Fitch Revises Venezuela's Rating Outlook to Negative; Affirms IDRs at 'BB-'

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Fitch Ratings today revised the Rating Outlook on Venezuela's long-term foreign and local currency Issuer Default Ratings (IDR) to Negative from Stable. At the same time, the agency affirmed the IDRs at 'BB-', the short-term foreign currency rating at 'B', and the country ceiling at 'BB-'. An increasingly unsustainable macroeconomic policy framework, which has resulted in greater vulnerability of external and public sector accounts to a decline in oil prices, an inability to significantly reduce inflation, and a widening of the spread between the official and parallel market exchange rates, underpins Fitch's concern with respect to sovereign creditworthiness. Additionally, Venezuela's external position, which is cushioned by capital controls, has also shown signs of weakening. Although expenditure growth has decelerated significantly this year, the government has more than doubled fiscal and quasi-fiscal expenditure since 2004, making the fiscal health of the country more reliant on the performance of the oil sector. Fitch estimates that the break-even price of the Venezuelan oil basket necessary to balance the fiscal accounts has now reached around US$59 per barrel, highlighting the vulnerability of the fiscal accounts to even a modest fall in international oil prices. Venezuela has the highest inflation rate in the hemisphere and the government's heterodox policy response through price controls, subsidies and financial repression has not only failed to address the root of the problem, but has also discouraged investment necessary to increase production to levels that match rising domestic demand. Furthermore, the government's increasing role in 'strategic sectors' has undermined private investment as well and eroded the non-oil productive capacity of the economy. Declining international reserves stemming from transfers to opaque government-managed funds, double-digit import growth, and disinvestment related to the nationalization of private companies will likely erode Venezuela's external liquidity ratio in forecast years. 'Given Venezuela's oil dependency, which causes an elevated degree of fiscal and balance of payments volatility relative to peers, the country should maintain higher levels of liquidity to support creditworthiness,' said Theresa Paiz Fredel, Senior Director in Fitch's Sovereign group. After peaking at 310%, Venezuela's external liquidity ratio will likely decline to 253% in 2008, significantly below five other 'BB' sovereigns, including oil exporters such as Nigeria (Fitch-rated IDR of 'BB-'). Fitch expects Venezuela's net external debt indicators to deteriorate this year due to the decline in international reserves. Although Venezuela's net external debt/current external receipts (CXR), forecast at 11.6% in 2007, remains significantly below the median of 23.6% for 'BB' rated peers, this ratio is expected to rise above the peer median by 2009. In addition, if current trends continue, the public sector could also become a net external debtor by 2009, while many 'BB' peers will remain net external creditors. Both Venezuela's long-term foreign and local currency IDRs were affirmed at 'BB-', reflecting low debt maturities and a high level of accumulated assets. However, it appears that political considerations have guided economic policy choice in recent years. As such, Fitch is concerned that the trend toward further centralization of power may tempt the government to maintain spending on key patronage programs at the expense of bondholder interests under a severe stress scenario for public finances. Venezuela's ratings could be downgraded in the absence of an appropriate policy response to mounting economic pressures or a further erosion of the country's external position. Fitch will closely monitor political developments in Venezuela, as political instability has directly affected the country's creditworthiness in the past. Contact: Theresa Paiz-Fredel +1-212-908-0534 or Shelly Shetty +1-212-908-1324, New York. Media Relations: Christopher Kimble, New York, Tel: +1 212-908-0226. Fitch's rating definitions and the terms of use of such ratings are available on the agency's public site, 'www.fitchratings.com'. Published ratings, criteria and methodologies are available from this site, at all times. Fitch's code of conduct,

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