

Venezuela Business Forecast Report Q2 2014

<https://marketpublishers.com/r/V235E273BA8EN.html>

Date: January 2014

Pages: 45

Price: US\$ 1,195.00 (Single User License)

ID: V235E273BA8EN

Abstracts

Core Views

We expect economic growth to remain sluggish, characterised by a slowdown in private consumption, net exports, and investment. President Nicolás Maduro has consolidated his power in recent months, bolstered by a strong PSUV performance in the December 8 elections, and will continue Chávez's policies of elevated social spending, resulting in sizeable fiscal deficits.

Inflation will remain elevated, at the highest level in Latin America, and the operating environment will remain very precarious for foreign multinationals in the country.

Major Forecast Changes

We have upgraded our Venezuelan fiscal deficit forecast for 2014, from 9.6% of GDP to 7.8%, due to reforms which will reduce some types of government spending.

Taking into account the most recent data made available by the Banco Central de Venezuela and our outlook for the oil sector, we have downwardly adjusted our current account surplus forecast for 2014, from 3.2% of GDP to 1.9%.

Key Risks To Outlook

Upside Risks: Higher than expected oil prices and more investorfriendly policies could see real GDP growth exceed our forecast. Downside Risks: The potential for elevated political tensions to materialise in a wider political crisis could see the economy enter a recession as soon as 2013.

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CHAPTER 1: POLITICAL OUTLOOK

SWOT Analysis

BMI Political Risk Ratings

Domestic Politics

Elections Not Likely To Alter Long-Term Economic Decline

Venezuela's municipal election results are a disappointment for the opposition, which trailed the ruling party by seven percentage points in the popular vote according to preliminary estimates. Although our fundamental concerns about macroeconomic governance and political risk in the country remain, the outcome will afford the administration of President Nicolás Maduro sufficient political cover to enact modest reforms without losing face, and may lead to a short-term improvement in the country's credit profile.

Table: Political Overview

Long-Term Political Outlook

Post-Chávez Era To See Greater Turbulence

Venezuela is entering a new era following the election of Nicolás Maduro as successor to the late President Hugo Chávez, but the narrowness of his victory points to an increasingly polarised electorate, which will make the country harder to govern. With the economy looking weak, Maduro could well lose office before his term expires in 2019. Regardless of who rules Venezuela, the country will face formidable economic challenges, such as excessive state control, high inflation, corruption, violent crime and a brain drain.

CHAPTER 2: ECONOMIC OUTLOOK

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Economic Activity

High Inflation And Private Sector Stagnation To Keep Growth Low

Growth in Venezuela will continue to be constrained in 2014, as soaring inflation impacts household purchasing power, oil production stagnates, and private sector

investment remains wary of a hostile operating environment. We are forecasting real GDP growth of 1.5% in 2014, down from 2.0% estimated for 2013.

table: ECONOMIC ACTIVITY

Fiscal Policy

Despite Positive Reforms Ahead, Gaping Fiscal Deficit To Persist

Recent decisions by the administration of President Maduro to rein in spending paint a more positive picture for Venezuela's fiscal account, and we have upgraded our forecast for 2014 accordingly. However, stagnant oil production, expensive yet politically important social programmes, the need for substantial infrastructure upgrades, and rising security costs will keep the deficit wide. We are forecasting a budget shortfall equal to 8.6% of GDP in 2014.

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Balance Of Payments

Stagnant Oil Production To Weigh On Current Account

Venezuela's balance of payments position is under increasing pressure, as oil export growth has stagnated and non-oil exports have failed to make up for lost ground, contracting substantially in recent years. We are forecasting a decline in the current account surplus from an estimated 2.2 % of GDP in 2013 to 1.9% of GDP in 2014.

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Unofficial Devaluation Impact: Keeping An Eye On Fundamentals

Venezuelan authorities, cognisant of the severe market distortions created by a grossly overvalued exchange rate, but hesitant to overtly devalue due to political considerations, have opted for a more covert devaluation, expanding the role of the auxiliary source of foreign exchange known as Sicad. There are many unknown variables about how the new system will affect the economy, and we will be watching the black market rate, the scarcity index and foreign reserves to judge the success of the policy. For now, we maintain our view that authorities will downwardly adjust the official exchange rate in 2014.

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The Venezuelan Economy to 2023

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Although the Venezuelan economy is likely to experience a tough time over the next few years, we believe there is significant economic growth potential over the long term. In our view, a more moderate and market-friendly government is needed, which is willing to make the necessary structural reforms to unlock this potential.

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