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Venezuela Economic Outlook

By Arca Análisis Económico

Here is our monthly summary of recent economic developments in Venezuela:

- After the end of 2020, the exchange market was defined by a substantial increase in the dollar price, despite the severe shortage of bolívares soberanos. At a time when economic agents are seeking to clarify their expectations for 2021 based on the signals and actions carried out by the authorites and the laws in force in the economic field, demand exceeded the weak supply due to the unwillingness of dollar holders to part with their foreign currency, which is expected to be issued in the coming months.

- The first economic policy signal was the government's announcement in which it unveiled the purpose of achieving the total digitalization of the Venezuelan payment system and advancing in foreign currency transactions within the banking system. The statements were generic, so the banking system's dollarization message does not define a clear path.

- In practice, the payment instrument digitalization is almost complete, but several gaps must be addressed. The cash disappearance makes it necessary to ensure that all citizens have access to digital means of payment. They must have bank accounts that allow them to use the various existing digital payment instruments (mobile payment, prepaid cards, P2P).

- One aspect of social importance is the use of electronic payment means in public transportation. There are already some prepaid payment cards that can be used for fare payment. As the use of public transportation cards progresses, the inconveniences that currently arise from the lack of cash in bolívares soberanos and the costs incurred by dollar payments in cash when the driver receives the dollars at 80 percent to 90 percent of their face value, due to lack of bolívares soberanos in cash to provide passengers with change in local currency when they pay bus fees with dollars. Transactional dollarization is advancing, and usage of foreign currencies is increasing daily. However, this dollarization relies mainly on the use of dollars in cash. Regulatory barriers impede the articulation of foreign currency transactions in the banking system by restricting funds between the various components of this incipient payment system.

- The government has made it clear that it does not want the bolívar soberano to disappear in the banking system, forcing the final payment of many transactions to be carried out in bolívares soberanos, even if first paid in dollars. Thus, the government aspires to obtain the benefits of partial dollarization to facilitate the arrival of remittances and alleviate the damages caused by the payment system's degradation. The government does not wish to dollarize the economy entirely, so it does not lose the freedom to control the money supply and manage the exchange rate. This partial dollarization will also allow the government to pay the salaries of public officials and subsidies in bolívares soberanos and create money to finance the fiscal deficit.

- With respect to the oil industry, Venezuelan crude oil production reached an average of 440,000 barrels per day (bpd) in January, according to the U.S. oil-price reporting agency Argus. The report indicates that oil extraction incremented 30,000 bpd in the first month of 2021.

- Venezuela has a limited buyer market for its blended oil due to U.S. sanctions. However, it has expanded its sales in the market, especially in Asia, where China has become a more frequent buyer again.

- According to a report issued by the British agency Reuters, Venezuela had already increased its exports by 12 percent in December 2020, a variation explained by shipments to the Asian giant, to which Caracas owes US$67.2 billion that it has been paying with oil supplies.

- In the United States, the refiner CITGO was able to place the entire US$650 million bond issuance. According to Petróleos de Venezuela, S.A.'s (PDVSA) Ad Hoc Administrative Board, this issuance was carried out to refinance its obligations expiring in 2022 which were contracted in 2014 by the management team appointed by the government of President Nicolás Maduro. The debt to be redeemed consists of US$650 million of senior secured notes at 6.25 percent, which will expire in July 2022.

- One market that has carried out interesting transactions due to the limited access to bank credit is the Venezuelan fixed income market, which has resumed high trading levels. In January, placements doubled to $265 billion bolívares soberanos (equivalent to approximately US$145,000). After the expiration of the $175 billion bolívares soberanos (near US$96,000), the total outstanding sum closed at $2,035 billion bolívares soberanos (just above US$1.1 million). Although new authorizations were low in January, there was substantial activity. Placements doubled expirations, and the outstanding amount in bolívares soberanos increased 21 percent. However, the depreciation of the bolívar soberano (70 percent) reduced the dollar equivalent to US$1.1 million from US$1.5 million.

- The coupon of the issuances placed in the last three months is 95 percent, with no difference to the expiration deadlines. The difference in yields is due to the placement price, ranging from 75 percent to 90 percent, depending on the expiration deadline and the issuer. The expiration deadlines are heavily concentrated in 90 days.

- It appears that in the following months, many structural changes in the Venezuelan economy will consolidate, as dollarization has allowed Venezuelan businesses' profitability to become more transparent and has boosted commercial activity in several sectors. Business investments (installed capacity, inventories) are expected to continue to grow, which has been relatively modest so far but has had an important impact on expectations. Spending by individual and families, who have seen their income rise in dollars, is also expected to increase.

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Venezuelan Central Bank Releases Rules Governing Reserve Requirement

By Holland & Knight

The Venezuelan Central Bank (BCV) on Jan. 19, 2021, issued Resolution 21-01-01 (Resolution), which establishes the "*Rules that will govern the constitution of the Reserve Requirement.*" These Rules must be adopted by Venezuelan banking institutions (including universal and microfinance banks and commercial banks undergoing transformation process before the Superintendency of Banks and Financial Institutions).

It is essential to mention that the Resolution took effect on Jan. 20, 2021, and the reserve requirement position will be determined by the BCV as follows: 1) based on five-day periods (counted from Monday to Friday), using the average of the daily balances of the transactions subject to reserve requirements during such period and; 2) according to the information provided by the banking institutions every week to the BCV.

Article 4 of the Resolution provides, as an exception, that the calculation of the legal reserve position will not take into account: 1) obligations of institutions arising from credits obtained from the BCV; 2) obligations arising from financial assistance operations of the Fund for the Guarantee of Deposits and Banking Protection (FOGADE) and; 3) obligations arising from funds received from state, national or foreign agencies for the financing of special programs in Venezuela, once such funds are earmarked for their respective financing; among others.

The BCV established in Article 9 of the Resolution that if the banking institutions do not provide the information required by the BCV within the set deadlines and terms, any non-compliant banking institution must maintain a special reserve of 1 percent with respect to the number of credit assets and investments in securities according to the last reported balance sheet.

Therefore, it may be concluded that the BCV implemented this measure for banking institutions to report to the BCV the transaction balances subject to reserve requirements every week. Non-compliance with such measure may result in the non-compliant banking institutions being obliged to maintain special reserve requirements established by the BCV.

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Banks to Indicate Receivables Only Through Use of Credit Value Unit

By Tinoco Travieso Planchart & Nuñez

The Venezuelan Central Bank (BCV) implemented a methodology for the indexing of bank loans based on an "Investment Index" (IDI) that considers the fluctuation of the dollar price in the official market – as part of the country's current unofficial dollarization process – and with the purpose of reactivating the granting of loans through the banking sector. Thus, the BCV will publish the Investment Index daily, an indicator that will increase in proportion to the dollar price increase. The Index is determined by dividing the day's exchange rate by a base value and then multiplying by 100. The indexing mechanism implies that the amount to be paid for principal and interest increases when the dollar increases in the official market, and will remain the same if the dollar decreases.

The BCV issued Resolution No. 21-01-02 establishing that credits must be only expressed through the Credit Value Unit (UVC). This Resolution took effect on Feb. 1, 2021. Among the most critical aspects of such Resolution are:

- Banking institutions must express the obligation in terms of UVC, on the date the loan is granted, resulting from the division of the amount in bolívares soberanos to be settled of the loan granted by the valid IDI on such date, determined by the BCV considering the variation of the market reference exchange rate published daily on its website.

- Loans granted within the framework of the National Single Productive Portfolio (CPUN), which aims to finance the agri-food, manufacturing, tourism, health and mortgage sectors, will have an annual interest rate of 2 percent on the balance resulting from its expression in UVC, in order to promote and strengthen the economic sovereignty of the country.

- Banking institutions must charge their clients an annual interest rate that may not exceed 10 percent or less than 4 percent, once expressed in UVC, for accounts receivable and microcredits in local currency.

- Banks may charge a maximum of 0.80 percent per annum for late payments in addition to the established annual interest rate for the respective transaction. In the case of loans other than those expressed in UVC, banks may charge their customers a maximum of 3 percent per annum for late payments.

- Banking institutions may not pay an interest rate lower than 32 percent per annum on savings deposits they receive, including liquid asset accounts. Said percentage shall be calculated according to the daily balance.

- Banking institutions may not pay an interest rate of less than 36 percent per annum on time deposits received and operations through which time share certificates are issued.

- Banking institutions must send periodic information to the BCV on their clients' interest rates for lending and deposit transactions.

- The annual interest rate to be applied by the BCV in its discount, rediscount and advance transactions are established at 12 percent.

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