

Venezuela Business Forecast Report Q3 2014

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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. However, a series of currency devaluations has begun to ease fiscal pressures.

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

Due in part to a downward adjustment by our Oil & Gas team for crude production in 2014, we have downgraded our growth forecast for the year, from 1.5% to 1.2%.

For the second consecutive quarter, we have upgraded our Venezuelan fiscal deficit forecast for 2014, and now believe the shortfall will reach 6.5% of GDP, compared to our earlier estimate of 7.8%, due to reforms which will bolster bolívar-denominated government revenues.

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Political Polarisation To Intensify, Increasing Medium-Term Risks

We believe that the widespread unrest and political violence in Venezuela since February has largely failed to provide the opposition with any significant traction, and the administration of President Nicolás Maduro has leveraged the situation to the ruling party's advantage, in line with our expectations. Nevertheless, political risk will remain elevated over the medium term, as the situation has further polarised an already deeply divided country, with more belligerent factions in the opposition having gained in popularity.

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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.

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We maintain our view that growth in Venezuela will be lacklustre in 2014, as high inflation suppresses household purchasing power, a poor business environment

constrains private sector investment, and stagnant oil production caps growth in net exports. We are forecasting growth of just 1.2% in 2014, above our 2013 estimate of 0.8%, but well below Venezuela's average over the past decade of 5.8%.

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Despite Optimism, Sicad 2 Is No Silver Bullet

We believe the adoption of the new exchange rate system known as Sicad 2 is a positive step for the Venezuelan government in the sense that it demonstrates an acknowledgement of the need for further reforms to begin addressing the extreme distortions in the country's external markets. However, the system further complicates the process of acquiring hard currency and in the absence of other major policy changes, it is unlikely to have a major substantive impact on the economy and fiscal position.

Balance Of Payments

We believe that Venezuela's current account surplus will continue to deteriorate over the course of 2014, thanks to stagnant export revenues and a structural limit on the scope of further import declines, despite depreciatory policies recently adopted by the government, which have seen the bolívar sharply fall in value and made foreign goods more expensive in local currency terms.

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