Venezuela's devaluation

The weakening of the “strong bolívar”

Jan 14th 2010 | CARACAS
From *The Economist* print edition

In a harsher world Venezuela faces a reckoning

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OFFICIALLY it is an “exchange-rate adjustment” to make the country more competitive. But Venezuelans have been here before, and they know what to do. Within hours of a presidential decree on January 8th devaluing the currency by up to 50%, long queues formed outside household-appliance shops in Caracas, the capital. The minority with a little spare cash wanted to swap it as fast as possible for something of more durable value.

Burned into Venezuelans’ collective memory is “Black Friday” in 1983, an earlier devaluation that marked the demise of what had been for decades one of the world’s most stable currencies. In a seeming attempt to hark back to that earlier era of prosperity, Hugo Chávez, Venezuela’s leftist president, first fixed the currency in 2005 and two years ago relaunched it with three fewer zeroes as the “strong bolívar”, at 2.15 to the dollar.

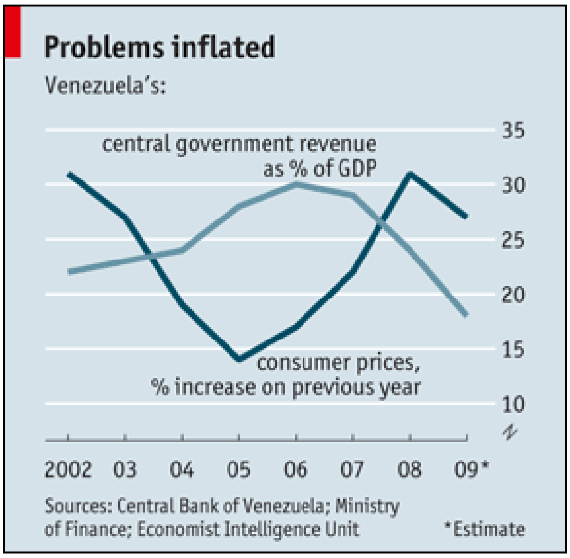
Heightening the sense of déjà vu, there will be a multiple exchange-rate, just as there was in the 1980s. Priority imports such as food and medicines will be paid for at 2.60 bolívares to the dollar, with a rate of 4.30 for the rest. The government will also legalise—and intervene in—the “parallel” (or free) market, where the rate this week was over six to the dollar. Hitherto, just publicising the parallel rate was in theory punishable with a heavy fine.

The big beneficiary will be the government’s finances. PDVSA, the state oil company, is the source of over 90% of the hard currency entering the country. Overnight this doubled in value in bolívar terms. The government was facing a fiscal deficit of 6-8% of GDP this year; now it might even manage a small surplus. At the same time the Central Bank was ordered to hand over $7 billion in “excess” reserves. Jorge Giordani, the planning minister, said this money will be used to “encourage import-substitution, reduce dependence on oil and create new jobs”. Sceptics say Mr Chávez will use the cash on social programmes and on raising the minimum wage so as to shore up his public support ahead of a legislative election in September.

Whether it will haul the economy out of stagflation is another matter. The finance minister, Ali Rodríguez, admitted that the devaluation would boost Venezuela’s already high inflation rate (of 27% last year) by three to five percentage points. José Manuel Puente, an economist at IESA, a Caracas business school, reckons that inflation could reach 35% to 40% this year.

Even as he was inviting the private sector to propose import-substitution projects, Mr Chávez threatened those who dared to raise their prices. “If the plunderers continue their abuses," he said, "the state will recover those businesses and hand them over to the people." The National Guard, the militias, the ruling United Socialist Party of Venezuela (PSUV) and the consumer-protection agency were all deployed in this effort. In the first few days more than 200 businesses that hiked prices were temporarily shut down.

Such harassment is one reason why few private economists reckon that the devaluation will stimulate export-led growth. While many other Latin American economies are recovering, some strongly, Venezuela is stuck in recession. The Central Bank says the economy contracted by 2.9% in 2009. The industrialists' association reckons that manufacturing output fell by 7.2%. Along with the devaluation, the government announced a $1 billion fund to provide credit and subsidies. But details are fuzzy. Mr Chávez's price controls, punitive regulation and threats of expropriation have depressed private investment. "There is no non-oil export industry to speak of in Venezuela today," noted Síntesis Financiera, a consultancy.



Under Mr Chávez the motor of economic growth was public spending, curtailed by the fall in the oil price (see chart). Repeating this formula with devalued bolívares is harder. In addition, drought has cut the output of hydroelectricity (and budgeted state investment in alternative sources of energy has failed to materialise). On January 13th Mr Chavez backed away from an unpopular but necessary plan, announced a day earlier, to impose national four-hour power cuts every other day—sparing Caracas from the measure. That humiliating U-turn cost Ángel Rodríguez, the electricity minister, his job.

Will the devaluation help Mr Chávez politically? Certainly the government will be able to reverse recent spending cuts. But most Venezuelans will see their purchasing power decline. The dual exchange-rate will remind many of its 1980s predecessor, run by an exchange-control body known as Recadi which became a byword for massive—and unpunished—corruption. A "Recadi Chinaman" entered Venezuelan vocabulary to describe a scapegoat, a reference to the only person ever convicted in connection with what became a massive scam. Today there are even fewer independent watchdogs to prevent corruption.

It is not only the opposition that thinks the president has set off on a downhill path. Heinz Dieterich, a Mexican-German political scientist and advocate of the "21st-century socialism" Mr Chávez proclaims, wrote this week that the devaluation "reveals once again the utter incapacity of the government and the leadership of the PSUV to understand and contain the terminal political crisis they are experiencing." After several years of oil-fuelled partying for Venezuelans, the hangover has begun.

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