



January 13, 2010

## LatAm Consulting Alert: Venezuela introduces Dual Foreign Exchange Control System with a significant devaluation

### New foreign exchange regulation.

The Government of Venezuela has enacted the "Exchange Agreement No.14 between the Central Bank and the Ministry of Finance" published by Official Gazette 374.064 on 1/8/2010 (hereinafter "the new forex regulation").

The new forex regulation creates a dual exchange system by introducing two official pegged controlled exchange rates: (i) 2.60 Bs.F per USD (applicable to what is herein defined as sector A); and (ii) 4,30 Bs.F per USD (applicable to what is herein defined as Sector B). Consequently, the devaluation of the official pegged control market rates is 20% and 100% for each sector respectively.

Sector A will only include the following essential industries, imports and transactions:

1. Food and health industries.
2. Heavy equipment imports
3. Public Sector transactions.
4. Remittances for dependents and students overseas.

Sector B includes all other listed remittances and non-essential imports authorized by CADIVI (the currency exchange board) at 4,30 Bs.F per USD. Payments of foreign debt, royalties and profit remittances (dividends) should be classified under Sector B. However, under article 7 of the new forex regulation it was not expressly defined which exchange rate will apply to foreign debt

service. It is expected that royalties and dividends would be eligible to the Bs.F. 4,30 per USD rate if CADIVI approves the remittances on a case-by-case basis; nonetheless, the authorities have not been very responsive to petitions for dividends and royalties lately.

Exporters will be allowed to retain up to 30% of their export proceeds.

The "Bond Swap" parallel market remains legal as an alternative, but the government has announced closer intervention. Towards that end, it is expected that the National Assembly will soon pass a reform to the exchange control law.

Finally, USD 7 billions will be transferred from the Central Bank international reserve to the FONDEM (Government Development Fund) to finance projects during 2010.

### The Implications.

The government intends to loosen-up its CADIVI approvals to several imports and remittances at the new Sector B 4,30 per USD rates, but giving priority to Sector A. However, the Ministry of Light Industry and Trade (MILCO) have subjected non-essential imports to their prior approval. Unless and until the new implementing regulations become more flexible in regards to the MILCO approval requirement, the whole process should be problematic, thus, creating several

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distortions and further demand in the parallel “bond swap market”.

CADIVI currently supplies 60% of the foreign exchange market, and the government is planning to increase such allocations to 75% under new regulations. Uncertainty and increased demand in the parallel “bond swap market” will remain until the new forex regulations are fully implemented, and the tools of intervention by the authorities in the “bond swap market” are defined. Significant activity in the “bond swap market” has resulted in the last few days, with an implicit rate of exchange of approximately Bs.F 6.50 per USD, therefore, a 8% devaluation in the parallel market in a couple of days.

As a result of the new regulations, the resulting official average pondered pegged controlled rate could be estimated at 3,85 Bs.F per USD based on data indicating that sector A represented 26.5 %, and Sector B represented 73.5 % of CADIVI approvals during the last quarter of 2009. The bond swap market should continue to be the source for at least 25% of the foreign exchange transactions in Venezuela.

Inflation should have a significant increase in 2010 due to monetary expansion through government expenditures upon the devaluation and the transfer of 7 billions of international reserves to FONDEM by the Central Bank. Tension with the private sector pursuant to price controls and other intervention measures by the government is likely. The

government has already intervened more than 70 businesses in the commercial sector for revising their prices after the devaluation.

### Recommended actions.

1) Review cash repatriation strategies to determine if any remittances could be covered under sector B pursuant to the new regulations; or else determine whether to implement a repatriation strategy by means of the “bond swap market” monitoring the best rates that might be available in the following months.

2) Define an adequate financial strategy in this new context.

3) Review the availability and impact of larger domestic NOLs due to devaluation, as well as the inflationary adjustments impact of these measures, for tax purposes, in order to ensure proper planning.

4) Review the impact of the new regulations on pricing policies under tight consumer regulations and price controls.

5) Implement asset protection strategies to minimize the adverse impact of government intervention and eventual expropriation measures, which could be extended to commercial sectors and basic industries of the economy.

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