Exports: The Pending Task

- *The fall in oil prices has occurred at a time when the country finds itself in a much more precarious situation than during the last global financial crisis.*
- *Now the country must face a situation of low prices with a reduced export volume, without any possibility of entering international debt markets and with relatively low levels of foreign exchange assets.*
- *From the 98 tariff chapters, 80 recorded fewer exports in 2014 than in 1998.*
- *The sector of non-oil exports has turned its back on global and regional trends.*

In this Report:

The fall in oil prices has affected an economy that was already in decline since the beginning of 2014. The growth model driven by a strong increase in consumption relied upon the sustainability of the overvalued exchange rate that favored imports and caused great damage to the country's export sector.

In addition, the re-nationalization of oil and steel industries ended up, as on other occasions, diminishing the output capacity of these industries. The country's export sector suffered a major setback, while the rest of the region went through a golden period. Venezuela repeated the mistakes of the past and eventually will be forced to make an adjustment that gives a boost to its export sector. It is important for domestic producers to be prepared for the moment when such changes occur.

Exports in Decline

Venezuela has always relied on exports of commodities. Before the War of Independence, it was the cocoa, then coffee, and for the last century, oil. Historically, external accounts have relied upon the price of these products in international markets. The current situation is not very different. In the last half of 2008 and early 2009, crude oil prices suffered a significant drop in international markets. Venezuelan oil basket fell from US$ 123.72 per barrel in July 2008 to US$ 32.83 in December of that year. Venezuelan total exports dropped from US$ 30,743 million in the third quarter of 2008 to US$ 9,838 million in the first quarter of 2009, as can be seen in Chart N° 1.

The collapse in crude oil prices forced a drastic contraction in imports, and the economy reported six quarters of recession between 2009 and 2010. Crude oil prices recovered relatively quickly, and in the last quarter of 2009, they stood at around US$ 70 per barrel. At that time, Venezuela boasted a respectable sum of international reserves and a manageable debt. However, economic recession was long, largely because the implemented economic policy was not aimed at deeply adjusting the economic growth model, but at weathering the storm of the international financial crisis in the best possible way.

The economy managed to recover slowly in 2011 and at a greater pace during 2012. Problems began to arise in 2013 and the economy entered into recession since the first quarter of 2014. Chart N°1 shows that the country's quarterly exports stood at above US$ 20,000 million that year; even in the last quarter of 2014, they totaled US$ 18,393 million, according to our estimates.

The fall in oil prices has occurred at a time when the country finds itself in a much more precarious situation than during the last global financial crisis. First, the economy was already in recession; the contraction in exports will force a greater reduction in imports and thus consumption. Second, Venezuela has fewer assets available. International reserves are far below the amount reported at the end of 2008 (US$ 43,127 million). Third, the borrowing capacity is more limited than at that moment and, the cost of external financing is prohibitive.

In the first quarter of 2015, according to our estimates, total exports of goods would have amounted to US$ 13,937 million, a decrease of 32.5% with respect to the first quarter of 2014. In the second quarter, total exports would have reached US$ 10,733 million, a sharp contraction of -48.3%. As we have said on other occasions, this contraction implies a deep fall in imports and thus consumption.

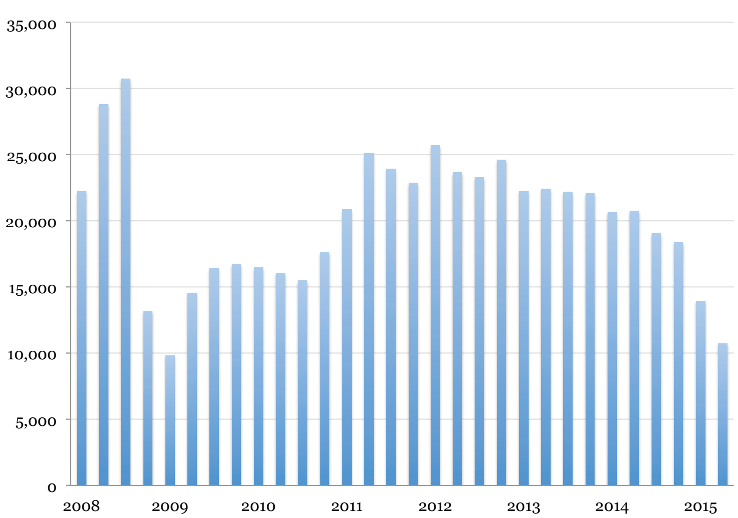
The dollar amount of exports depends on their price and volume. This applies to all kinds of goods, not only oil. Chart N° 2 shows the year-on-year change of nominal and real exports. The figures for the last three quarters are our estimates, since the BCV has not released official data yet.

Several points remain clear in the Chart. First, nominal exports show greater volatility than real ones. This occurs because of the heavy weight of oil exports in the export basket and the volatility of crude oil prices. Second, nominal exports may be growing while the exported volume is contracting. This happened in 2010 and at the end of 2011. Third, real exports have shown a poor performance in recent years. For the past thirty quarters, they have grown in only ten and shrunk in twenty of them. The current fall in commodity prices adds up to six consecutive quarters of decline in real exports, largely due to the decrease in crude oil barrels and other products exported by the country. Now Venezuela must face a situation of low prices with a reduced export volume, without any possibility of entering international debt markets and with relatively low levels of foreign exchange assets.

The difference between real and nominal oil exports can clearly be seen in Chart N° 3. To build it, we created an index based on the first quarter of 1998; once again, the last three quarters are our estimates.

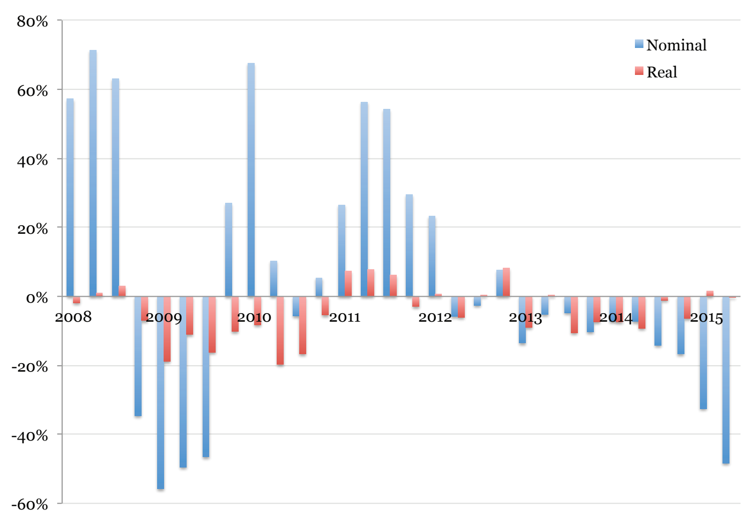
A remarkable increase in exports has been recorded since 2003; even with the current fall in prices, exports are now three times higher than at the beginning of 1998. A problem arises when assessing real exports. As can be seen, there was a relative stability, even a slight increase, until 2006. From that year on, exports have fallen significantly. We must remember that in 2007 a decree was issued to force the migration of all oil concessions in the Orinoco Belt to joint ventures where Pdvsa now holds the majority stake. Major transnational oil corporations did not accept the new arrangement. While it is possible that the decline in production has

Chart Nº 1: Exports of Total Goods (quarterly, US$ millions)



Source: Econométrica based on BCV, PDVSA, OPEC, INE and WTO.

Chart Nº 2: Year-on-year Variation of Nominal and Real Exports



Source: Econométrica based on BCV, PDVSA, OPEC, INE and WTO data.

been due to other reasons, it is difficult to state that this process has not affected investment projects and thus future production. For many years, the country has enjoyed very favorable terms of trade and has neglected production. This is not the first time that it occurs.

Non-oil Exports, More of the Same

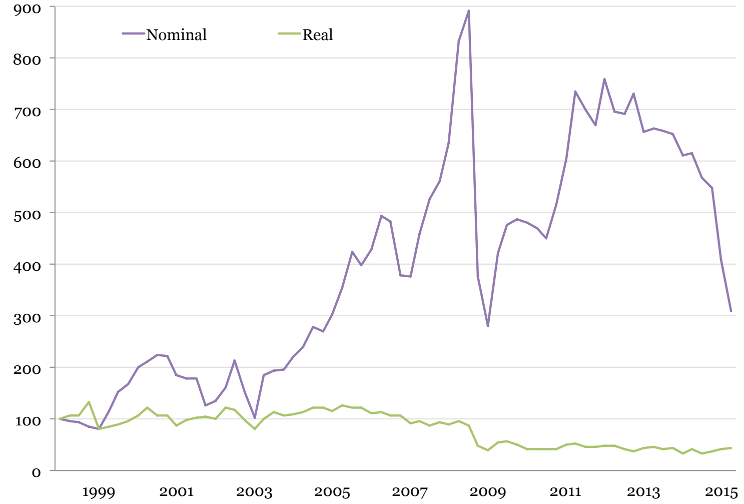
The vast majority of Venezuelan exports are oil. However, there has been a long national obsession to try to diversify the export matrix. Although there were moments when non-oil exports enjoyed better health, their weight has always been rather modest. In addition, it is frequently ignored that most non-oil exports are also linked to commodities like iron and aluminum. Diversifying the export matrix is something desirable, but it requires an economic policy very different from the existing one.

Unlike what happens with oil exports, the country exports today less non-oil products than in 1998, both in nominal and real terms. Chart N° 4 shows quarterly non-oil exports from the beginning of 1998 to the second quarter of 2015. Figures for the last three quarters are our estimates.

The first thing that must be pointed out is that we have never exported more than US$ 2 billion in non-oil products in one quarter. At current oil export volumes and prices, it takes only 25 days to reach that figure. The second point is that there was indeed a period of expansion of non-oil exports in recent years. Between the fourth quarter of 2002 and 2006, exports grew from US$ 1,190 million to US$ 1,936 million, an increase of 63%. While it is true that part of this increase was due to the growth in commodity prices, it is also true that there was an increase in export volumes between those years. The third point to highlight is that a collapse occurred in this type of exports at the end of 2008. The fall was largely due to the drop in commodity prices because of the international financial crisis. Finally, the point of greatest interest, despite the slight recovery in 2010 and 2011, a new cycle of contraction in non-oil exports started in 2012 and led to minimum levels. This contraction is not directly related to any commodities price cycle.

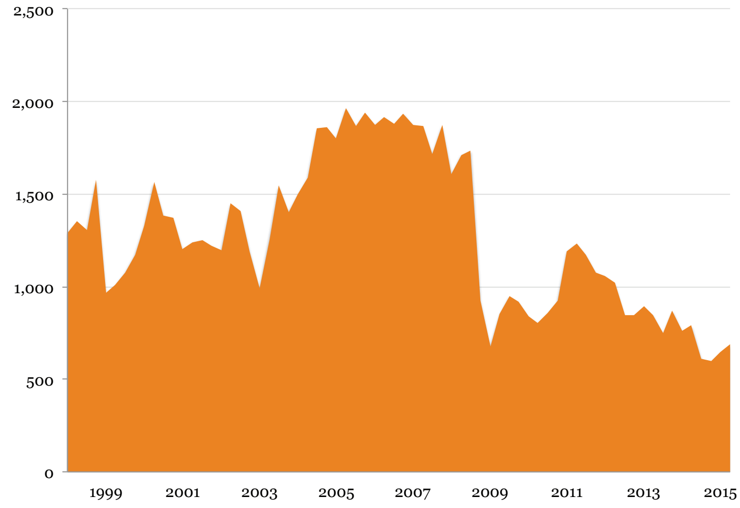
This brief analysis shows that the trend of non-oil exports in recent years is motivated by factors that are beyond the commodity price cycle. Three fundamental aspects have negatively influenced the non-oil exports. First, the reversal of the integration process with Colombia. Venezuela had trade agreements with this country within the framework of the Andean Community and the G-3. The country decided to take a turn by leaving these schemes and joining Mercosur. The second factor is the re-nationalization of the steel industry. Production levels in this industry have decreased and thus the supply of products for export. The last factor, and perhaps the most crucial one, is the FX control. The extended FX control, along with long periods of exchange rate overvaluation, has generated a very difficult environment for exporters. Reversing the current trend requires fundamental changes in the country's economic and trade policies.

Chart Nº 3: Nominal and Real Oil Exports Index (quarterly, I-1998 = 100)



Source: Econométrica based on BCV, PDVSA, OPEC, INE and WTO data.

Chart Nº 4: Exports of Non-oil Goods (quarterly, US$ millions)



Source: Econométrica based on BCV, INE and WTO data.

Chart N° 5 shows an index of quarterly nominal and real non-oil exports. It is observed that, as with oil exports, there seems to be more change in nominal exports. This is due to the volatility experienced by commodity prices in recent years, a volatility which also affects an important component of non-oil exports. It can also be observed that volumes exported today are lower than those at the beginning of 1998, but there is no remarkable cycle of decline as it is the case with oil exports. At this point, it is necessary to be cautious. The non-oil basket is far more varied than the oil basket, and national accounting figures are based on 1997. It is no secret that national accounting statistics require a new base year. The last change took 13 years (between 1984 and 1997). At present, we have 18 years with the same base year.

By Sector

The fall in non-oil exports has spread to all sectors. From the 98 tariff chapters, 80 reported fewer exports in 2014 than in 1998. Chart N° 6 shows the figures of the main sectors in 1998 and 2014. Figures for the second half of 2014 were estimates.

The most affected non-oil export sector has been that related to agricultural products, vegetable products and the foodstuff. In 1998, it exported US$ 689 million, while in 2014 it did not reached US$ 50 million. Exports grouped under the heading Rest totaled US$ 1,259 million in 1998 and US$ 712 million in 2014. Mineral products and base metals, representing nearly 40% of non-oil exports in 1998 with US$ 2,040 million, barely reached US$ 920 million in 2014. The only sector that reported an increase in exports between 1998 and 2014 was chemicals, plastic and manufacturing, from US$ 1,226 million to US$ 1,294 million. Within this sector, the increase is exclusively due to increased organic chemicals and fertilizers.

Non-oil exports went from US$ 5,214 million in 1998 to US$ 2,973 million in 2014, which represented a contraction of 43% in a period when world trade increased markedly. Venezuela's sector of non-oil exports has turned its back on global and regional trends.

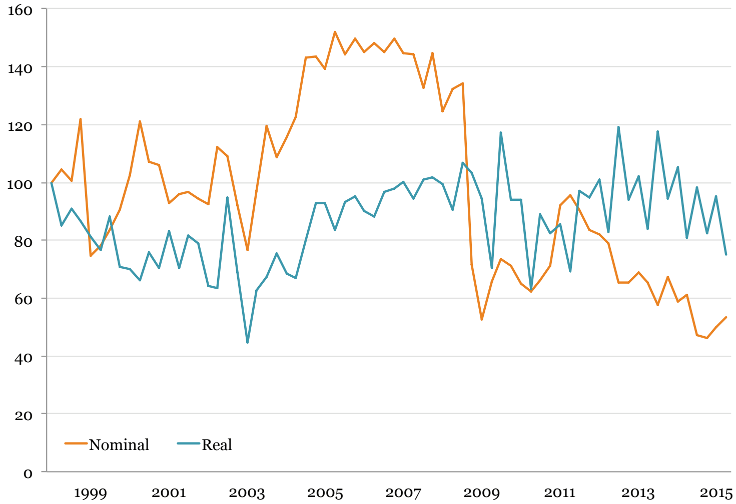
By Destination

An even clearer pattern emerges when we analyze the behavior of non-oil exports by country of destination. Chart N° 7 shows the four main destinations for these exports in 1998 plus China.

In 1998, the main destination of non-oil exports was Colombia. The neighboring country is a natural market for Venezuelan products, and an important integration process between both countries was underway at that time. A total of US$ 1,337 million were exported to Colombia in 1998. In 2014, non-oil products exported to Colombia totaled US$ 275 million. Despite the big drop, Colombia remains one of the major destinations of this type of exports.

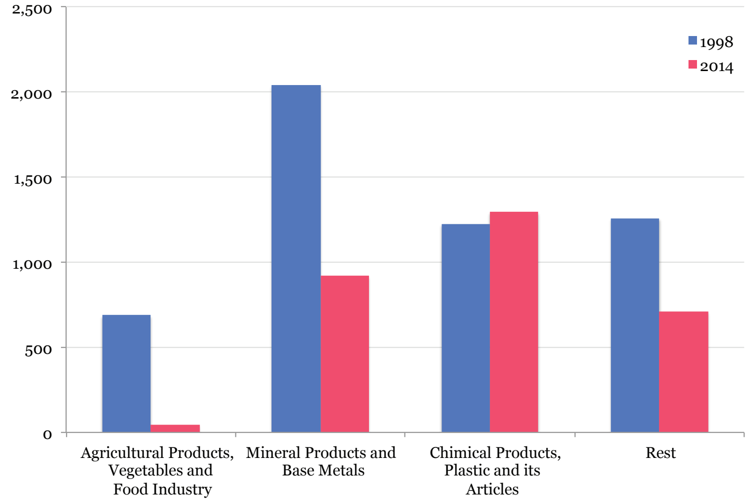
The second country of destination in 1998 was the United States, with US$ 1,216 million; in 2014, this

Chart Nº 5: Nominal and Real Non-oil Exports Index (quarterly, I-1998 = 100)



Source: Econométrica based on BCV, INE and WTO data.

Chart Nº 6: Non-oil Exports by Sector



Source: Econométrica based on BCV, INE and WTO data.

figure declined 31% to US$ 836 million. At present, it is the main destination of Venezuela's non-oil exports. The United Kingdom imported US$ 298 million in 1998 and just US$ 34 million in 2014. Something similar happened with Mexico, which reported a fall from US$ 224 million to US$ 22 million. From the countries listed in the Chart, the only country with which trade has increased was China, from practically nothing to US$ 199 million in 2014. Brazil and Switzerland are among the few countries where exports have grown.

It should be noted that much of non-oil exports in 1998 had for destiny countries of Latin America. This type of intra-regional trade has always had a minor commodity component. In 1998, nearly half of non-oil exports were destined for any country in the region, while in 2014 this percentage fell to 25%. It can be said that in recent years the country's export matrix was less diversified and more dependent on commodities.

When in 2006 the country decided to leave the Andean Community and the G3, and join Mercosur, emphasis was made on the fact that this integration process would enable the country to access a much larger market and that such a measure would be favorable for the economy. The reality has been very different. Non-traditional exports to the two integration schemes are shown in Chart N° 8. Bolivia is considered a member of the Andean Community, since it was accepted this year to start the incorporation protocols to achieve the Mercosur full membership. In 1998, non-oil exports from Venezuela to the Andean Community amounted to US$ 1,685 million. In 2014, the figure reached US$ 295 million, a contraction of 82.4%. This fall could be due to the commercial displacement from an integration scheme to the other, but when we look at the amounts exported to Mercosur, the history is different. In 1998, it exported US$ 175 million, and in 2014 US$ 298 million. This modest growth is due solely to the increase in trade with Brazil, since trade with the other three partners of the bloc was lower in 2013 than in 1998. The withdrawal of Venezuela from the Andean Community did not displaced trade from an integration bloc to the other, but contributed to destroy it.

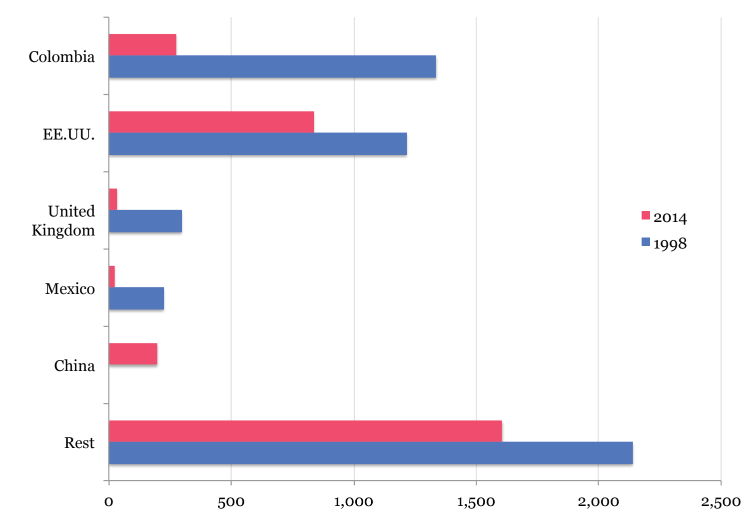
Conclusions and Recommendations

The model of economic growth of recent years has been based on an expansion of consumption supported by an increase in foreign purchases. This model operated relatively well while oil prices were rising; the stagnation of crude oil prices and their subsequent decline highlight the situation of Venezuelan economy. The current recession, which has lasted six consecutive quarters, will be worse than that recorded in 2009 and 2010.

The cycle in commodity prices has had a serious impact on exports of the country, which has been and still is extremely dependent on commodity exports. Most non-oil exports are commodities.

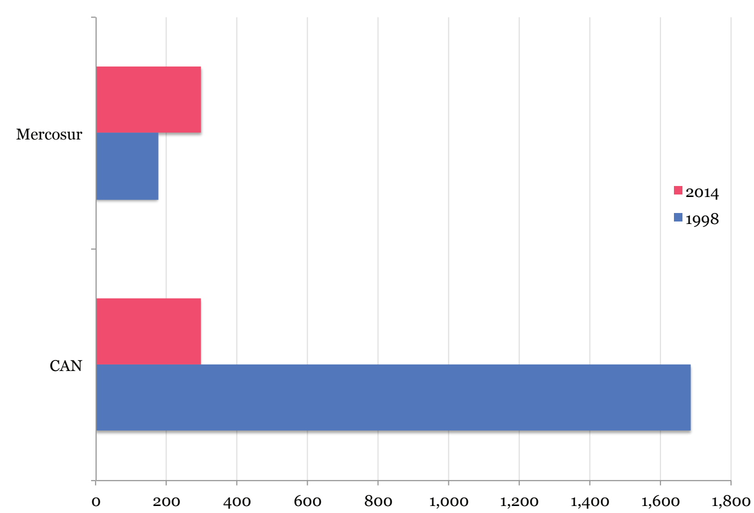
The country's real exports, of both oil and non-oil products, have decreased in volume. At present, the country generates less exportable products and therefore is more dependent on commodity prices, in particular oil. The fall in exports, under the current circumstances,

Chart Nº 7: Non-oil Exports by Destination



Source: Econométrica based on BCV, INE and WTO data.

Chart Nº 8: Non-oil Exports by Destination



Source: Econométrica based on BCV, INE and WTO data.

should be addressed with a contraction in imports, as it is indeed happening. We estimate that this process will continue and deepen in the coming quarters.

The country must rethink its scheme of insertion into international markets in the medium term. It must change drastically the foreign exchange scheme and improve its trade policy. We estimate that these changes will begin in the coming months. While recovering non-traditional exports will be a long-term task, those companies that generate tradable products should begin to explore these possibilities.

The key in this process is to restore currency convertibility. The national export sector could not be promoted, if the current exchange allocation is not eliminated and a single foreign exchange rate is not established. There are still trade agreements with several countries in the region, including Colombia, which is a natural market for Venezuelan products.

In order to recover non-oil exports, it is necessary to return to those markets where non-oil products were sold in the past and commercial links are already established. Those companies interested in exporting should make efforts to study the markets where they want to export. Several years have passed and the circumstances may have changed.

For some transnational companies, the export of products may be an alternative to reduce the debit balance they may have with the parent company or other companies.

The country has great potential to develop its non-oil export sector, but this requires an appropriate economic and trade policy. While it is true that the country does not have any, we believe that things may begin to change in the future. National employers should be prepared for the opportunities that could arise.

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