Holland & Knight

Venezuela Economic Outlook

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

- In a context marked by a very high abundance of funds which made it easy to predict strong demand for foreign currency, in the order of US$200 million, the Central Bank of Venezuela (BCV) on Aug. 22, 2022, presented itself with a sale of foreign currency for only US$15 million at $6.18 bolívar soberanos. Almost simultaneously, BCV announced doubling the interest rates of the indexed Currency Hedge Securities (TCC). When the market perceived the deficit of foreign currency supply in the banking system, a portion of the demand went to the parallel market, where the exchange rate closed that day at $6.94 bolívar soberanos (up 3.3 percent).

  Aug. 23 began without an announcement from the BCV to the public or the banks explaining its new policy. It simply sold the banks a lower amount than the previous day (US$10 million) at $6.24 bolívar soberanos. The exchange rate in the parallel market rose to $7.27 bolívar soberanos (up 4.7 percent).

  Uncertainty was exacerbated on Aug. 24 by the deficit in the foreign currency supply. The usual intervention of the BCV, which usually informs the banks of the amount allocated at around 8:15 a.m., did not occur. The BCV called the banks to a foreign currency auction one hour later. The amount to be auctioned was not known, and the pricing strategy seemed to seek a "sincere" dollar price by setting a floor of $7.10 bolívar soberanos, 13 percent above the Aug. 23 official closing and 2 percent below the average of the parallel markers. It allotted US$38 million at $7.10 bolívar soberanos, but the parallel was on the rise and on the day increased 19.8 percent to $9.17 bolívar soberanos, while the official closing rose 11.7 percent to $7.01 bolívar soberanos. The gap between both rates widened to 24 percent, the week's highest level.

  On Aug. 25, the BCV tried to stop the spiral. It auctioned US$93 million at $7.88 bolívar soberanos, but did not clarify whether the auctions would become the usual method of foreign currency allocation. The pace of depreciation slowed. In the parallel market, the exchange rate closed with an increase of 5.3 percent, while the official exchange rate rose 11.7 percent. The gap narrowed to 17 percent.

  On Aug. 26, the BCV finally managed to push back the exchange rate. It resumed the intervention mechanism and raised the sale of foreign currency to US$100 million. The parallel closed at $8.57 bolívar soberanos, a drop of 6.6 percent and the official rate remained virtually stable at $7.85 bolívar soberanos. The gap closed at $9.12 bolívar soberanos.

  It is inferred that the BCV was looking for a formula that would allow it to defend the bolívar with less foreign exchange sacrifice but underestimated (or dismissed) the strength of the demand for foreign exchange as it overestimated the attractiveness of the TCC. The pattern of the first two days of the week was aimed at dosing daily sales and making TCCs more attractive in order to attract excess bank liquidity to the BCV. The abrupt drop in the amount of foreign currency sold and the decision to experiment on Aug. 24-25 with the auction technique added to the confusion. The damage was mitigated when the BCV returned to the allocation technique and flooded the market on the last business day of the week with US$100 million.

The episode allows interpreting that TCCs are not effective instruments to attract large amounts of funds, even more so in periods when the exchange rate seems unstable, because of the unattractive conditions of TCCs. Therefore, dispensing with a managed exchange rate policy so conditioned by the BCV's currency sales is a challenge.

- Reuters reported that oil exports rose to 760,000 barrels per day (bpd) in August. This is an increase of 37 percent over July 2022 and 22 percent over August 2021. This is good news, but it is not accompanied by elements indicating that this is a sustainable upward trend. The news points out that high inventories persist, which reflects marketing difficulties rather than increases in unplaced production.
- Approximately 46 percent of this volume has not generated cash: 10 percent has gone to Cuba, 24 percent to pay Iran for the supply of diluents, and 7 percent to pay the debt with China.

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