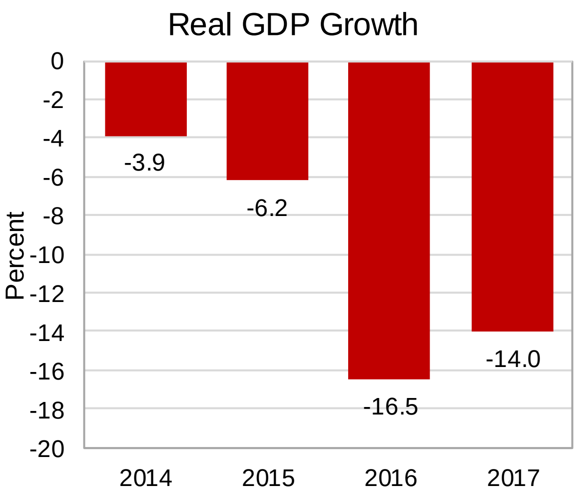
Venezuelan President Maduro's Sweeping Economic Policy Announcements

Current conditions in Venezuela

The DevTech Debt Restructuring Team recently visited Caracas and witnessed conditions on the ground. Everyday life is becoming impossible for the lower strata of the income distribution. The National Survey of Living Conditions (*Encuesta Nacional de Condicionnes de Vida, or ENCOVI)* reported average of weight loss of 11 kilograms (22 pounds) in 2017, following an average loss of eight kilograms (16 pounds) in 2016.

Difficulties obtaining cash have created a premium on payments made using debit cards of around three times prices paid using cash. In addition, transactions are limited by continuous failures of the electronic payment system. Certain prices have been dollarized quickly, mostly tradable goods, while many non-tradable goods and services have not. The availability of products in the market is higher compared to previous years, partly due to the increasing flow of remittances following massive migration, mixed remuneration strategies of some companies (for example paying a portion of wages in USD), and an implicit relaxation of the price controls policy. However, given the current policy mix, the situation will soon worsen.

Basic services (electricity, fixed and mobile telephony, water, transportation) also present significant deficiencies, ranging from rationing to the complete suspension of supply, negatively affecting the quality of life of citizens.



Real GDP has contracted by 35 percent since Hugo Chávez's death in 2013. Venezuela's real economic output growth rates reached -3.9 percent in 2014; -6.2 percent in 2015; -16.5 percent in 2016; and -14.0 percent in 2017. During this period, hyperinflation has set in, with accelerating annual inflation rates that regularly reach three digits. For example, 2015 annual inflation closed at 181 percent, only to be followed by 2016 inflation of 303 percent and 2017 inflation of 2,582 percent.

Information from the National Assembly of Venezuela indicates that tax collections from the SENIAT decreased in July by 95.2% compared to the same month of 2017. It is also estimated that oil production has declined to one million barrels per day is also estimated, which translates into a significant decrease in fiscal revenues from crude oil.

Against this backdrop, the President of Venezuela has dictated a set of new policy measures:

Beginning in August 2018, Venezuelan President Nicolás Maduro has made a series of announcements introducing new economic policies. The new policies attempt to create a policy framework which supports economic recovery.

Currency Conversion

On August 17, 2018, President Maduro ordered a 96 percent currency devaluation. The "sovereign bolivar" will replace the "strong bolivar" from August 20. One sovereign bolivar is equal to 100,000 strong bolivar. The sovereign bolivar is anchored to the "petro" cryptocurrency, a cryptocurrency developed by the Venezuelan government. The Venezuelan government claims the petro is backed by reserves of natural resources, mainly oil, as an alternative to circumvent the sanctions imposed by the US government since August 2017. The petro is mined exclusively by the Venezuelan government and can be purchased with Russian rubles, euros and other crypto-currencies. Its base price is the equivalent of the price of a single Venezuelan oil barrel, which is defined by the Venezuelan Ministry of Petroleum and Mining. This cryptocurrency is meant to be the fluctuating unit of account that will serve to fix the value of labour and that of the prices of consumer goods and services.

The potential for the petro to be a real cryptocurrency relies on its liquidity in the market, but so far the government has not been able to increase the demand for the instrument.

Minimum Wage

A new salary system will establish the minimum wage at 1,800 sovereign bolivars, effective 1st September. This is the 9th minimum wage increase carried out by the Venezuelan government since 2017. President Maduro also announced that he will assume the differential in the payroll of the small and medium industry for the next 90 days, as part of the monetary reconversion process, with the objective of minimizing the inflationary impact on the purchasing power of the workers.

It is presumed that the Venezuelan government will assign direct subsidies to the payroll of the small and medium-sized Venezuelan companies. This will impose significant risks to the private sector, since for employees to receive payments they will need to register with the government and provide detailed information about the company.

According to Official Gazette Extraordinary No. 6,403, dated August 31, 2018, the new monthly minimum remuneration in Venezuela is set at 1,800 sovereign bolivars monthly for employees who work in both the public sector and the private sector. Adolescents and apprentices will receive a remuneration of 1,350 sovereign bolivars monthly. In addition, the complementary food voucher (Cestaticket) was adjusted up to 180 sovereign bolivars[1], which is equivalent to 10% of the minimum wage. However, the same official gazette does not indicate how the payment of the 90 days compensation allowance to companies will be carried out, nor does it

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[1] This implies that the food bonus experienced an increase of 820% with respect to the value on July 1, 2018. In addition, this increase ignores the indexation that the supplement to wages used to have with respect to the unit of account for tax purposes ("Unidad Tributaria"), and instead it became a fixed value whose fixation will depend exclusively on what the Venezuelan Head of State announces.

establish the fractional payment of the new salary increase. The fractional payment of the wage increase indicates the implementation difficulties that the authorities have. The difficulties will be even greater for the private sector, which does not have the ability to print money for fractional payments.

Fiscal Deficit

Head of State Maduro also announced a fiscal plan called "fiscal deficit equal to zero", which will consist of the following:

> a) The rate of Value Added Tax (VAT) will be increased by four percentage points to 16 percent of all luxury goods, while maintaining exemptions for certain goods and services.
> b) Establishment of an income tax[2] on the payment of advances of 1 percent on the daily sales of special taxpayers, and of 2 percent in the insurance financial sector. Weekly payments will be required, up from previous biweekly payments.
> c) The range for the payment of monthly advances for the concept of income tax is fixed between 0.5 percent and 2 percent, and for the tax on large financial transactions[3], a range of 0 to 2 percent for the universe of special contributors.
> d) Implementation, via the national identity card "el Carnet de la Patria", of a "conversion bonus" which will have a value of 600 sovereign bolivars. This is a direct transfer associated with the currency conversion and is estimated to benefit some 10 million inhabitants.

Currency Auctions

The government will restore inter-bank foreign exchange currency auctions, last used in 2002, where the Central Bank auctions foreign reserves to the banking sector. They will establish three to five weekly auctions under the Foreign Exchange Rate System Floating Market (*Sistema de Divisas de Tipo de Cambio Complementario Flotante de Mercado* or Dicom), to boost a new exchange system that will be anchored to the petro and will act in a fluctuating manner.

On September 3 President Maduro announced that the petro will be part of the auctions of the DICOM Currency Allocation System starting next October. It is expected that auctions will be carried out daily, with the objective of stabilizing the economy with a market exchange rate, thus displacing the parallel market.

Gasoline Prices

President Maduro announced a plan to reduce fuel subsidies in order to curb smuggling of inexpensive Venezuelan gasoline to neighboring countries. It is estimated that around $10 billion is lost annually from the smuggling of gasoline to Colombia.

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[2] This is a tax on what is applied to sales advances of small business owners, with the highest gross income reported in their income tax returns and value added taxes.

[3] The tax on large financial transactions is responsible for taxing, among others, debits or withdrawals made in bank accounts, correspondent accounts, deposit in custody, etc., made in banks and financial institutions by legal persons and other qualified economic entities as subjects special liabilities by the Venezuelan Tax Revenues Agency (SENIAT).

Venezuelans who hold the national identity card, el Carnet de la Patria, will continue to receive direct subsidies for two years. For those without a national identity card, the price will rise to international levels. The final price has not been determined.

Gold Savings Plan

A national savings plan was launched: certificates backed by gold ingots of 1.5 and 2.5 grams respectively are available to all Venezuelans. The gold will be held by the Central Bank of Venezuela. The plan is also available in petros.

Restructuring of Minerven

Faced with the complaints of corruption, President Maduro also announced the total restructuring of the General Mining Company of Venezuela (Minerven), attached to the Corporación Venezolana de Guayana (CVG), with the objective of increasing gold production in the country.

Ministry of Internal Trade

A Ministry of Internal Trade was created to govern the domestic market.

International Road Show

Executive Vice President Delcy Rodríguez embarked on an international business tour with the purpose of presenting investment opportunities in Venezuela. At the same time, President Maduro invited Shell International to carry out its operations in Venezuela.

Special Reserves

The Board of the Central Bank of Venezuela issued Resolution No. 18-08-01 published in the Official Gazette 41,472 of August 21, 2018, which states that financial entities are required to "maintain a special reserve, in addition to the ordinary reserve requirement. (...) equal to 100% of the increase in surplus bank reserves at the close of August 31, 2018”. This economic measure, according to the vice president of the economy sector, Tareck El Aissami, aims to prevent the financial system from granting credits which would be used to buy dollars in the parallel market, using the money that the Venezuelan State deposits for the payment of salaries. Nevertheless, this measure will force banks to use all their surplus reserves, which will lead to an expansion of domestic credit, which in turn implies an increase in monetary liquidity in the economy, accelerating inflation even more.

Exchange Regime

On September 7, the Minister of Economy and Finance, Simón Zerpa, and the president of the Central Bank of Venezuela, Calixto Ortega Sánchez, announced that a floating exchange rate and free convertibility of the currency scheme will be adopted throughout the national territory. In addition, private companies (including exporting firms and those in tourism) will be obliged to sell 20% of their profits to the Central Bank.

The Central Bank of Venezuela will be in charge of governing and administering the new exchange regime, and authorities claim that they will allow the purchase and sale of dollars "without any restrictions", where the price of the American currency fluctuates freely "according to supply and demand."

Conclusions

These policy announcements fail to outline a clear path towards stabilization. Revenues will be insufficient and quickly eroded by hyperinflation, while expenditures are expected to continue to rise (financed by the Central Bank). The private sector will be unable to afford the wage increase, as there are neither increases in productivity nor external resources, like foreign currency inflows in the form of loans or aid, to support the increase. The Central Bank will continue to print money to finance the fiscal deficit, further accelerating Venezuela's economic decline. The International Monetary Fund forecasts an economic decline of 15 percent and inflation of 1,000,000 (one million) percent are expected this year.

Despite the establishment of the new exchange system, there are gaps and inconsistencies that significantly question its operation. For example, given that the exchange agreement establishes that the supply and demand positions of the participating individuals are unknown, only the exchange rate established by the Central Bank the previous day would be taken as reference, and it would not be known if there were higher positions or less than the reference value. On the supply side, only the private sector is expected to participate, which means that there will be a very low supply of foreign exchange and high demand. This is true not only because the government control almost the totality of exports in Venezuela but also because the government is continuously creating new bolivars to finance the fiscal deficit. These potential inconsistencies are reflected by the significant departure between the official exchange rate and the black market rate, which is already more than 50%, after just a few days of the government announcements. In addition, this new flotation system is not compatible with the price control system of "agreed prices" of basic goods that was established since the end of August, which would further exacerbate scarcity problems in the Venezuelan economy.