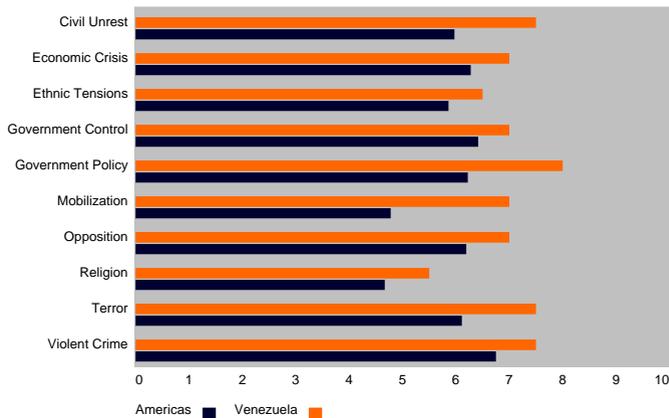


GAD Instability Indicators: Venezuela



## SUMMARY OF KEY DEVELOPMENTS

Campaigning for the presidential recall referendum began amid mutual recriminations. Suspicions grew of irregularities in the state-owned oil company's accounts, and the security situation continued to deteriorate.

## GAD INSTABILITY INDICATORS

**Economic Crisis:** Even as most economic forecasts see Venezuela's GDP expanding at an average of 9 per cent in 2004, the persistent poor performance of the construction sector has undermined the prospects for sustained economic growth. Political instability has taken its toll in keeping investors out of new commitments, which has been reflected in the prevailing low demand for credits for building ventures.

**Government Control:** Less than 2 months before a vote is held on whether President Hugo Chavez should step down, both the government and the opposition have officially launched their campaigns, airing advertisements on radio and television and staging rallies across the country. At former US President Carter's behest, Harvard University conflict resolution expert William Ury held a meeting with Mr Chavez and opposition-leaning media groups. Both camps allegedly reached an agreement on media regulations, fostering ways to alleviate tensions in the run-up to the referendum. However, the opposition has accused Mr Chavez of breaching the agreement, as he ordered all of Venezuela's media to broadcast a graduation ceremony of hundreds of military officers from military academies, and headed a huge military parade on Venezuela's Independence Day, where soldiers featured in the Battle of Santa Ines, a historical combat that Mr Chavez has taken as the motto of his anti-referendum campaign. Unsurprisingly, spats over opinion polls have flared up, with mutual accusations of the manipulation of information. While most polling firms are allegedly aligned with the opposition, most surveys have nonetheless revealed that the group that will most likely define the referendum's fate is the so-called 'ni-nis', or neutrals. In the meantime, opinion polls will continue to be used as political weapons.

**Government Policy:** State-owned oil company PDVSA and its subsidiary PSVSA Finance requested more time to file their 2003 financial results with the US Securities and Exchange Commission (SEC), alluding to administrative problems resulting from the crippling December 2002-January 2003 general strike. PDVSA confirmed on 6 July that it would finalise its financial reports within 2 months, breaching a 30 June deadline. This is the second time that PDVSA has missed the SEC deadline, reigniting long-held fears among independent analysts that the company has not fully recovered its production to pre-strike levels, contrary to PDVSA's own claims. The SEC

filing deadline came 2 days after PDVSA announced that it would buy back US\$2.5bn and EUR88bn in external bonds, which was interpreted as a move to reduce its exposure to SEC rules, feeding further speculation about the state of the oil company's accounts. These developments are likely to weaken investor confidence in the company, which is directing almost a third of its 2004 investment budget to finance government social programmes.

**Opposition:** The opposition appears to be taking steps to decide on a single candidate, in an move to try to address its most important problem - the fact that it is united merely in its aim to unseat Mr Chavez, and does not have an obvious leader. Nongovernmental Organisations (NGOs) connected with the umbrella opposition alliance, the Democratic Coordinating Board (CD), have started to debate methods of selecting a candidate, including primaries, surveys, or political agreements. Manuel Cova, a central figure in the independent trade union movement, the CTV, has recently advocated the holding of primary elections, suggesting that they take place on 22 August. In doing so, he argues, Mr Chavez would have less possibility to delay the 15 August referendum. The issue is likely to exacerbate existing divisions among the various opposition factions and candidates of what is predominantly a nebulous group. The CD has also fostered discussions on a coherent social policy proposal to counter Mr Chavez's popular social programmes, based on heavy social spending coming largely from oil revenues.

**Violent Crime:** At least 10 people suspected of illegal drug trafficking were killed in a police raid in the central state of Guarico on 25 June, and 6.5 tons of cocaine were confiscated. A band known as 'The Bombardiers of the Plain' was dismantled during the operation. US figures have revealed that Venezuela has become a crucial land bridge for the transportation of cocaine destined for the US and Europe, with an estimated 150 tons transported every year. Also, the National Guard killed 4 suspects in the kidnapping for ransom of a rancher near the border with Colombia. The police are investigating the slaying of at least 9 homeless people found brutally murdered on the streets of Caracas over the past fortnight. According to local police, the victims were beaten to death with a heavy object while they were sleeping in residential and business zones of East-Central Caracas. The probes have not identified any suspects of the murders so far. The news raised concerns of a possible campaign of social cleansing, at a time when the number of homeless people and the level of crime have mushroomed as a result of Venezuela's deteriorating socio-economic situation.

## FORECAST

Even if Mr Chavez is unseated in the 15 August referendum, investor sentiment in Venezuela is likely to remain anxious, as the effects of the government's spending policy, its looming presence in economic and political institutions, and ongoing currency restrictions will in the short term undermine any new government's strategy to bring the country back on track.

## THREAT LEVEL CHART

