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Venezuelans Chase Dollars Amid Worries Over Economy

CARACAS, Venezuela—Like many people they know in Caracas these days, Alfred and Norma Muñoz are bracing for what they believe is inevitable: a currency crash brought about by President Hugo Chávez's policies.

The middle-class couple plan to borrow as much as they can from a local bank and buy an apartment outside the country. If Venezuela's bolívar plunges against the dollar, they figure, the loan will be cheap to pay off in dollar terms, and the overseas apartment will hold its dollar value. "Plus, it gives you somewhere to flee if things really get bad," says Mr. Muñoz, who runs a small business.

At the moment, with oil at near record prices, Venezuela's economy is booming. The fourth-largest oil exporter to the U.S. has averaged 12.6% annual growth since 2004 -- the fastest in Latin America. Three-month waits to buy new cars are standard at Caracas dealerships amid a boom in consumer financing. Unemployment has fallen to single-digit rates for the first time in more than a decade.

But there are signs of trouble. Oil production is falling as the state oil company loses top managers and invests less. Inflation is running at 19%, according to the Venezuelan government, though many private economists say the rate is more like 25%, given the increasing role of a black market in hard-to-obtain goods. Partly as a result, the bolívar, officially fixed at 2,150 per dollar, has lost more than half its value on the black market. Many locals fear that official devaluation and runaway inflation is inevitable.

The global credit squeeze caused by mortgage problems in the U.S. may give Venezuelans new reasons to worry. That's because oil prices could fall if, as some economists fear, a world slowdown in lending leads to a broad economic slump. Declining oil prices would deprive Mr. Chávez of income for his vast social programs and accelerate pressure on the bolívar.

Exasperated Voters

In decades past, currency declines and hyperinflation have reared up across Latin America, destabilizing governments and spreading misery among ordinary people. Indeed, Mr. Chávez's own rise to power was helped by a financial collapse and soaring inflation under the mid-1990s government of Rafael Caldera, which prompted exasperated voters to back Mr. Chávez in a 1998 election. If such problems emerge again in Venezuela, they could erode Mr. Chávez's popularity at home, as well as curtail his influence in the region by forcing him to cut back on foreign aid.

While the bolívar is weakening, many other oil nations are watching their currencies get stronger. The explanation for the discrepancy lies, at least in part, in Mr. Chávez's economic policies. His attempt to manage the economy for the benefit of the poor has produced unforeseen problems, which he has treated with unorthodox solutions that in turn have created new

problems. With each policy turn, people like the Muñozes have become more convinced things will spin out of control.

Since 2003, Mr. Chávez has more than doubled government spending on free medical care, higher salaries, gasoline subsidies and other services. That created more demand for goods and services, which fueled inflation. In response, Mr. Chávez expanded price controls, which now cover meat, sugar, eggs, milk and other products. That led to food shortages as producers balked at selling their goods at the mandated prices. The shortages produced a black market, where prices have soared.

This mixture of food shortages, black markets and rising inflation is déjà vu for the Venezuelans who have lived through three financial meltdowns since the 1980s. In the most recent, a collapse of a big bank helped bring on a currency crash and inflation that topped 100% in 1996. To protect themselves from a repeat, Venezuelans are trying to get their hands on dollars, further weakening the bolívar.

"We all know what is coming, we just don't know when," says David Macedo, who drives a delivery truck that supplies small grocery stores. When he has a few bolívares saved, he says, he often goes to the Caracas airport to buy dollars from arriving tourists. He pays far more than the official rate of 2,150 bolívares per dollar, but less than the black-market rate, now about 4,800.

Wealthier Venezuelans have discovered they can use credit cards to exploit the difference between official and black-market currency rates. Some have flown to the nearby island of Aruba and bought \$5,000 worth of gambling chips, the maximum overseas credit purchase allowed by the Venezuelan government, according to a person who arranges the trips. They cash in the chips for dollars, then, back at home, buy enough bolívares on the black market to pay off the credit-card debt, this person says. They pocket the rest -- around \$2,300 at current rates, more than enough to pay for the trip.

Once locals start expecting a crisis, it becomes harder for the government to avoid one. If shopkeepers expect inflation-fighting policies to fail, they will try to raise prices no matter what the government does. Such a phenomenon was recently seen in Argentina: In 2001, Argentines who lost confidence in their government's ability to avoid debt default began withdrawing their bank deposits en masse, ultimately speeding the economic collapse and currency crash they feared.

In Venezuela, Mr. Chávez came to power promising to use the country's oil wealth to benefit the poor. His economic problems started after a 2002 coup attempt and an oil workers' strike. The ensuing economic turmoil prompted many Venezuelans to take money out of the country, which threatened to bring down the banking system. Mr. Chávez stopped the capital flight by banning overseas money transfers and dollar purchases.

When oil prices rose, Mr. Chávez sharply increased spending, which helped him win crucial votes in 2004 and 2006. But the capital controls trapped new spending inside Venezuela, more than quadrupling the amount of bolívares in circulation. The bloated money supply undermined the bolívar and fueled inflation.

The Chávez government realizes the dangers and vows to tamp down inflation before it gets out of control. In July, it required banks to pay customers higher interest on deposits, in hopes of making the bolívar more attractive and encouraging savings. But the new rate is only about half the inflation rate. Finance Minister Rodrigo Cabezas says the government will moderate spending for the first time in years and will keep the official exchange rate unchanged at least through 2009. "We have no plans for devaluation," he says.

Few economists who follow Venezuela are forecasting deep financial trouble, at least while oil prices remain high. Latin American economies generally run aground when they can't afford to pay their bills for imports and debt service. Venezuela currently does not face this problem.

But the longer-term prognosis is far from clear. Mark Weisbrot, co-director of the Center for Economic and Policy Research, a Washington think tank, who is generally supportive of Mr. Chávez, says the government has time to boost economic growth by investing in industries outside the oil sector. Other economists are more skeptical. They contend that the government isn't making enough long-term investments, such as building factories, and that it remains far too dependent on oil revenue.

"We don't know when a crash will happen," says Alberto Ramos, a senior Latin America economist at Goldman Sachs. "But Chávez is driving down the wrong side of the road."

Many Venezuelans are preparing for the worst. Mr. Chávez's control of the legislature, courts and military means it's unlikely the government will alter its current economic course. In mid-August, Mr. Chávez proposed constitutional reforms that would end the autonomy of the country's central bank and eliminate presidential term limits, a move critics say is his bid to become president for life. At the extreme, concerns about the future have prompted thousands of better-off Venezuelans to leave the country in recent years for Miami and such oil centers as Houston and Alberta, Canada.

Next year, Mr. Chávez plans to relaunch the bolívar, minus three zeros and with a new name: the "strong bolívar." The plan includes the reintroduction of a 12.5 centavo coin, *la locha*, a historical throwback to the days of the South American military leader Simón Bolívar, Mr. Chávez's hero. For months, the government insisted that the currency "reconversion" would solve many of the country's ills, such as inflation. The plan was widely disparaged, and in July, a senior Chávez official acknowledged that it "will have no primary effect on the inflation phenomenon."

While inflation always hurts the poor by eating into their purchasing power, some of Mr. Chávez's policies to curtail it are helping bankers, securities brokers and other wealthy Venezuelans. With capital controls limiting the amount of bolívares that can be transferred abroad, bank deposits have risen sevenfold since 2002. Financial firms have done a brisk business helping Venezuelans get their money out of the country legally through debt swaps. Using bolívares, the customer buys a Venezuelan security that trades on a foreign exchange, then sells that security, taking payment in dollar-denominated debt such as Treasuries. The payment gets deposited in an offshore account.

A Chávez plan to bolster Venezuela's currency by selling dollar-denominated government bonds has largely backfired. The government figured that asking Venezuelans to buy the bonds with bolívares would take the currency out of circulation, boosting its value. Shrewd buyers realized they could get the dollar bonds from the government at the official exchange rate, then resell them on the official Caracas exchange, where the bonds trade at prices much closer to the currency's higher black-market rate.

The government tried to give small investors first dibs on the bonds by saying that orders by private individuals for less than \$3,000 would be filled first. Brokerage firms paid maids, doormen and laborers about \$50 each to sign over their rights to the bonds, says Pedro Torres, a middleman who is paid by brokerages to find working-class Venezuelans willing to turn over their rights to the bonds. He says he signed up 170 for the last bond sale, earlier this year.

Black-Market Rates

Savvy Venezuelans have also used the dollar bonds to speculate against the bolívar. Purchasing bonds with loans from local banks, they sold enough at black-market rates to pay off the loans, pocketing the difference. By exploiting the gap between the central bank's rate and the market rate, investors have in effect taken free dollars at the expense of Venezuelan reserves.

The downward pressure on the currency doesn't end there. Because the Chávez administration's bank regulations have kept loans cheap, Venezuelans have an incentive to borrow not only to buy bonds but other goods as well. They take out loans to buy big-ticket items, such as dishwashers or expensive watches, that will keep their value. These loans, too, pump new cash into circulation, counteracting the government's anti-inflationary goal.

"Chávez is the first president to publicize, organize and incite a run on his own currency," said Alejandro Grisanti, an economist who opposes Mr. Chávez. He estimates that at least two-thirds of the government's last dollar-bond issue was bought on credit, including the ones he bought for himself. Venezuela's Finance Ministry declined a request for comment.

At a crowded Fiat dealership in Caracas's posh Las Mercedes neighborhood, would-be buyers add their names to three-month waiting lists. They are so eager to purchase they don't care what model or color they get, as long as they get it soon, says sales manager Beatriz Machado. Some used Fiats sell for more than new ones because they are available on the spot, she says.

Champagne and Whiskey

"They don't want a car. They want a place to put their money," says Ms. Machado, who wears a red blouse and earrings to show her support for Mr. Chávez, whom she credits with helping the poor. She, too, has doubts about the economy, and says she spends her bolívares quickly. Using a bolívar loan, she bought an apartment and a car. Recently, she says, she loaded up on imported champagne and whiskey.

The biggest losers may be the poor, many of whom are Mr. Chávez's supporters. Antonio Buitrago, a 57-year-old cab driver, credits Mr. Chávez with helping his son to walk again. Last

year, after the young man was badly injured in a car crash, the government paid for medical treatment, including a rehabilitation trip to Cuba. "I trust Chávez is going to take care of me," Mr. Buitrago says.

But Mr. Buitrago says his life is getting more difficult these days. He is among what a local pollster estimates are the 45% of Venezuelans who've had trouble finding milk and chicken this year. He can't afford black-market prices for scarce goods, so he stands in long lines at markets that sell subsidized foods. He deposits his savings in a bank, where it's being eaten away by inflation, saying buying dollars on the black market would be unpatriotic.

At a recent "Expo Crédito" in Caracas, lines curled around the conference hall. Upper-middle-class Caracas residents waited alongside men in army and fire-rescue uniforms to sign up for credit cards. The conference slogan: "Credit for Everything."

Denis Naranjo, an engineer, said he's considering his options. He wants to take out a loan, but isn't sure whether to buy real estate or cars. What he really needs, he says, is a bank account in the U.S. "In Venezuela, things are always changing," he explains. "You need to have a plan, and you need to be flexible."