

Full Rating Report

Venezuela

Ratings

<b>Foreign Currency</b>	
Long-Term IDR	B+
Short-Term IDR	B
<b>Local Currency</b>	
Long-Term IDR	B+
Country Ceiling	B+

Outlooks

Long-Term Foreign-Currency Rating	Stable
Long-Term Local-Currency Rating	Stable

Financial Data

<b>Venezuela</b>	
(USDbn)	2010
GDP	236
GDP per head (USD 000)	8.1
Population (m)	29.1
International reserves	28.4
Net external debt (% GDP)	-59.7
Central government total debt (% GDP)	0
CG foreign-currency debt	0
CG domestically issued debt (VEFbn)	0.1

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Related Research

- Applicable Criteria**
- *Sovereign Rating Methodology (August 2010)*
- Other Research**
- *Guide to Sovereign Credit Report (October 2008)*
  - *Global Economic Outlook (March 2011)*
  - *Latin America Sovereign Credit Trends: Likely to Remain Positive (February 2011)*
  - *Venezuela (February 2010)*

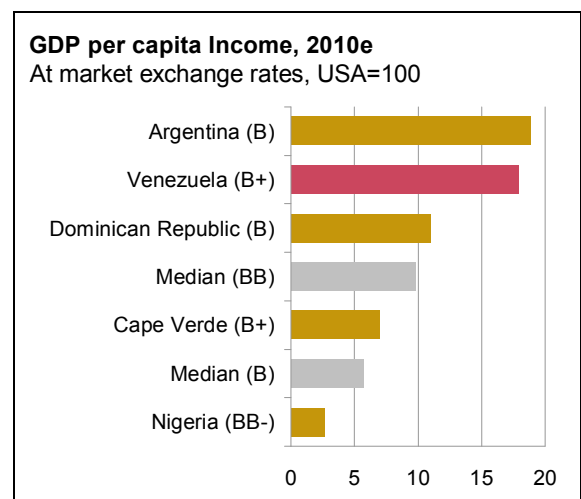
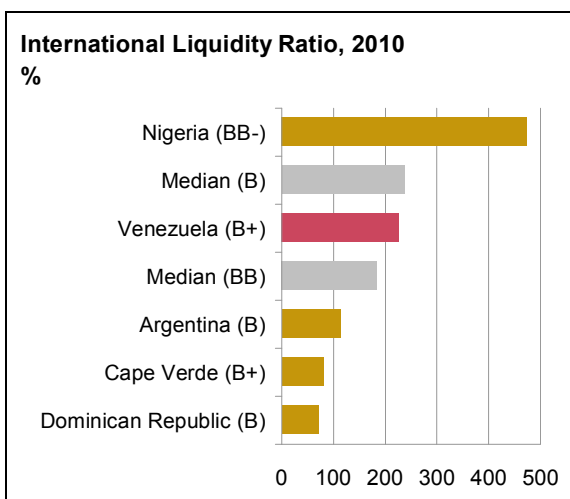
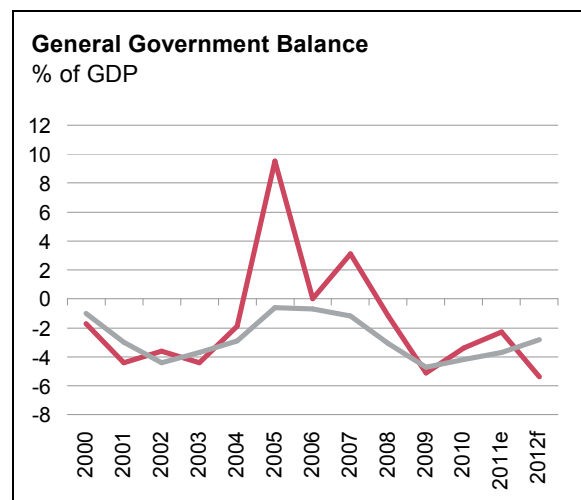
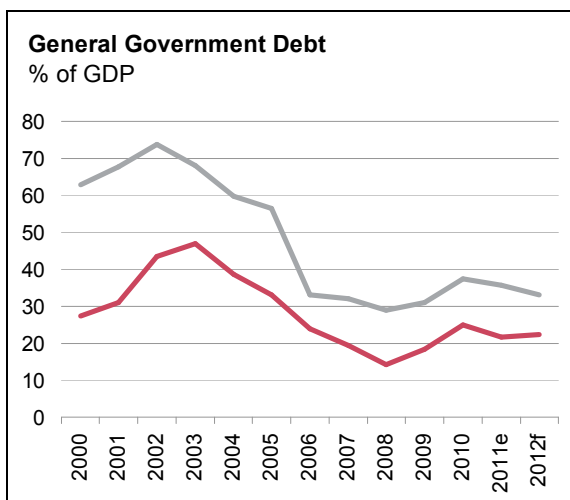
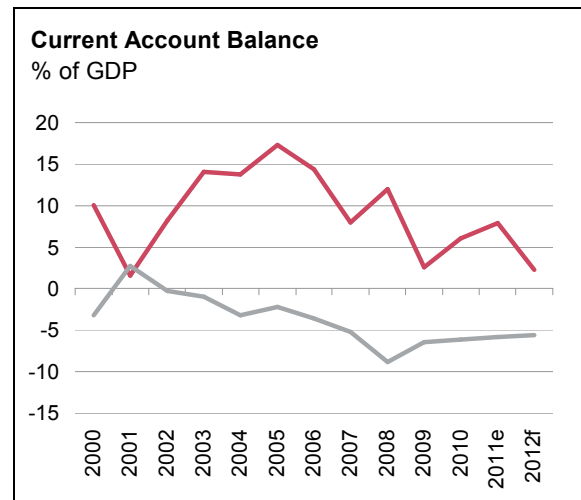
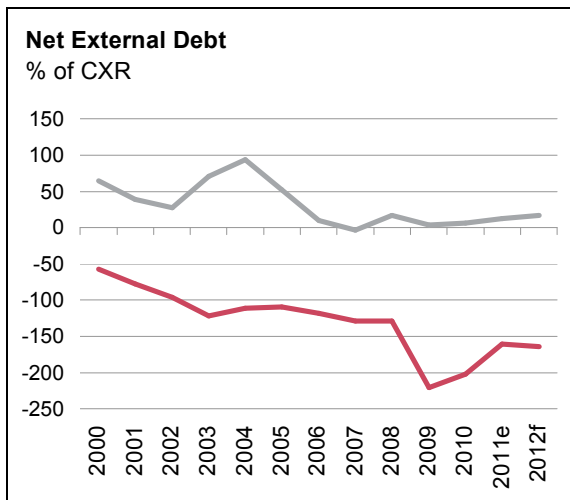
Rating Rationale

- Venezuela’s ratings are underpinned by its manageable debt-service profile, relative financing flexibility and good record of servicing debt even under political and economic stress in recent years. In addition to international reserves, the sovereign has foreign-currency liquid assets (19% of current external receipts and 46% of end-2010 international reserves) that could be used for debt service. The current favourable international oil price environment is also supportive of Venezuela’s external and fiscal accounts.
- Venezuela’s credit strengths are balanced by a volatile macroeconomic performance and an exchange regime that leads to lower growth, higher inflation and the deterioration of external credit metrics. The importance of international oil prices for external and public accounts has increased in recent years. At the same time, there is limited transparency on the administration and use of the government’s financial assets, as well as the “oil and devaluation-related” windfalls.
- The country’s macroeconomic performance continued to lag behind that of peers in the aftermath of the global financial crisis of 2008-2009 as the economy remained in recession in 2010 and inflation stubbornly high. Despite oil averaging USD100 per barrel in 2011, growth is not likely to return to pre-crisis levels over the outlook period. Inflation could remain stubbornly high, closing 2011 at 29.5%, up from 27.4% in 2010.
- The country’s exchange rate regime continues to weigh on creditworthiness as it: contributes to macroeconomic volatility by embedding devaluation expectations; constrains growth through limiting supply of FX for the private sector; and leads to the build-up of external liabilities through issuance of FX public debt instruments in the local market.
- Although the favourable oil price outlook could be supportive of external and fiscal metrics, this is not likely to fully reverse the deterioration since 2009, especially on the external front, where liquidity will remain lower than for peer oil exporters. As the sovereign is likely to continue issuing external debt in the local market, Venezuela will also remain a net external debtor.
- Central government debt, at 25% of GDP in 2010 calculated at the VEF4.3 exchange rate, remains below that of peers, but its growth has been rapid since 2009. Moreover, limited transparency in the administration and use of government-managed funds, and in fiscal operations, poses challenges to accurately assessing the stance of fiscal policy and the full financial strength of the sovereign.

Key Rating Drivers

- Venezuela’s ratings could benefit from policy adjustments that improve macroeconomic performance and reduce the vulnerability of the economy to oil price volatility. Fitch Ratings would view positively significant strengthening of external solvency and liquidity indicators, and greater transparency in the administration and use of government-managed funds.
- Fitch would view negatively greater-than-expected deterioration in external and fiscal credit metrics in relation to peers. Increased macroeconomic pressures and oil price shocks that reduce the sovereign’s debt-service capacity would negatively affect Venezuela’s creditworthiness.

## Peer Comparison



— Venezuela

— Medians

## Rating Factors

### Peer Group

Rating	Country
BB-	Armenia
	Gabonese Republic
	Kingdom of Lesotho
	Nigeria
	Serbia
B+	Venezuela
	Angola
	Bolivia
	Cape Verde
	Georgia
	Ghana
	Kenya
	Mongolia
	Sri Lanka
	Vietnam
Zambia	
B	Argentina
	Benin
	Cameroon
	Dominican Republic
	Lebanon
	Mozambique
	Rwanda
	Seychelles
	Suriname
	Uganda
	Ukraine

### 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+

Source: Fitch

### Summary: Strengths and Weaknesses

Rating factor	Macroeconomic	Public finances	External finances	Structural issues
Status	Weakness	Neutral	Strength	Neutral
Trend	Stable	Stable	Stable	Stable

Note: Relative to 'B' category (sovereigns rated 'B+', 'B' and 'B-')  
Source: Fitch

### Strengths

- A combination of comparatively low debt service and FX assets in government-managed funds supports Venezuela's creditworthiness. In addition, a "captive" domestic market provides the government with a degree of funding flexibility.
- External and fiscal solvency ratios presently compare favourably with those of peers due to rapid economic growth before the global financial crisis and favourable oil prices. However, these indicators are flattered by an overvalued official exchange rate and high inflation.
- Venezuela is relatively rich country by GDP per capita and has the second-largest oil reserves in the world, as well as other abundant natural resources.

### Weaknesses

- Years of inconsistent macroeconomic policy choices, combined with a narrow, commodity-based economy, explain Venezuela's historically volatile growth and inflation performance.
- The Bolivarian Republic's exchange rate regime has not only accentuated macroeconomic distortions, but has also led to a noticeable increase in FX-denominated public indebtedness, eroding external credit metrics.
- Venezuela's public and external finances have increased their dependence on the dynamics of the oil sector. Oil accounts for about 95% of total exports, while the central government's revenue volatility is high even compared with other non-investment-grade oil-exporters.
- Lack of transparency in the government's administration and use of special funds such as the National Development Fund (FONDEN) limit Fitch's ability to fully evaluate the sovereign's financial strength.
- Comparatively weak political and civil institutions detract from the credibility and predictability of the policy framework. Continued electoral processes also limit the government's flexibility to rationalise economic policy to sustainably address increasing macroeconomic imbalances.

### Local-Currency Rating

Fitch maintains the same Local- and Foreign-Currency Long-Term Issuer Default Ratings (IDRs) on Venezuela because it perceives as similar the sovereign's expected ability and willingness to service each category of debt. The government employed market-based exchange mechanisms to refinance large short-term domestic maturities in 2002-2003.

### Country Ceiling

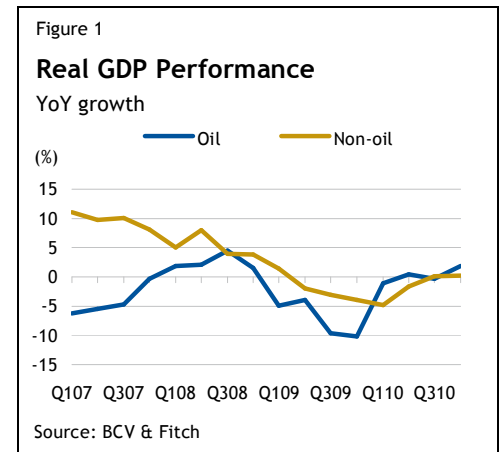
Fitch equalises Venezuela's Country Ceiling and Long-Term IDR due to the extensive use of capital controls since 2002. Despite modifications, the inefficiency of the system's administration through the Foreign Exchange Administration Commission (CADIVI) delays the access of the private sector to foreign exchange.

## Outlook and Key Issues

### Lagging Macroeconomic Performance

The Venezuelan economy remained in recession for much of 2010 as the economy contracted on average by 1.4%. Exchange rate policy modifications, high inflation, constraints in the electricity sector, limited FX supply for the private sector and continued deterioration in the business environment weighed on the Bolivarian Republic's growth performance.

Despite the weak domestic demand dynamics, inflation, at 29.1% on average, remained the highest in the region, and among peers and all sovereigns rated by Fitch.



Fitch expects growth to be a modest 0.8% in 2011 despite the positive impact of international oil prices. Government spending, increased FX availability, improvements in the electricity sector, and positive statistical effects reduce downside risks to growth performance. However, inflation could average 28.5% or higher in 2011 as a result of supply shocks, especially in the food sector.

Oil remains a necessary but no longer a sufficient condition for boosting growth prospects. Venezuela's recent performance contrasts with that of higher- and similarly rated oil/hydrocarbon exporters. The development of the Orinoco oil reserves could provide some upside for investment and oil production in 2012.

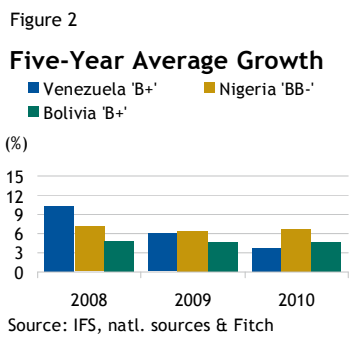
### Exchange Rate Policy Continuing to Weigh on Creditworthiness

Venezuela operates under a fixed exchange regime supported by tight capital controls. The mechanism for allocating FX resources at a fixed official exchange rate to the economy is the CADIVI<sup>1</sup>. In January 2010, the government announced the devaluation of the official exchange rate, previously VEF2.15 per US dollar, and introduced two official exchange rates. The US dollar exchange rate for "essential imports" such as food was set at VEF2.60, while the rate for other foreign-exchange transactions was set at VEF4.30. The Banco Central de Venezuela (BCV) also began issuing short-term US dollar-denominated securities totalling USD520m. However, this policy was quickly abandoned.

In May 2010, the government introduced legislation (the Law against Illicit FX Transactions). This placed all operations in foreign currency and FX-denominated assets in Venezuela under the direct control of the BCV in an effort to control the volume of operations in the parallel market<sup>2</sup>. Although this market had been used by the private sector to accumulate FX assets abroad, it was also used to finance imports and other FX-needs for domestic economic actors that could not obtain US dollars at the official exchange rate.

<sup>1</sup> Since 2003, this government agency has been in charge of allocating FX to the private sector for imports, debt service, remittances, and purchases abroad at the fixed official exchange rate.

<sup>2</sup> In the parallel or "swap market", Venezuelan brokerage houses determined an unofficial exchange rate by swapping Venezuelan bolivares fuertes-denominated assets for FX-denominated ones, mostly from the public sector (PDVSA and the republic). As this exchange rate traded with a significant premium in comparison to the official rate (above 100%), it fed into inflationary pressures.



To replace the parallel market, the authorities introduced the System of Transactions with Securities in Foreign Currency (SITME)<sup>3</sup>. This enables Venezuelans to purchase FX-denominated public assets at an exchange rate determined by the BCV (VEF5.3 per US dollar on average in 2010). As Venezuelans usually resell these assets abroad, the system requires a continuous supply of FX public sector securities over time to be sustainable, implying additional FX debt issuance. The sovereign and state-owned oil company Petróleos de Venezuela S.A. (PDVSA) also place global bonds directly in the domestic market to ease the private sector's FX constraints.

In Fitch's view, Venezuela's multitier exchange rate regime and its implementation have negative implications for macroeconomic stability and may also lead to the deterioration of the sovereign's external and fiscal credit metrics. The issuance of FX-denominated assets to address CADIVI's limitations is likely to further weaken the sovereign's net external position.

### Deterioration in Public Finances Performance and Transparency

Fiscal accounts have yet to recover from the global financial crisis, as higher oil prices and the official devaluation failed to significantly reduce the central government deficit. Moreover, central government fiscal indicators have become less informative in terms of assessing the stance of fiscal policy. Central government revenue and expenditure have declined as a percentage of GDP, not only as a result of persistently high inflation, but also due to the increased off-budget/discretionary management of revenue and expenditure.

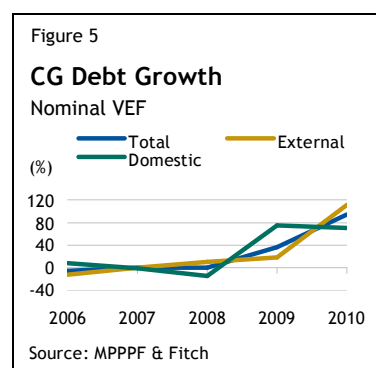
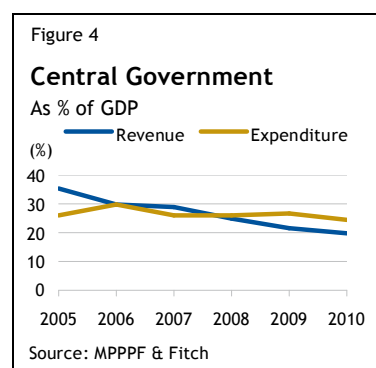
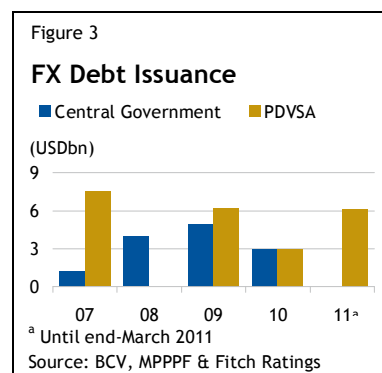
After a 5.1% of GDP deficit in 2009, the central government performance improved slightly in 2010, with an estimated 4.3% of GDP deficit. The recovery in revenue was underpinned by higher oil prices and continued over-performance in non-oil tax collection. Revenue gains resulting from the January 2010 devaluation reached VEF25.8bn (2.6% of GDP) and were partly channelled into an off-budget fund, the Fondo Independencia, to finance increased costs related to the electricity sector emergency.

Central government expenditures could have grown slightly above inflation in 2010 after declining sharply in real terms in 2009. Nevertheless, an increasing proportion of government spending is being channelled off budget as resources from FONDEN, the China-Venezuela Fund (FCCV) and the China-Venezuela Agreement<sup>4</sup>, and PDVSA social spending, are directed towards government priorities, limiting Fitch's ability to establish the fiscal stance based solely on central government figures.

The 2011 budget was prepared based on conservative assumptions regarding inflation (23%-25%) and oil prices (USD40 per barrel). As in previous years, the budget represents a starting point, as a better-than-expected revenue performance would be likely to finance additional spending. It is difficult to evaluate the extent to which the government will increase discretionary and off-budget spending to meet the costs related to flooding in the latter part of 2010, and to fund social programmes. Although favourable international oil price dynamics are likely to benefit oil-related taxes and royalties for the central government, PDVSA will deduct the value of its oil exports to China under the forward sales agreements from the taxes the company pays to the central government.

<sup>3</sup> This is a central bank platform that regulates the trading of FX-denominated instruments in Venezuela. The central bank determines the securities' type and price. The private sector can purchase FX-denominated instruments with bolivares fuertes.

<sup>4</sup> The FCCV is composed of a total of USD8bn contribution from China and USD4bn contribution by Venezuela. It was initially created in 2008 to fund infrastructure, agriculture, electricity and energy projects. The China-Venezuela Agreement (2010) provides a credit line to Venezuela for USD20bn (half in US dollars and half in renminbi) to fund projects in sectors similar to the FCCV. China's contribution to both funds is repaid through oil exports. Banco de Desarrollo Económico y Social de Venezuela is the Venezuelan counterparty in both agreements.



Central government debt remains below rating category peers at 24.9%<sup>5</sup> of GDP, compared with the 37.6% 'B' median. However, the official exchange rate devaluation and fiscal deterioration have led to vertiginous growth of debt since 2009. Debt to government revenue deteriorated significantly, but its level remained below that of peers and could improve as oil revenue gets a boost from higher oil prices. Nevertheless, Fitch considers that the current pace of debt accumulation is not sustainable and could lead to further deterioration in solvency ratios compared with peers. Furthermore, the continued issuance of central government FX-denominated debt increases currency risk, especially in light of the potential for future devaluations to partly address macroeconomic imbalances.

### Favourable Financing Conditions

Despite the fiscal deterioration of 2009-2010, government financing needs for 2011, at 4% of GDP, remain well below the 'B' median. Moreover, despite increased borrowing over those two years, the government has been able to issue mostly medium- and long-term debt. Central government maturities, at 1.8% and 1.3% of GDP in 2011 and 2012, respectively, are lower than for peers and manageable in light of current international oil price dynamics and the availability of liquid FX-denominated financial assets that could be used for debt service and financing flexibility.

Figure 6

#### Public Finances: Sources and Uses

(% GDP)	2009	2010e	2011f	2012f
<b>Uses</b>	<b>6.9</b>	<b>7.3</b>	<b>3.9</b>	<b>6.6</b>
Budget balance	-5.1	-4.7	-2.3	-5.4
Amortisation (by place of issue)	1.8	2.6	1.7	1.2
Domestic	1.6	2.0	0.9	1.0
Foreign	0.2	0.6	0.8	0.2
<b>Sources</b>	<b>6.9</b>	<b>7.3</b>	<b>3.9</b>	<b>6.6</b>
Gross borrowing (by place of issue)	6.9	7.3	3.9	6.6
Domestic	5.3	5.3	2.5	5.4
Foreign	1.6	2.0	1.5	1.3
Other				

Source: Fitch

Moreover, Fitch recognises that Venezuela has demonstrated its capacity to service its debt obligation during periods of high political stress (eg, the 2002 coup and 2003 PDVSA strike) and external shocks (global financial crisis and the collapse in the international oil prices in late 2008 and early 2009).

The government continues to have a captive market in domestic investors, as capital controls and the exchange rate regime lead to excess demand for FX assets. Bank liquidity also remains high and is being channelled towards meeting the government's financing needs. Moreover, the government has also been able to access bilateral funding from China equivalent to USD28bn since 2009 by signing forward oil sales agreements. These not only increase the sovereign's financing options but also its access to FX resources.

Although this type of agreement does not constitute a direct obligation of the sovereign, as the public development bank, Banco de Desarrollo Económico y Social de Venezuela, is the Venezuelan counterparty in the agreement, the government indirectly services this obligation through a lower tax intake from PDVSA. Venezuela received USD8bn under the China-Venezuela Agreement in 2010.

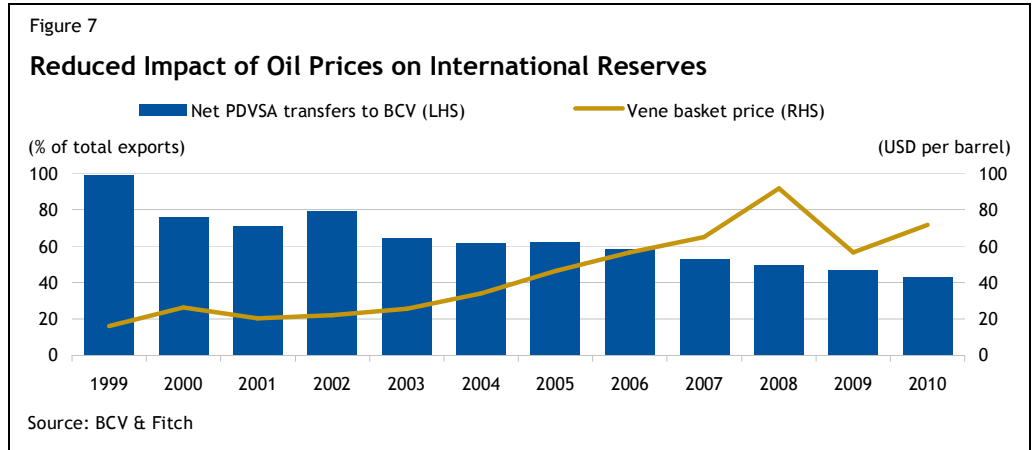
Although high oil prices and exchange controls support the availability of FX and government financing flexibility, the government will still have to carefully manage

<sup>5</sup> Fitch used the official VEF4.3 per USD1 exchange rate to calculate 2010 credit metrics, as it considers that this level is closer to a more representative exchange rate for the Venezuelan economy.

its expenditure commitments in terms of compensation for nationalisations and FX commitments for regional financial institutions (such as Banco del Sur).

**Limited Upside for External Balance Sheet**

The recent rise in international oil prices is likely to support the maintenance of a healthy current account surplus at 6.1% of GDP in 2011. Oil exports, accounting for 95% of total exports, could grow by 22% in nominal terms in 2011 based on Fitch’s base-case scenario of Brent averaging USD100 per barrel, which implies USD92 for the Venezuelan basket.



Nevertheless, the favourable oil price environment will not be reflected fully in terms of international reserve accumulation, limiting upside risks for external liquidity improvements. First, the modification of the BCV law in 2005 allows PDVSA to retain a significant portion of oil revenue. Net transfers of FX from PDVSA to the BCV have therefore consistently declined in recent years despite higher oil prices. Moreover, the BCV will continue to transfer “excess reserves” to government-managed funds such as FONDEN (USD2bn already in 2011). In addition, supply agreements with China and continued implementation of the Petrocaribe initiative will detract from the improvement in actual export receipts. Fitch estimates that up to 550,000 barrels of Venezuela’s oil exports (23% of total oil exports) are encumbered in forward sales or supply agreements, implying reduced cash receipts for oil sales abroad.

International reserves declined to USD28.5bn in 2010 from USD35bn in 2009, bringing external liquidity to 152.7% in 2011. The reserve decline owed to the transfer of USD7bn to FONDEN to deal with an electricity crisis and other infrastructure spending. Liquidity compares poorly with peer oil exporters such as Nigeria and Gabon, which have 2011 liquidity ratios at 473% and 398%, respectively. Moreover, the importance of gold (through valuation effect) has increased within international reserves and it accounts 53.8% of gross international reserves in 2011 compared with 19.7% in 2005. This reduces liquid operating reserves.

International reserves could increase to USD34.6bn by end-2011 with upside risks. Nevertheless, in light of past years’ practice, the “excess reserves” above USD29bn will continue to be transferred to the FONDEN in early 2012, especially in the context of the impending election cycle. However, government external debt issuance is likely to continue in order to supply the domestic market with FX assets in 2010. Venezuela will therefore remain a net sovereign external debtor despite the favourable terms of trade and in contrast to most oil exporters.

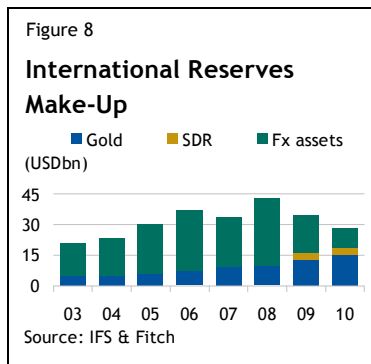


Figure 9

**External Finances: Sources and Uses**

(USDbn)	2009	2010	2011e	2012f
<b>Uses</b>	<b>-6.4</b>	<b>-11.7</b>	<b>-17.1</b>	<b>-3.5</b>
Current account balance	8.6	14.5	23.4	8.6
MLT amortisation	2.1	2.8	6.2	5.1
Sovereign	0.8	2.4	2.3	0.7
Non-sovereign	1.3	0.4	4.0	4.4
<b>Sources</b>	<b>-6.4</b>	<b>-11.7</b>	<b>-17.1</b>	<b>-3.5</b>
Gross MLT borrowing	12.5	5.5	10.5	11.0
Sovereign	4.6	2.4	2.0	3.6
Non-sovereign	8.0	3.2	8.5	7.4
Net FDI	-4.9	-3.8	-0.6	-0.6
Net portfolio equity	0.1	0.0	0.0	0.0
Other credit flows nes	-24.9	-22.1	-20.9	-14.9
Change in FX reserves	10.8	8.6	-6.1	1.0

Source: Fitch

External financing needs, at 33% of international reserves, are the second lowest in the 'B' category and continue to be fully covered by the current account surplus. The government also maintains its monopoly over export receipts and has shown its capacity to adjust to temporary negative terms-of-trade shocks (such as the global financial crisis) and avoid significant balance-of-payment pressures.

**Already in the 2012 Electoral Cycle**

Although the governing Partido Socialista Unido de Venezuela maintained control of the National Assembly (95 out of 165 deputies), the opposition coalition, Mesa de Unidad Democrática, obtained 65 seats in legislative elections on 26 September 2010. The opposition parties had boycotted similar elections in 2005, which resulted in the almost total control of the National Assembly by the government.

After the National Assembly elections, President Chavez deepened his economic and political programme by passing a series of laws dealing with telecommunications, political and education reform. Moreover, the outgoing Assembly granted the President the power to rule by decree for 18 months in order to address the shortage of adequate housing in Venezuela. The government noticeably accelerated its nationalisation programme in 2009 and 2010.

Despite the electoral results of September 2010, the past two years' macroeconomic deterioration, supply bottlenecks and problems regarding crime and infrastructure constraints, President Chavez remains the candidate to beat in 2012. Increased resources resulting from high international oil prices, control of the state apparatus and his experience as a formidable campaigner favour the president's bid for re-election. Policy initiatives and adjustments are likely to be influenced by the background of the 2012 presidential electoral cycle. Consequently, policy unpredictability and political uncertainty could remain over the forecast period, negatively affecting economic activity, increasing nervousness in the domestic market and maintaining excess demand for US dollars from the private sector.

## Forecast Summary

	2006	2007	2008	2009	2010	2011e	2012f
<b>Macroeconomic indicators and policy</b>							
Real GDP growth (%)	9.9	8.2	4.8	-3.3	-1.4	0.8	1.4
Consumer prices (annual average % change)	13.7	18.7	31.4	28.6	29.1	28.5	30.0
Short-term interest rate (%) <sup>a</sup>	5.3	8.7	11.1	10.0	5.4	7.0	9.0
General government balance (% of GDP)	0.0	3.1	-1.2	-5.1	-4.7	-2.3	-5.4
General government debt (% of GDP)	24.0	19.5	14.2	18.4	24.9	21.7	22.3
VEF per USD (annual average)	2.1	2.1	2.1	2.1	4.3	4.3	4.3
Real effective exchange rate (2000=100)	72.8	80.0	98.1	130.3	132.9	168.7	215.9
<b>External finance</b>							
Current account balance (USDbn)	26.5	18.1	37.4	8.6	14.5	23.4	8.6
Current account balance (% of GDP)	14.4	8.0	12.0	2.6	6.1	7.9	2.3
Current account balance plus net FDI (% of GDP)	13.3	8.4	11.7	1.1	4.5	7.7	2.2
Net external debt (USDbn)	-89.7	-105.0	-136.4	-137.2	-140.8	-140.8	-137.4
Net external debt (% of GDP)	-48.9	-46.3	-43.8	-42.1	-59.7	-47.8	-37.3
Net external debt (% of CXR)	-118.5	-129.1	-129.0	-220.3	-202.0	-161.7	-165.8
Official international reserves including gold (USDbn)	36.7	33.8	43.0	34.4	29.8	34.5	30.8
Official international reserves (months of CXP cover)	9.0	6.4	7.5	7.7	6.5	6.5	5.0
External interest service (% of CXR)	3.4	3.4	2.9	4.7	4.7	6.4	7.7
Gross external financing requirement (% int. reserves)	-64.0	-38.2	-88.2	-15.0	-34.0	-57.5	-10.6
<b>Memo: Global forecast summary</b>							
<b>Real GDP growth (%)</b>							
US	2.7	1.9	0.0	-2.6	2.8	3.0	2.8
Japan	2.0	2.4	-1.2	-6.3	3.9	1.0	2.2
Euro area	3.1	2.7	0.4	-4.1	0.9	1.5	2.0
World	3.8	3.7	1.4	-2.5	3.1	2.9	2.7
<b>Commodities</b>							
Oil (USD/barrel)	65.4	72.7	97.7	64.0	79.9	100.0	90.0

<sup>a</sup> Money market rate (annual average)

Source: Fitch

Comparative Analysis: Macroeconomic Performance and Policies

Venezuela

	2010							
	Nigeria 'BB-'	Cape Verde 'B+'	Venezuela 'B+'	Argentina 'B'	Dominican Republic			
					'B'	'B' median	'BB'	'BB' median
Real GDP (5yr average % change)	6.6	6.9	3.6	6.7	7.1	6.3		3.6
Volatility of GDP (10yr rolling SD)	4.6	1.9	8.7	7.0	3.7	2.3		3.2
Consumer prices (5yr average)	10.1	3.9	24.3	9.0	6.4	9.4		6.3
Volatility of CPI (10yr rolling SD)	4.1	2.6	7.2	7.0	15.3	5.5		2.9
Years since double-digit inflation	0.0	20.0	0.0	0.0	2.0	n.a.		n.a.
Unemployment rate	0.0	-	8.9	7.4	14.1	7.4		8.2
Type of exchange rate regime	Managed float	Managed float	Fixed	Managed float	Managed float	n.a.		n.a.
Dollarisation ratio	-	7.3	0.0	16.8	28.0	36.9		51.0
REER volatility (10yr rolling SD)	7.4	3.1	15.9	19.9	13.8	7.5		8.2

Source: Fitch

Strengths

- The absence of financial dollarisation reduces the vulnerability of the financial system to adjustments to the fixed exchange rate, providing the authorities with increased flexibility to adjust to external shocks.

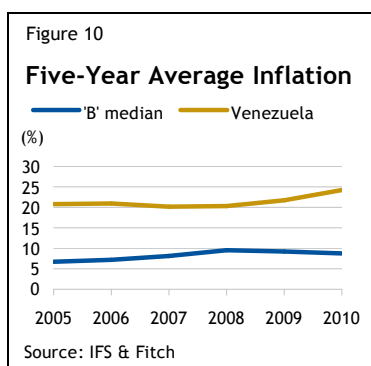
Weaknesses

- Despite rapid growth rates during 2004-2007, Venezuela's recent GDP growth has been lower and more volatile than that of peers.
- Venezuela's five-year average inflation is more than 2x that of peers, and 2009 year-end inflation, at 27.4%, was the highest among all Fitch-rated sovereigns.
- In light of Venezuela's high inflation, and inflation volatility compared with trade partners such as Colombia or the US, real exchange rate volatility is considerably higher than for peers despite a fixed exchange rate regime.

Commentary

The limited supply of FX through CADIVI, the implementation of the dual official exchange rate regime in January 2010, the closure of the parallel exchange rate market and the delay in the establishment of the SITME have taken their toll on the growth performance of an economy traditionally reliant on imports. The official exchange rates were unified at VEF4.3 in January 2011, which is likely to feed into inflation as that for "essential" imports was financed at the lower VEF2.6 rate. Moreover, the limited credibility of the regime leads to inflation inertia, as future devaluation expectations are priced in.

Monetary policy remains accommodative, with negative interest rates and continued expansion of monetary aggregates. The BCV also reduced reserve requirements twice in 2010 to 17% in order to support credit growth. Inflationary pressures continued to be fuelled by constraints in domestic supply and the product of years of heterodox measures such as price controls and subsidies, which have led to shortages and deepened domestic supply constraints.

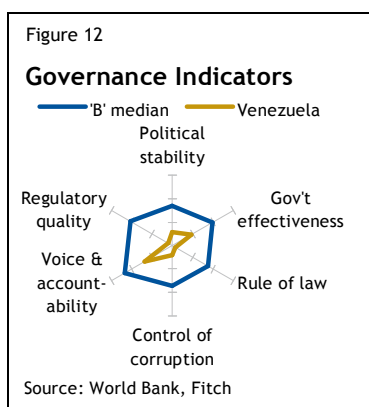
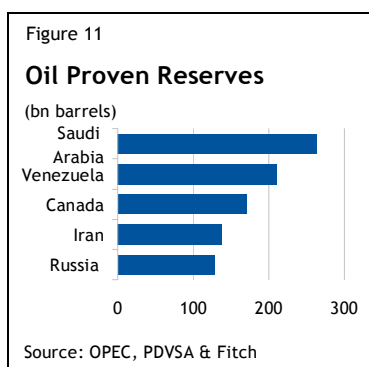


## Comparative Analysis: Structural Features

### Venezuela

	2010							
	Nigeria 'BB-'	Cape Verde 'B+'	Venezuela 'B+'	Argentina 'B'	Dominican Republic 'B'	'B' median	'BB' median	
GNI per capita PPP (USD, latest)	2,070	3,530	12,220	14,090	8,110	4,475	10,550	
GDP per capita (USD, mkt. exchange rates)	1,201	3,201	8,117	8,618	5,032	2,599	5,400	
Human Development Index (percentile, latest)	16.0	30.3	55.9	73.2	47.6	37.2	53.5	
Ease of Doing Business (percentile, latest)	25.3	28.1	6.1	37.4	50.6	38.0	47.1	
Trade openness (CXR and CXP % GDP)	40.7	72.5	26.5	23.6	34.2	n.a.	n.a.	
Gross domestic savings (% GDP)	27.8	5.0	31.7	26.2	5.8	13.2	17.6	
Gross national savings (% GNP)	31.7	34.6	26.6	24.3	9.5	16.6	17.7	
Gross domestic investment (% GDP)	9.4	45.1	20.7	22.3	16.7	22.3	21.0	
Private credit (% GDP)	33.7	63.4	21.2	13.3	22.6	24.6	34.0	
BSR indicators	E3	-	D1	D2	D1	n.a.	n.a.	
Bank system CAR	6.9	12.0	12.7	17.7	17.1	n.a.	n.a.	
Foreign bank ownership (% assets)	11.8	-	16.8	25.1	8.0	n.a.	n.a.	
Public bank ownership (% assets)	0.0	-	34.0	43.2	27.0	25.9	17.1	
Default record (year cured) <sup>a</sup>	-	-	1999	2010	2005	n.a.	n.a.	

<sup>a</sup> Modern (ie, since 1980) rescheduling history 1986; 1999, capital losses in Brady deal  
Source: Fitch and World Bank



### Strengths

- Venezuela is richer than both the 'B' and the 'BB' medians in terms of GDP per capita. In addition, social indicators, according to the UN's Human Development Index, compare favourably with peers and higher-rated sovereigns. Official statistics also point to important advances in poverty reduction.
- Venezuela has the second-largest oil reserves in the world at 211 billion barrels. As the reserve certification period moves forward, it could eventually surpass Saudi Arabia. However, Venezuela's heavy oil requires significant investment in production and refining capacity.

### Weaknesses

- Venezuela's institutional framework is "weak" when compared with the 'B'-category median, according to the World Bank Governance Indicators. Since 2000 episodes of political instability have negatively affected the economy, while highly centralised decision making in the figure of the president weakens the effectiveness and predictability of economic policy.
- Despite high savings rates and investment levels broadly in line with peers, high inflation, a poor business environment and the increasing participation of the state in the economy discourage greater private-sector involvement.

### Commentary

The country's Banking System Indicator (BSI) of 'D' characterises the Venezuelan system as "weak", while its Macro-Prudential Indicator of '1' implies low potential vulnerability to systemic stress as credit growth has decelerated in recent years.

Supported by capital and exchange controls, the government has been able to increase financial repression through mandatory credit allocations and controlled interest rates. Pressure could increase further as the government has officially designated the banking sector as being of public utility. The public sector has already increased its direct participation in the banking system to 34% of total assets.

Comparative Analysis: External Finances

Venezuela

	2010					Last 10 years	
	Nigeria 'BB-'	Cape Verde 'B+'	Venezuela 'B+'	Argentina 'B'	Dominican Republic 'B'	'B' median	'BB' median
GXD (% CXR)	26.6	132.5	122.6	155.4	103.8	97.7	103.4
GXD (% GDP)	13.4	88.1	36.2	37.8	31.6	46.4	39.7
NXD (% CXR)	-14.2	78.4	-202.0	-67.0	35.3	22.3	11.7
NXD (% GDP)	-7.2	52.1	-59.7	-16.3	10.7	9.3	5.0
GSXD (% GXD)	42.6	61.0	48.5	58.5	65.7	63.1	49.9
NSXD (% CXR)	-25.9	34.5	17.4	30.0	42.1	22.0	6.3
NSXD (% GDP)	-13.1	22.9	5.2	7.3	12.8	10.1	2.4
SNFA (USDbn)	25.0	-	-10.0	0.0	-6.6	-1.0	-0.1
SNFA (% GDP)	13.1	-	-4.2	-7.3	-12.8	-9.8	-1.2
Ext. debt service ratio (% CXR)	2.3	5.0	8.7	23.6	17.2	8.7	15.2
Ext. interest service ratio (% CXR)	0.9	2.8	4.7	9.7	5.3	2.8	4.2
Liquidity ratio (latest)	472.5	79.5	226.2	112.9	70.4	160.4	146.1
Current account balance (% GDP)	19.7	-11.9	6.1	1.4	-7.6	-4.5	-1.9
CAB plus net FDI (% GDP)	21.7	-5.2	4.5	2.3	-4.6	-1.2	1.5
Commodity dependence (% CXR, latest)	70.6	6.4	89.9	52.3	11.3	39.4	28.9
Sovereign net FX debt (% GDP)	-16.6	32.1	6.9	9.0	14.6	-	-

Source: Fitch

Figure 13  
Venezuela FX Liquid Financial Assets

(USDm)	Dec 10
International reserves	28,437
<b>Non-reserve assets</b>	
FONDEN	2,212
Banco de Desarrollo Económico y Social de Venezuela	1,510
Treasury deposits	786
FCCV	517
China credit line	8,000
<b>Total non-reserve</b>	<b>13,025</b>

Source: Fitch estimates based on unaudited data provided by authorities

Strengths

- Most of Venezuela's gross and net external solvency ratios, relative to both GDP and CXR, compare favourably with 10-year peer medians, benefiting from the continued implementation of capital controls since 2003 and a generally favourable oil price cycle.
- Although the sovereign has turned into a net external debtor, its external position still compares favourably with the 10-year 'B' median. Moreover, the government had USD13bn (19% of CXR) in FX liquid assets at end-2010, which boost the sovereign's payment capacity.
- Venezuela's liquidity is higher than the 10-year 'B'-range median in 2010. Nevertheless, this indicator is likely to deteriorate in the absence of greater international reserve accumulation.
- Despite various shocks related to international oil prices volatility or domestic unrest, Venezuela has had consecutive current account surpluses since 1998.

Weaknesses

- Venezuela's balance-of-payments dependence on oil revenue has deepened in recent years, with oil accounting for 95% of total exports. Net FDI has consistently underperformed and could remain negative in 2011 for a fourth consecutive year.

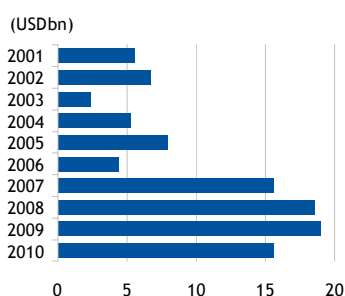
Commentary

Improvement in the net external position has been driven by the accumulation of assets of the non-bank private sector despite capital and exchange controls.

Capital controls and the public sector's monopoly of FX receipts provides Venezuela with some flexibility to absorb external shock by limiting the supply of US dollars to the private sector. Nevertheless, the costs in maintaining this regime are reflected in increased external indebtedness and weak macroeconomic performance.

Figure 14  
YOY Private External Asset Growth

Includes only cash & deposits



Source: BCV & Fitch

Comparative Analysis: Public Finances

Venezuela

	2010					Last 10 years	
	Nigeria 'BB-'	Cape Verde 'B+'	Venezuela 'B+'	Argentina 'B'	Dominican Republic 'B'	'B' median	'BB' median
Budget balance (% GDP)	-1.6	-11.1	-4.7	-0.8	-2.3	-2.9	-2.5
Primary balance (% GDP)	-0.4	-9.7	-3.4	1.7	-0.3	0.2	0.2
Revenue and grants (% GDP)	30.3	28.3	19.8	35.5	13.7	30.5	25.4
Volatility of revenue/GDP ratio	23.4	6.7	19.0	13.0	9.6	10.4	6.2
Interest payments (% revenue)	5.7	5.6	6.8	6.9	15.0	6.4	9.5
Debt (% revenue)	61.0	265.4	125.4	149.1	214.3	162.6	161.1
Debt (% GDP)	18.5	75.1	24.9	53.0	29.3	39.5	40.2
Net debt (% GDP)	4.8	63.8	23.2	49.7	26.9	34.3	34.9
FC debt (% total debt)	13.0	71.6	69.6	44.9	73.0	73.0	63.5
CG debt maturities (% GDP)	5.2	1.4	2.6	7.2	3.4	4.2	4.8
Average duration of CG debt (years)	0.0	0.0	n.a.	-	-	1.6	3.3

<sup>a</sup> GG if not otherwise specified  
Source: Fitch

Strengths

- The central government debt ratios, both gross and net, are among the lowest in the 'B' rating category and are likely to remain so over the forecast period. Although pre-crisis oil windfalls and high economic growth positively influenced debt dynamics, high inflation and an overvalued fixed-exchange rate also flatter central government solvency ratios.
- Central government debt composition is less vulnerable to exchange rate risk than the 10-year 'B' median. Moreover, 78% of government debt is issued under fixed rates and 40% of domestic debt is held by public sector financial institutions.
- The combination of a manageable maturity profile and the existence of financial assets that could be used for debt service support Venezuela's creditworthiness. Moreover, it appears that the government remains committed to servicing its debt, even under difficult political and economic conditions.

Weaknesses

- In light of the importance of oil prices (estimated 39% of central government revenue in 2010), revenue volatility is almost 2x the 'B'-range 10-year median. In addition, revenue as a percentage of GDP has declined below that of peers.
- The fiscal framework has weakened, as budgets have not accurately reflected actual levels of year-end spending, increasing the discretionary nature of spending and reflecting only part of total government operations.

Commentary

Despite negative external effects on macroeconomic stability, the sovereign has demonstrated some flexibility to adjust to the oil revenue shock by increasing non-oil revenue (tax increase in early 2009), debt issuance in a "captive" market, and the use of quasi-fiscal funds.

Although the sovereign has comparatively lower FX-denominated debt, debt dynamics remain subject to currency risk. This vulnerability is likely to increase in the event of continued issuance of FX debt in the domestic market and future drastic exchange-rate adjustments to address existing macroeconomic distortions.

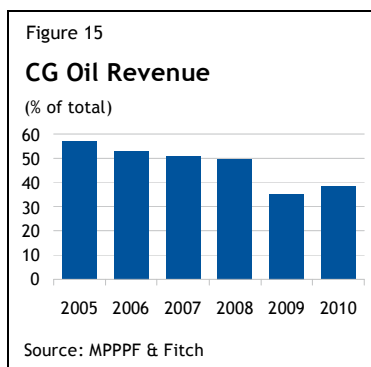


Figure 16  
**Fiscal Accounts Summary**

(% of GDP)	2007	2008	2009	2010	2011e	2012f
<b>General government</b>						
Revenue	29.1	24.9	21.6	19.8	20.4	18.4
Expenditure	26.0	26.1	26.7	24.5	22.5	23.7
O/w interest payments	1.5	1.3	1.3	1.4	1.5	1.5
Primary balance	4.6	0.1	-3.7	-3.3	-0.8	-3.9
Overall balance	3.1	-1.2	-5.1	-4.7	-2.3	-5.4
<b>General government debt</b>	19.5	14.2	18.4	24.9	21.7	22.3
% of general government revenue	67.0	57.0	84.9	125.4	106.8	121.2
General government deposits	4.0	2.2	2.7	1.4	1.2	0.8
Net general government debt	15.5	12.0	15.7	23.2	20.5	21.5
<b>Central government</b>						
Revenue	29.1	24.9	21.6	19.8	20.4	18.4
O/w grants	0.0	0.0	0.0	0.0	0.0	0.0
Expenditure and net lending	26.0	26.1	26.7	24.5	22.5	23.7
O/w current expenditure and transfers	19.7	19.8	20.5	19.1	18.1	18.8
- Interest	1.5	1.3	1.3	1.4	1.5	1.5
O/w capital expenditure	5.9	5.8	5.5	4.7	4.0	4.5
Current balance	9.3	5.1	1.1	0.6	2.2	-0.5
Primary balance	4.6	0.1	-3.7	-3.3	-0.8	-3.9
Overall balance	3.1	-1.2	-5.1	-4.7	-2.3	-5.4
Central government debt	19.5	14.2	18.4	24.9	21.7	22.3
% of central government revenue	67.0	57.0	84.9	125.4	106.8	121.2
<b>Central government debt (VEFbn)</b>	94.6	94.6	128.6	249.6	275.3	352.7
By residency of holder						
Domestic	-	-	-	-	-	-
Foreign	-	-	-	-	-	-
By place of issue						
Domestic	36.0	30.5	53.2	90.3	-	-
Foreign	58.6	64.1	75.5	159.2	-	-
By currency denomination						
Local currency	28.6	23.4	42.9	75.9	-	-
Foreign currency	66.1	71.2	85.7	173.7	-	-
In USD equivalent (eop exchange rate)	30.8	33.2	39.9	40.4	-	-
By maturity						
Less than 12 months (residual maturity)	14.7	15.2	12.9	26.6	-	-
Average maturity (years)	9.0	9.9	9.5	7.7	-	-
Average duration (years)	-	-	5.8	-	-	-
<b>Memo</b>						
Non-financial public-sector balance (% GDP)	-2.9	-3.5	-8.8	-	-	-
Net non-financial public-sector debt (% GDP)	-	-	-	-	-	-
Nominal GDP (VEFbn)	486.4	668.0	700.2	1,002.8	1,266.1	1,582.3

Source: Ministry of Finance and Fitch estimates and forecasts

Figure 17  
**External Debt and Assets**

(USDbn)	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
<b>Gross external debt</b>	<b>38.8</b>	<b>39.2</b>	<b>43.0</b>	<b>42.3</b>	<b>46.0</b>	<b>42.9</b>	<b>56.0</b>	<b>60.8</b>	<b>74.5</b>	<b>85.5</b>
% of GDP	31.6	42.2	51.4	37.6	31.6	23.4	24.7	19.5	22.8	36.2
% of CXR	125.1	132.7	142.8	98.2	75.0	56.7	68.9	57.5	119.6	122.6
<b>By maturity</b>										
Medium- and long-term	34.0	34.6	38.8	37.8	40.4	37.0	45.8	49.2	64.8	77.9
Short-term	4.7	4.6	4.2	4.5	5.6	5.9	10.2	11.6	9.6	7.6
% of total debt	12.2	11.8	9.7	10.5	12.2	13.7	18.2	19.0	13.0	8.9
<b>By debtor</b>										
Monetary authorities	0.2	0.1	0.1	0.4	0.3	0.3	0.7	0.9	4.3	4.4
General government	21.8	21.9	24.4	27.2	31.1	27.3	27.3	29.9	35.1	37.0
O/w central government	21.8	21.9	24.4	27.2	31.1	27.3	27.3	29.9	35.1	37.0
Banks	0.5	0.3	0.1	0.2	0.2	0.6	0.9	0.6	0.5	0.4
Other sectors	16.3	16.9	18.3	14.6	14.3	14.8	27.2	29.5	34.5	43.6
<b>Gross external assets (non-equity)</b>	<b>70.2</b>	<b>71.7</b>	<b>80.9</b>	<b>91.5</b>	<b>119.6</b>	<b>141.6</b>	<b>168.9</b>	<b>209.1</b>	<b>221.8</b>	<b>229.4</b>
International reserves, incl. gold	12.3	12.1	20.8	23.4	29.8	36.7	33.8	43.0	34.4	28.4
Other sovereign assets nes	7.1	3.8	1.2	1.1	6.6	9.0	7.8	11.9	10.2	3.1
Deposit money banks' foreign assets	0.7	0.7	0.8	1.4	2.6	4.0	7.1	3.6	1.1	1.2
Other sector foreign assets	50.1	54.7	58.1	65.6	80.6	91.9	120.2	150.6	176.1	196.7
<b>Net external debt</b>	<b>-24.2</b>	<b>-28.3</b>	<b>-36.8</b>	<b>-48.1</b>	<b>-67.0</b>	<b>-89.7</b>	<b>-105.0</b>	<b>-136.4</b>	<b>-137.2</b>	<b>-140.8</b>
% of GDP	-19.7	-30.5	-44.1	-42.7	-46.0	-48.9	-46.3	-43.8	-42.1	-59.7
% of CXR	-78.1	-95.9	-122.3	-111.6	-109.1	-118.5	-129.1	-129.0	-220.3	-202.0
Net sovereign external debt	2.5	6.2	2.5	3.1	0.5	-9.9	-6.6	-13.1	4.2	12.2
% of GDP	2.1	6.7	3.0	2.7	0.4	-5.4	-2.9	-4.2	1.3	5.2
Net bank external debt	-0.1	-0.4	-0.7	-1.2	-2.4	-3.4	-6.2	-3.0	-0.6	-0.8
Net other external debt	-26.6	-34.1	-38.6	-49.9	-65.1	-76.3	-92.2	-120.3	-140.8	-152.2
<b>Net international investment position</b>	<b>-1.8</b>	<b>3.0</b>	<b>8.9</b>	<b>16.9</b>	<b>36.2</b>	<b>60.8</b>	<b>89.2</b>	<b>131.6</b>	<b>132.8</b>	<b>144.0</b>
% of GDP	-1.5	3.3	10.6	15.0	24.9	33.1	39.4	42.3	40.7	61.0
<b>Sovereign net foreign assets</b>	<b>-2.5</b>	<b>-6.2</b>	<b>-2.5</b>	<b>-3.1</b>	<b>4.9</b>	<b>18.2</b>	<b>13.6</b>	<b>24.1</b>	<b>5.1</b>	<b>-10.0</b>
% of GDP	-2.1	-6.7	-3.0	-2.7	3.4	9.9	6.0	7.7	1.6	-4.2
<b>Debt service (principal &amp; interest)</b>	<b>7.4</b>	<b>6.0</b>	<b>8.8</b>	<b>9.7</b>	<b>6.5</b>	<b>9.9</b>	<b>6.8</b>	<b>10.7</b>	<b>5.0</b>	<b>6.0</b>
Debt service (% of CXR)	23.8	20.2	29.2	22.5	10.5	13.1	8.3	10.1	8.1	8.7
Interest (% of CXR)	8.1	7.4	7.0	4.8	3.9	3.4	3.4	2.9	4.7	4.7
Liquidity ratio (%)	135.5	120.7	95.7	156.4	227.1	208.7	321.4	195.6	280.7	226.2
Net sovereign FX debt (% of GDP)	8.7	12.4	5.9	4.4	1.5	-4.3	-1.0	-2.9	3.0	6.9
<b>Memo</b>										
Nominal GDP	122.9	92.9	83.5	112.5	145.5	183.5	226.5	311.1	326.1	236.0
Gross sovereign external debt										
Inter-company loans	14.6	14.3	15.0	13.8	13.9	11.8	11.7	9.7	8.7	6.6

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

Figure 18

**CG External Debt Service Schedule on Medium- and Long-Term End-2010**

(USDbn)	2011	2012	2013	2014	2015	2016	2017
<b>Sovereign</b>							
Official bilateral	100.9	142.7	142.6	129.8	115.9	69.4	56.6
O/w Paris Club	0	0	0	0	0	0	0
Multilateral	410.0	421.4	396.3	311.7	225.8	270.7	218.9
O/w IMF	0	0	0	0	0	0	0
Commercial Banks	238.2	173.3	126.9	107.5	66.3	46.4	16.1
Bonds placed in foreign markets	1,508.9	0	1,539.5	1,498.0	1,310.0	1,500.1	0
Suppliers	2.6	2.6	0	0	0	0	0
<b>Total sovereign debt amortisations</b>	<b>2,260.7</b>	<b>740.1</b>	<b>2,205.3</b>	<b>2,047.1</b>	<b>1,718.1</b>	<b>1,886.5</b>	<b>291.6</b>

Source: Ministry of Finance, Central Bank and Fitch

Figure 19

**Balance of Payments**

(USDbn)	2007	2008	2009	2010	2011e	2012f
<b>Current account balance</b>	<b>18.1</b>	<b>37.4</b>	<b>8.6</b>	<b>14.5</b>	<b>23.4</b>	<b>8.6</b>
% of GDP	8.0	12.0	2.6	6.1	7.9	2.3
% of CXR	22.2	35.4	13.7	20.7	26.8	10.3
<b>Trade balance</b>	<b>23.0</b>	<b>45.7</b>	<b>19.2</b>	<b>27.2</b>	<b>37.4</b>	<b>22.1</b>
Exports, fob	69.0	95.1	57.6	65.8	79.8	70.9
Imports, fob	46.0	49.5	38.4	38.6	42.5	48.8
<b>Services, net</b>	<b>-7.0</b>	<b>-8.4</b>	<b>-7.6</b>	<b>-8.9</b>	<b>-9.2</b>	<b>-12.0</b>
Services, credit	1.8	2.2	2.0	1.4	1.8	1.7
Services, debit	8.7	10.5	9.6	10.2	11.0	13.7
<b>Income, net</b>	<b>9.4</b>	<b>7.1</b>	<b>1.6</b>	<b>1.4</b>	<b>4.3</b>	<b>9.2</b>
Income, credit	10.2	8.1	2.3	2.3	5.1	9.9
Income, debit	0.8	1.0	0.7	0.9	0.8	0.8
O/w: Interest payments	2.7	3.1	2.9	3.3	5.6	6.5
<b>Current transfers, net</b>	<b>-0.4</b>	<b>-0.6</b>	<b>-0.3</b>	<b>-0.5</b>	<b>-0.4</b>	<b>-0.4</b>
<b>Memo</b>						
Non-debt-creating inflows (net)	1.1	-0.7	-4.5	-3.8	-0.6	-0.6
O/w equity FDI	1.0	-0.9	-4.5	-3.8	-0.6	-0.6
O/w portfolio equity	0.1	0.2	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	9.5	-10.8	-7.7	5.1	-0.9
Gross external financing requirement	-14.0	-29.8	-6.4	-11.7	-17.1	-3.5
Stock of international reserves, incl. gold	33.8	43.0	34.4	29.8	34.5	30.9

Source: IMF and Fitch estimates and forecasts

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