34.2	-40.7	-46.9	-47.9
% of CXR	-15.4	-18.6	-41.5	-54.5	-70.2	-94.5	-89.3	-96.5	-115.3	-134.4
Net sovereign external debt	0.3	1.2	-5.6	-3.9	0.8	-1.7	1.5	-1.6	-10.4	-9.9
% of GDP	0.3	1.3	-4.8	-3.2	0.8	-2.1	1.4	-1.1	-5.6	-4.3
Net bank external debt	-0.2	-0.7	-0.6	-0.1	-0.4	-0.7	-1.2	-2.4	-3.4	-4.8
Net other external debt	-3.4	-5.2	-9.6	-12.9	-21.1	-26.0	-38.7	-55.3	-72.7	-94.5
Net International investment Position	-11.8	-11.4	-1.7	-1.8	3.0	8.9	16.9	36.8	60.0	86.9
% of GDP	-12.9	-11.6	-1.4	-1.5	3.3	10.6	15.0	25.3	32.5	38.1
Sovereign Net Foreign Assets	-0.3	-1.2	5.6	3.9	-0.8	1.7	-1.5	7.0	18.6	16.9
% of GDP	-0.3	-1.3	4.8	3.2	-0.8	2.1	-1.4	4.8	10.1	7.4
Debt service (principal & interest)	11.2	11.4	12.4	11.6	11.6	14.0	14.7	10.6	10.4	8.9
Debt service (% of CXR)	51.5	45.9	32.6	37.4	39.2	46.6	34.0	17.3	13.9	10.9
Interest (% of CXR)	11.1	10.9	7.6	8.1	7.4	7.0	4.8	3.9	3.4	3.0
Liquidity ratio (%)	110.4	90.1	92.6	101.5	78.8	66.9	111.7	162.5	209.2	283.6
Net Sovereign FX debt (% of GDP)	1.3	2.2	-0.1	2.9	6.0	0.2	2.6	-0.3	-5.2	-1.8
Memo:										
Nominal GDP	91.3	98.0	117.1	122.9	92.9	83.5	112.5	145.5	184.5	228.1
Gross Sovereign External Debt	14.5	16.2	15.5	15.3	16.2	19.5	25.3	28.3	26.4	22.4
Inter-company loans	9.6	11.2	12.9	14.6	14.3	15.0	13.8	13.8	11.4	12.0

Sources: NBP, IMF, World Bank and Fitch estimates and forecasts

Amortization Schedule on Medium- and Long-Term Public Debt (Sept. 08)

(USDbn)	2009	2010	2011	2012	2013	2014	2015
Sovereign							
Official bilateral	0.1	0.1	0.1	0.1	0.1	0.1	0.1
o/w Paris Club	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Multilateral	0.3	0.3	0.4	0.4	0.3	0.2	0.1
o/w IMF	0	0	0	0	0	0	0
Other	0.3	0.3	0.4	0.4	0.3	0.2	0.1
Bond Debt	0.3	1.5	1.7	0	1.5	1.5	1.3
Commercial Credit	0.3	0.3	0.2	0.2	0.1	0.1	0.1
Total	1.3	2.5	2.8	1.1	2.3	2.1	1.7

Sources: Ministry of Finance, Central Bank and Fitch

Balance of Payments

(USDbn)	2005	2006	2007	2008 ^f	2009 ^f	2010 ^f
Current account balance	25.1	27.1	20.0	26.4	-7.2	-12.4
% of GDP	17.3	14.7	8.8	8.0	-2.0	-3.4
% of CXR	40.9	36.2	24.6	26.5	-11.6	-23.3
Trade balance	31.5	32.7	23.7	37.4	4.6	-1.7
Exports, fob	55.6	65.2	69.2	89.7	55.8	47.0
Imports, fob	24.2	32.5	45.5	52.3	51.2	48.7
Services, net	-4.0	-4.4	-5.8	-6.5	-6.1	-6.2
Services, credit	1.3	1.6	1.7	2.2	2.1	1.6
Services, debit	5.3	6.0	7.5	8.6	8.2	7.8
Income, net	-2.3	-1.1	2.6	-4.0	-5.6	-4.4
Income, credit	4.1	7.9	10.1	7.4	4.3	4.4
Income, debit	6.4	9.1	7.5	11.4	9.9	8.8
O/w: interest payments	2.4	2.5	2.4	3.6	5.1	5.3
Current transfers, net	-0.1	0.0	-0.4	-0.5	-0.2	-0.1
Memo:						
Non-debt creating inflows (net)	2.1	1.4	-1.5	-3.2	-1.6	-1.2
o/w equity FDI	2.3	1.3	-1.6	-3.2	-1.6	-1.2
o/w portfolio equity	-0.2	0.0	0.1	0.0	0.0	0.0
o/w other	0.0	0.0	0.0	0.0	0.0	0.0
Change in reserves (-=increase)	-5.4	-5.1	5.4	-3.3	10.0	13.1
Gross external financing requirement	-16.9	-19.3	-13.5	-17.8	15.0	21.2
Stock of international reserves, incl. gold	29.0	36.4	32.2	37.7	26.8	12.6

Sources: IMF and Fitch estimates and forecasts

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