BANCTRUST & CO.

Venezuela weekly report

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BancTrust & Co. Research team
research@banctrust.com
+582129038400

banctrust.com
BTCO <GO>

PDVSA picture for 2015

- We reshaped the PDVSA breakeven levels
- The government allegedly will announce economic measures soon
- We evaluate the status of the domestic FX market

The oil price continues to fall down, braking general market expectations and forecasts for 2015, including ours. Such a bearish situation leads us to rethink our initial oil breakeven level for PDVSA. According to our estimates, PDVSA total costs and expenses for 2015 will increase a 3.5% from USD97.6bn registered in 2013, to cUSD101bn for 2015 (take into consideration the lack of official 2014 figures). Meanwhile, we expect a 53.8% increase in social spending through PDVSA in order to carry out the typical populist campaign during electoral years, from USD13.02bn in 2013 to cUSD20bn for 2015. Bearing in mind these two figures and an estimated 20% decrease on financial operations income, from USD20.35bn in 2013 to USD16.28bn for 2015, PDVSA would need the yearly average Venezuelan oil price over USD100 for 2015 in order to be at a breakeven level aligned with the government expectations in maintaining or increasing social spending.

Of course, this breakeven level can change drastically if the government alongside PDVSA officials decides to dramatically reduce social spending levels through the company, due to the cash shortage caused by the c44.23% fall in oil prices YTD. For example, if social spending coming from PDVSA is reduced in 2015 by USD3bn to USD10bn, the oil breakeven level would locate over USD90; meaning USD10 less in the average oil price. The same could happen if PDVSA actually accomplishes to increase its financial operations income. Following this line, we do not expect more efficiency in technical procedures, reason why we discard a decrease in total costs and expenses related to the productive activity of the Venezuelan oil giant.

The paramount issue here is the fact that oil prices are not likely to go back to levels above USD90. So far, the yearly average Venezuelan oil price of 2014 is at USD90.2, and plausibly will be between USD65-75 for the next year according to our oil experts. Obviously, President Nicolas Maduro and his team are not happy with such scenarios, reason why they are pushing multilateral organizations as the OPEC in order to reduce oil outputs. As of 28 November, the global oil oversupply reached 2.2 million bpd (2.6 million bpd in October). It is clear that the OPEC not only is unable to reduce such numbers, but also is not willing to do so, if we follow the rhetoric of the Persian Gulf bloc (Saudi Arabia, Kuwait, United Arab Emirates and Qatar).

What happens with PDVSA's outlook under these aforementioned forecasts? If the yearly Venezuelan oil price locates at USD75 during 2015, the government will have an USD15.32 fall on total revenues compared to 2014 (USD8.75 in cash revenues). Taking a more bearish scenario and placing the yearly average at USD65, PDVSA would have an USD25.4bn fall on total revenues (USD14.5bn in cash revenues). Undoubtedly, this is not a fair picture.

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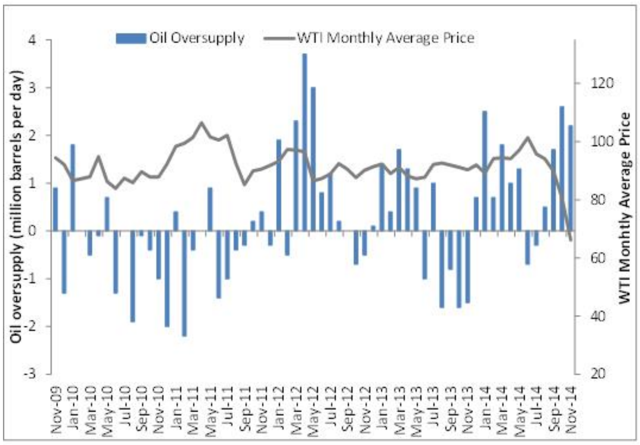
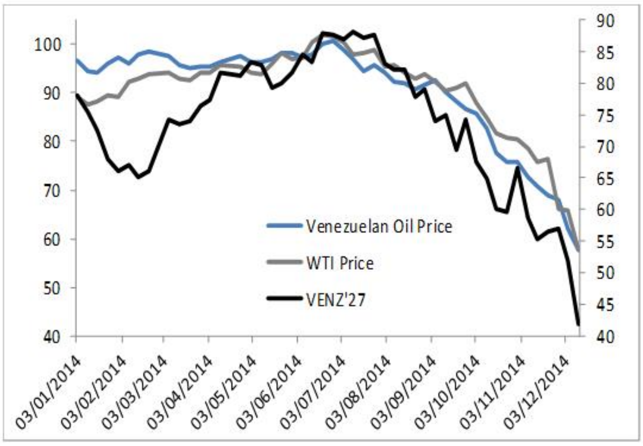
Chart 1: Oil Oversupply



Source: Bloomberg

Chart 2: Venezuelan Oil Price



Source: MPPEE, Bloomberg

Following this line, an important question arises: will PDVSA default next year? In our view we do not think there will be a default next year. As stated in previous reports (see Venezuela Weekly Report "2015 Outlook: there's time to avoid the iceberg"), Venezuela counts with several ways to meet its 2015 compromises. Currently Maduro is juggling four balls: paying the external debt, social spending, assuring cheap basic imports, and paying the debt to the private sector. The most likely to maintain in the air are paying the external debt and assuring cheap imports, while social spending could be reduced as an emergency measure. The debt with the private sector (CADIVI's debt) will not be solved next year in our view simply because funds are not enough to meet non-financial compromises. Besides, the government has a huge negotiation advantage with the private sector, which consistently was used this year to postpone the payments.

Government Announcements

Once again President Nicolas Maduro announced that 2015 will be a year of extraordinary economic adjustments in order to face macroeconomic distortions and the oil price fall of the recent months. In regards of this subject, Deputy Ricardo Sanguino, President of the Finance & Economic Development Commissionof the National Assembly, reiterated the intention in implementing one of the following FX measures: FX rates unification, establishment of a system of bands or applying a system of floating currencies. Sanguino also spotted out that all the economic reforms under current analysis are feasible and only the President has the final word.

Official authorities admitted that having a FX system with four rates (three officials and one unofficial) is complex, reason why Nicolas Maduro is performing a revision of the SICAD II to make it "more dynamic and efficient" in respect of greenbacks allocation. In his own words, "new elements will have to be added to SICADII in order to perfect its structure". We strongly believe the erosion of greenbacks revenues due to oil prices drastic fall, is driving he government towards seeking for a better system of dollars supply in order to offset the foreign currency accounts. Nevertheless, we do not expect the government to meet market expectations in this subject. Repeating the words of previous weekly reports, we need to see it to believe it.

According our estimations, considering a yearly average Venezuelan oil price equivalent to USD/bbl70, the yearly revenue of the country through oil exports in cash, locates close to USD40.3bn. Bearing in mind the characteristics and rates of the official FX schemes, this sum does not represent a sufficient amount for the needs of the country (both in foreign and domestic currencies). What we foresee more likely to happen, it is a devaluation of the currency to VEF/USD20-75 for SICAD I and SICAD II respectively. Under this scenario there would be a c500% increase in domestic currency inflows for the government which represent nearly half the fiscal deficit expected for the year ahead. Even so, this measure by itself would not solve the hardships of the Venezuelan economy, if there is no room for further measures in terms of fiscal discipline, production incentives, and the lift of harsh regulations such as prices controls.

The other announcement was related to decreasing gasoline subsidies. The head of the State expressed there is not urgency in taking such delicate measure. In fact, taking into account the current hardships in Venezuelan economy, executing a non-beneficial measure for society is to add “more fuel to the fire” and will certainly bring eve lower Maduro´s popularity levels; particularly during an electoral year such 2015. We do not see such an expensive measure – socially wise- to be part of the preferred option within Maduro´s spectrum of choices. As we have mentioned in our previous report, the government will continue to avoid, as much as they can, accomplishing radical changes that carry high political costs and could trigger a social unrest.

Official FX market status

According to Foreign Trading Center figures, the last dollars allocations provided through SICAD I, was on the 15 October and since then. None new biddings have taken place, which illustrates the ongoing short of dollars supply to the private sector.

Since January 2014, the scheme has assigned a total amount equivalent to USD5.2bn to diverse productive sectors. According to private estimations, the daily allocations were located at USD43million in April, whereas in October they placed at USD18million (a 58% decline). In addition, the recent reforms in the Central Bank law regarding to the FX rate schemes include further requirements to private companies to be able to access to the system, making the market more restrictive and more exclusive.

These measures and restrictions have hugely affect operations of productive sector at local and macro level. Authorities of the Venezuelan Industrial Confederation (Conindustria) claim that businesses are at 50% of their installed capacity. Inefficiency in dollars allocation to the sector not only has affected the imports and availability of inputs and raw materials for production, but has also contributed to a massive debt with foreign suppliers which today places at over USD10bn. The national Association estimates a 10% fall of GDP in Manufacture sector for 2015. In order to enhance this adverse situation, a set of legal measures will have to be taken, for instance, to guarantee private property as well as to free the market from restrictions such as products price limit. However, the government has not taken any relevant step on this matter so far.