



2004

YEAR END ADDRESS
PRESIDENT
THE CENTRAL BANK OF VENEZUELA

A PERFORMANCE GUIDE
BY PRINCIPLES

2004

**YEAR-END ADDRESS
PRESIDENT
THE CENTRAL BANK
OF VENEZUELA**

**A performance guided
by principles**

Caracas, December 22nd, 2004



© 2004, Banco Central de Venezuela
Caracas-Venezuela

Source cataloging
Biblioteca Ernesto Peltzer

Banco Central de Venezuela
Year-End Address of the President of
Banco Central de Venezuela, 1994-24 p.

Formerly:
Declaración de fin de año del Presidente
del Banco Central de Venezuela/
Banco Central de Venezuela.-
Caracas: BCV, 1976-1993.

Dewey Classification : 330.987064
JEL Classification: E58, E60
VENEZUELA-CONDICIONES
ECONÓMICAS
BANCO CENTRAL DE VENEZUELA

All pertinent legal registration
requirements met

Legal Registration N°. If 35220033306

For free distribution

Editorial Producción :
Gerencia de Comunicaciones
Institucionales
Departamento de Publicaciones
Torre Financiera, Avenida Urdaneta,
Esquina de Las Carmelitas,
Piso 14, ala sur,
Caracas 1010.
Telephone: 801.55.14 / 801.52.35
Fax: 801.87.06

Graphic design:
María de Lourdes Cisneros

E-mail:
libreriabcv@bcv.org.ve

Internet:
<http://www.bcv.org.ve>

| | | |
|------------|--|-----------|
| I | VALUES OF BANCO CENTRAL DE VENEZUELA | 5 |
| II | ECONOMY ON YEAR 2004 | 15 |
| III | 2005, ANOTHER YEAR OF ECONOMIC AND SOCIAL DEVELOPMENT | 21 |

2004
YEAR-END ADDRESS
PRESIDENT
THE CENTRAL BANK
OF VENEZUELA

The Constitution of the Republic of Venezuela has reached its fifth anniversary. Even though during these five years the transformations have been exceptional, this five-year period of time would not be enough in order to assess its significance with the necessary retrospective approach that history has to offer.

One of the features that characterized this period of time is the degree in which the traditional limits of rationality are being challenged, mainly on account of the fact that the issue of an incomplete information has been acknowledged. This must be coupled to the antagonism between the participants and the clear rejection to cooperate. The successes and mistakes are not obvious for everyone. Likewise, less calculations are made in order to ensure a unique outcome and further reformulations in order to design viable strategies and actions.

This context is not alien to Venezuela, where we can evidence a series of transformations that are related to a structural change, which is aimed at solving the major problems that have been derived from the dynamics of the system and that have been based on an articulation of rules, structures and processes that contribute to new balances, both within the scope of the micro economy, as well as at a macro economic scale. In turn, this is coupled to the creation of the conditions required in order to have the best possibilities for the adequate operation of the system.

This leads to the need of a new ethics that has, as its main values, a clear commitment and criticism, while its objective is the human dimension.

This ethics -which was at the very origin of the economic science- has a historical and regulatory nature. Upon accepting the conditionality of rational acts *per se*, efficiency is no longer an ultimate goal of society. Within the framework of the design and application of public policies, there is an absolute need for taking into account the assessment of social effects, specifically those that are related to the creation of equal opportunities -this being an element that is consubstantial of human development.

None of this can be, or has been alien to the Central Bank of Venezuela.

The economic policies would be useless if they were not inserted within the framework of human purposes. Hence, when decisions are adopted within the framework of the legislation that is in effect, it is absolutely necessary to carefully bear in mind the possible consequences that they may have on society as a whole and, most specifically, on the less favored members of society.

This is one of the reasons why it will still be necessary to discuss the ethics and the moral dimension of institutions that have -as one of their main purposes- taking up responsibilities for facing the economic and social challenges.

I am barely a few days away from the fifth anniversary of my capacity as President of this Institution and I would like to take advantage of this suc-

Within the framework of the design and application of public policies, there is an absolute need for taking into account the assessment of social effects, specifically those that are related to the creation of equal opportunities -this being an element that is consubstantial of human development.

successful completion of the year 2004 in order to share some reflections around the principles that have guided the responsible action of the Bank in the country, in full synchronization with its main objective and the exercise of its public function. This process of change also requires a time horizon in order to assess it in all its full scope.

During these years, the Year-End Message of the President of the Central Bank of Venezuela has also been the ideal means for rendering accounts to the general population.

This is a most timely opportunity to point at the foundations of activities that have been true to the principles and in tune with the set of ideas that make up the public service and citizenship for the consolidation of Venezuela.

Thus, during the 2003 Year-End Message, I was able to state that:

...in fulfilling its mission, part of the efforts of the Institute have not only been devoted to act in a coordinated manner with the National Executive Power, but they have also been aimed at building the capabilities and the architecture that is required in order to enable an efficient coordination that yields, as a result, the well being of each and every Venezuelan citizen.

...the principles that guide the activities and the performance [of the Bank], have contributed to configure a Central Bank that is more transparent, that is accountable and that takes up all its responsibilities before society. In fact, it is evident that there is an increase in the amount and quality of the information that is furnished to different audiences regarding the operations, policies and performance, being accountable directly and repeatedly for its attributes, responsibilities, actions and decisions.

THE ETHICS GUIDING THE BANK

The distance in the relationship between ethics and the economy has been growing as efforts have been made at setting up a sort of borderline for knowledge, where ethics determines the purposes and the economy is mainly in charge of the means.

This notion is deeply rooted in an interpretation that identifies the economic policy maker as a supplier of technical information that is only useful for the adoption of decisions and that is devoid of value judgements. Consequently, a false separation has been made between the dilemma of what is and what should be.

An argument that is brought up in this respect is that of the need to preserve an alleged economic rationality, by means of which agents select options that emerge from a set of restrictions, preferences, beliefs and expectations that can be clearly quantifiable. In the extreme derivation of Hayek and Friedman, the separation between economic power and political power is based on the need to protect individual freedom.

This is a most timely opportunity to point at the foundations of activities that have been true to the principles and in tune with the set of ideas that make up the public service and citizenship for the consolidation of Venezuela.

These ideas do not take into account the fact that moral notions have an influence on the behavior of the agents and, hence, on the evolution itself of the economic facts. Likewise, the notions with respect to political well-being and the means to achieve it are based on uncontested moral assumptions along with the public policies that are derived from economic interpretations with a high-level moral commitment.

The founders of the political economy -the classics and, mainly, Smith and Marx- pointed at the close interrelation that existed between the new science and philosophy. They argued that the ethical and moral notions of society are conditioned by the nature of the economic relations that prevail in society and by their market derivations. In this respect, the behavior of the different social groups is determined by their location and by the development of those relationships, along with the role of the market.

Two main ideas are derived from what has been mentioned above. One of them is that the socioeconomic structures amply shape the contents of the motivations. The other one rejects the fact that iniquity can be the result of selfishness as a characteristic of human nature. The phenomenon is still being evidenced and the most relevant contemporary economists have warned about the degree in which these ethical values could be –and, in fact, have been- strongly undermined by the degree in which these market relationships have been turned into a real myth.

Not many people currently question the validity of a new and growing dimension of the relationship between ethics and the economy, which is none other than the topic of equity: "...the species undergoing the strongest danger of extinction among political ideals", as mentioned by Dworkin, one of the most outstanding philosophers of equality, when faced with the criticism that these policies lead to a loss of efficiency. And what happens is that the scale of values for measuring efficiency and equity is considerably different and the set of instruments of the latter is still in a more incipient or earlier phase. Besides, it is more controversial on account of the interests that affect these instruments. In case this is not done, we would have to accept that the social world in which we hope to live and its ethical perceptions will always be under the control of an eminently quantitative rational calculation.

However, besides this, moral attitudes have an important influence on distribution facts and, in Venezuela, it has been clearly evidenced over and over again, that the uneven distribution of income is morally questionable. Hence, we should not only carry out efficiency assessments, but also equity assessments and these should be a part of the ethical behavior.

Only in this way will it be possible to understand the principles that rule the formulation of public policies and the moral factors that have an influence on the economic behavior.

From the point of view of the neo liberal approach, people sometimes forget to mention categories as the following: needs, opportunities, rights or impartial individuals and the assumptions of dignity. Therefore, systematically the perverse effects associated to the more orthodox application of the macro-

Not many people currently question the validity of a new and growing dimension of the relationship between ethics and the economy, which is none other than the topic of equity.

The scale of values for measuring efficiency and equity is considerably different and the set of instruments of the latter is still in a more incipient or earlier phase. Besides, it is more controversial on account of the interests that affect these instruments.

However, besides this, moral attitudes have an important influence on distribution facts and, in Venezuela, it has been clearly evidenced over and over again, that the uneven distribution of income is morally questionable. Hence, we should not only carry out efficiency assessments, but also equity assessments and these should be a part of the ethical behavior.

economic policies have been disregarded, whether it is the exchange, the monetary or the fiscal policy. As a result of this, when we regard all the economic agents as agents that have equal rights, we lose the possibility of measuring the redistribution impact -generally regressive- between the different strata of the population. There lies the moral responsibility of contributing to modify the prevailing conditions of iniquity.

To this end, it is necessary to make qualitatively new representations that, in short, lead to a revision of traditional assessments.

Hence, we can not avoid addressing an important ethical responsibility of international institutions. The latter is related to the role currently played by multilateral economic organizations, specifically the International Monetary Fund, the World Bank and the World Trade Organization.

More than half of the world population and two thirds of the countries of the planet lack an effective and autonomous self-control over their economic policies. They rather depend on the technical and material contributions of those international organizations. Furthermore, the latter mostly have a limited effect on human development. This tends to worsen many of their institutional problems without attaining a renewed pace of growth with a greater degree of equity.

This responsibility is not alien to an international order that deepens the differentiation between countries and, consequently, it has a deep moral significance.

In the Message that I submitted at the end of the year 2000, I mentioned the following in this respect:

It is an order that makes all the nations come in contact, though at the same time it contains deep fissures between different groups of countries and the social groups of each country and, undoubtedly, it leads to a marked asymmetry between the regions to the detriment of the less developed ones. Among others, its trends are the following: the fast growth and internationalization of financial markets fostered by the technological revolution and opening of the markets, the transformations of trade patterns favoring the services and manufactured products that have a high technological content, the displacement towards the Pacific as an area where trade intensifies, the proliferation of regional commercial agreements, and the expansion of trade within transnational companies, among others. Institutionally, this has been coupled to the creation of the World Trade Organization (WTO) that supplements the International Monetary Fund, the World Bank, the Organization for Economic Cooperation and Development (OECD) and the Trilateral Commission, acting as leading organizations.

THE NEW DIMENSION OF PUBLIC POLICIES: HUMAN DEVELOPMENT

The arguments that address the capability that intervention policies would have for facing economic unbalances -in view of the fact that they would be

anticipated by the agents- acquired more strength after the Keynesian approach was questioned in the decade of the seventies, in the XX century.

This has led to several corollaries. One of them refers to the inefficiency of state intervention when attempting to modify the path towards economic progress and the boom of the neo liberal criticisms towards the deleterious effects of government expenditures. The latter tend to idealize a world where the full activity of the market should be expanded without any obstacle whatsoever.

The other one refers to the limits of stability and it is related to the interpretation made by the orthodox positive economy that associates economic balances to purely accounting ones that, in most of the cases, lead to tautological results. This is also a discussion that started many years ago when the modern theory of development was formalized as the expression of a historical process that generates structural deformations in dependent countries. Every since that time, it was acknowledged that overcoming underdevelopment generated costs that forced us to modify the paradigms that had been set forth for other societies.

From this point of view, we can evidence the limited validity of the economic models that are being used and that set forth *a priori* that future relationships of the system are constant when they respect in time the continuity of those observed in the past. At the same time, they assume the stability of the technical coefficients and insist in showing truth under changing historical conditions.

This attack has been cornering more and more the political economy and the debate with respect to its objectives. There are several new approaches that have tried to rescue some of the main values of the economic thought.

The new institutionalists emphasize the study of structures and the role played by organizations in the operations of the economies. The contributions of Amartya Sen to the theory of social election have as their main purpose that of integrating the application of the economy to politics. Hence, the system of interests of the members of society by means of non-mercantile decisions -in other words, those that are outside the market- lead to social well-being. We can no longer fail to recognize the existence of asymmetries of information that privilege some agents to the detriment of others, by means of the market. More recently, a widely shared vision that points at the fact that political factors are crucial for determining economic events, has acknowledged the heterogeneity of interests and conflicts between economic agents. This is the case, both on account of political preferences, and of aspects related to the distribution of the income. Finally, several experimentation techniques have evidenced that the behavior of the agents follows patterns that are contrary to those that have been specifically set forth by the orthodox thought that has been ruling the discipline.

It is worth remembering -as we did sixty years ago, in the midst of the euphoria that still prevailed after Bretton Woods- that Latin America was able to create a line of thought of its own, in order to interpret the problems of the region and to find solutions that were adapted to the region.

From this point of view, we can evidence the limited validity of the economic models that are being used and that set forth *a priori* that future relationships of the system are constant when they respect in time the continuity of those observed in the past. At the same time, they assume the stability of the technical coefficients and insist in showing truth under changing historical conditions.

In turn, structuralism enabled the study of phenomena ranging from inflation and distribution of income, to the role of the State, which included the recognition of the imperfections of the markets. This phenomena found due explanations in a theory that also privileged the long term as the time horizon that was capable of giving an answer to the necessary qualitative changes that are associated to the possibility of overcoming economic underdevelopment.

A key role was attached to the explanation of the economic behavior of the different social players. Furthermore, the latter was also historically conditioned and, as a result of this, was organized into a system of institutions that clearly represented both their interests and power.

Besides, one way or another, this phenomena are still present today and other new ones are coupled to them.

Currently, it is absolutely necessary to adopt a new theoretical approach in order to face up and assess the growing impact of internationalization on the inequity and the process of Latin American integration. These relationships -as the center of powers would like to impose- include the reduction of trade barriers, migration, capital flows, direct foreign investment and technology transfers. The differences between similar manifestations that were evidenced around the end of the XIX century and those that are taking place now, clearly point at the fact that, back then, there were convergent relationships between countries. In turn, that situation differs considerably from the current asymmetries, related to differences, not only with respect to the level of economic and technological growth, but also to the growth of the human capital and with respect to the price levels of the factors involved.

Within this new context, it is absolutely necessary to adopt the notion of human development as a core category, thus turning it into the strategic objective of the public policies and into their main element. Consequently, the mission of economy was turned into a reality and this is none other than being at the service of the human condition.

In this way, the origins of science are rescued along with the eminently social dimension of the political economy as a discipline that has, as its core aspect, the research on social relationships that are set up in the process of value generation. Therefore, the economy and economists would be at the service of human creation, thus enabling a dignified society for us all.

The notion of human development enables a global approach of the relationships of society. It is based on the consideration of social aspects as the element of a complex system of interactions that includes offering basic public services, as is the case of health, education and the generation of employment, elements related to the economic, institutional and legal conditions that are indispensable for eradicating inequalities. It is worth mentioning that, within that framework, price stability acquires this dimension of a public good.

In the areas mentioned above, the participation of the State finds specific fields of action that also require the contribution of other players in order to guarantee social well-being and so as not to turn common property into the less common and scarce among the properties.

In turn, structuralism enabled the study of phenomena ranging from inflation and distribution of income, to the role of the State, which included the recognition of the imperfections of the markets. This phenomena found due explanations in a theory that also privileged the long term as the time horizon that was capable of giving an answer to the necessary qualitative changes that are associated to the possibility of overcoming economic underdevelopment.

Currently, it is absolutely necessary to adopt a new theoretical approach in order to face up and assess the growing impact of internationalization on the inequity and the process of Latin American integration.

Within this new context, it is absolutely necessary to adopt the notion of human development as a core category, thus turning it into the strategic objective of the public policies and into their main element. Consequently, the mission of economy was turned into a reality and this is none other than being at the service of the human condition.

When the human being is posed as the object and subject of the economy, the model acquires another dimension and dynamics and it is absolutely necessary to assure integrity. In other words, it is necessary to set forth the conditions for offering equitable opportunities to the population, for fostering the deployment of their capacities and for facilitating citizen action, in order to achieve a wider and participative democracy, thus setting forth spaces for all its members.

Venezuela has taken up as a strategic option the commitment that is not possible to ensure a real process of change without a prior social equity. The road is not an easy one to follow, nor is it clearly delimited. As is the case of any other social process, it definitely requires political will.

This option is also inherent to the Central Bank of Venezuela and, in this respect, the Bank has been acting in the pertinent manner.

This conviction was also stated in the Message prepared for the closing of the year 2001:

This is an excellent occasion for insisting on the conviction that reforms that are associated to the exclusive attainment of macroeconomic balances are not enough by themselves to solve the problem of inequities. Hence, other transformations are indispensable and this must enable everyone to achieve these sustainable rates and to fulfill higher human development standards, along with the significant reduction of poverty. These transformations refer to what is institutional, in order to render feasible the structuring of a system of rules that defines the behavior of individuals and organizations. In this way, it would be possible to achieve more efficiency in the markets and administrations in order to generate favorable conditions for a productive investment.

THE LIMITS IMPOSED ON THE ACTIVITIES OF THE CENTRAL BANK OF VENEZUELA

Throughout all these years, the activities of the issuing institute have been completely in accordance with the Constitution of the Bolivarian Republic of Venezuela, with the law that rules it and with the policies that are the competence of its Board of Directors.

Under the notion of a democratic and social State framed within law and justice, the Central Bank of Venezuela safeguards the compliance with the principles of the social and economic regime that has been set forth in the Constitution. The latter are the base for macroeconomic stability, namely the fiscal balance and a wise level of public debt; autonomy of the monetary authority in exercising its functions and an adequate accountability mechanism; coupled to a transparent coordination of the macroeconomic policies with the National Executive Power.

As a result of what has been mentioned before, in order to exercise the monetary competence of the public power, the legal ordainment has entrusted to the Central Bank of Venezuela the functions aimed at formulating and executing the monetary policy, participating in the design and implementa-

The Central Bank of Venezuela safeguards the compliance with the principles of the social and economic regime that has been set forth in the Constitution. The latter are the base for macroeconomic stability, namely the fiscal balance and a wise level of public debt; autonomy of the monetary authority in exercising its functions and an adequate accountability mechanism; coupled to a transparent coordination of the macroeconomic policies with the National Executive Power.

Under such a notion, price stability is the foundation of equitable public policies that, as has been mentioned before, turns into a public right in order to implement a more general objective, which is that of a society that is worried about inequality and poverty, as well as about economic growth and the efficiency of its investments.

In this respect, the Central Bank of Venezuela has aimed all its decisions and activities at its main objective and at the principles for exercising public functions, while at the same time adapting the model of organization and functioning of the Institute and the decision-making process to what is set forth in the Constitution and the laws that rule it. In this way, it has further expanded its political and social responsibility as a modality for contributing to social change and democracy.

It is a matter of reconciling at every point in time the encouragement of a productive economic with the economic policies. This means combining a new modality for socially organizing production via the design and implementation of guidelines for harmonizing macroeconomic policies within a context that is characterized by consensus building.

It is necessary to insist that the structural change can not be analyzed simply on the bases of national accounts and the behavior of macroeconomic indicators. The basic premise is that a balance is not equivalent to accounts that cash up. The theory of games enables a practical approximation to this type of problems because it considers that the results are a consequence of the balance that is present in the strategies of the different players.

tion the exchange policy, regulating the currency, exclusively issuing the coins and bills, as well as managing and centralizing international reserves.

Under such a notion, price stability is the foundation of equitable public policies that, as has been mentioned before, turns into a public right in order to implement a more general objective, which is that of a society that is worried about inequality and poverty, as well as about economic growth and the efficiency of its investments.

In this respect, the Central Bank of Venezuela has aimed all its decisions and activities at its main objective and at the principles for exercising public functions, while at the same time adapting the model of organization and functioning of the Institute and the decision-making process to what is set forth in the Constitution and the laws that rule it. In this way, it has further expanded its political and social responsibility as a modality for contributing to social change and democracy.

It is a matter of reconciling at every point in time the encouragement of a productive economic with the economic policies. This means combining a new modality for socially organizing production via the design and implementation of guidelines for harmonizing macroeconomic policies within a context that is characterized by consensus building.

The challenge is indeed important because, as has been mentioned before, the Bank is designing a new management model that includes the possibility of overcoming the prevailing orthodox visions that led to a rupture between positive and the regulatory aspects of the economic analysis under exceptional circumstances when an in-depth transformation of the main economic structures is also being faced.

It is necessary to insist that the structural change can not be analyzed simply on the bases of national accounts and the behavior of macroeconomic indicators. The basic premise is that a balance is not equivalent to accounts that cash up. The theory of games enables a practical approximation to this type of problems because it considers that the results are a consequence of the balance that is present in the strategies of the different players.

This is precisely what leads not only to the significance of an agreement regarding policies, but also to role played by the Central Bank of Venezuela as an autonomous and independent organization that is fully independent when exercising its competence, that must inform about the results of its activities and policies and that must be accountable for all of them before society. Insofar as its activities are coherent with the message and the information that is furnished, it will be able to strengthen its credibility and will increase the prestige and the reputation of the Institute in the defense of the interests of the citizenship. This is where the monetary policy of the Central Bank of Venezuela can be inserted.

It is worth insisting that, on account of the objectives of the monetary policy, there is a need for an effective consistence with those more general objectives of the economic policy and, hence, there is a need to be very careful when determining what can be achieved, or not, with such a policy. In this respect, the criterion that the permanent encouragement of the real economy by means of the monetary policy is not a sustainable option is acquiring more validity. This is even more evident in the current conditions of uncertainty and deep social changes that are taking place in Venezuela.

For the Central Bank of Venezuela, the more general concerns start with the contrast between the ideal of a monetary policy that is fully coordinated with the fiscal policy and other components of the macroeconomic strategy –that are even recognized in the Constitution and in other laws– and the reality imposed by historical and structural characteristics in Venezuela. In this respect, mention can be made of the following: an open economy that is small though highly influenced by cyclical movements of the prices of oil, without any clear rules for the functioning of stabilization fund and where the fiscal policy plays a leading role conditioning monetary objectives.

The Venezuelan case is also characterized by important weaknesses with respect to the depth of its financial market. In turn, this erodes the credibility itself of the monetary policy and of the issuing institute. As stated by Professor Stiglitz, “...the absence of a specific market... has deep implications in the way in which other markets operate”, which could even lead to adverse effects on the level of living of society.

Besides, we can not forget that both the time horizon where the objective of stability that the Central Bank of Venezuela must establish, as well as the own goals of economic growth are also at stake and, in this respect, there should be full consistency.

In terms of economic governance, into would indeed be a mistake to center ideas only around the quality of the policies, without taking into due account adequate institutional structures that will make the markets more efficient. The restructuring of the institutional frameworks must be analyzed from the perspective of efficiency in adapting the social economic system to the transformations of the environment. Professor Douglass North insists in the clear differentiation that exists between economic growth and economic change.

Convinced of the need of going forward towards a new model of interpretation and management of the policies that are entrusted to the Bank, the 2002 Message stated as follows:

...has posed the possibility of counting on an agenda of research, modern and sophisticated analysis tools, simulation and forecasting; promoting modernization of the payment systems; analyzing more in depth the risk management and setting the bases for the consolidation of knowledge networks in issues related to the policies that are the competence of the Bank.

It is worth insisting that, on account of the objectives of the monetary policy, there is a need for an effective consistence with those more general objectives of the economic policy and, hence, there is a need to be very careful when determining what can be achieved, or not, with such a policy.

For the Central Bank of Venezuela, the more general concerns start with the contrast between the ideal of a monetary policy that is fully coordinated with the fiscal policy and other components of the macroeconomic strategy –that are even recognized in the Constitution and in other laws– and the reality imposed by historical and structural characteristics in Venezuela.

In terms of economic governance, into would indeed be a mistake to center ideas only around the quality of the policies, without taking into due account adequate institutional structures that will make the markets more efficient.

... [In this way] a model of management based on the approach of change in being consolidated. This model takes into account conceptual and organizational design criteria.

In the first one, the directors are based on the construction of a culture centered on learning, the adoption of an institutional management by results, based on the existence of clear rules of the game, acting principles and interaction mechanisms that reinforce the capabilities for maintaining the autonomy of the Institute, guaranteeing its sustainability and feasibility and facilitating transparency and accountability.

A very significant consolidation was attained in the political movement lead by the President of the Republic, which ensured the viability of the process for changing basic structures of society. At the same time, the national economy evidenced a significant improvement. All this was coupled to a contradictory international environment. On the one hand, mention can be made of the US military occupation of Iraq and the climate of violence and risk that this entailed. This brought about strong uncertainties in the oil market, thus leading to the effects evidenced in significant price increases. On the other hand, mention can be made of the recovery of the US economy with a cycle that is still uncertain, along with the strong growth of the economies of both China and India. This has had a positive influence on international markets. Venezuela, indeed, could benefit from that situation with expectations that go beyond the short term.

THE INTERNATIONAL ENVIRONMENT

The growing rate of expansion that has been evidenced in the world economy since 2001, led to an estimated rate of 5% in 2004. This accounted the maximum annual figure registered in 30 years. At the same time, the estimates of the world trade volumes point at an increase of 8.8% -almost 4 percent points higher than 2003. This enabled the strengthening of the regional integration processes when the intraregional and interregional trade gained significance and the general vulnerability with respect to the economic cycle of the United States decreased.

Even though the growth of the world economy has shown trends of being more sustainable and less volatile at the long term, there are still some risks related to the prices of basic products, due to the impact that the countries with an accelerated growth as China (9%) and India (7%) has on the world supply and demand. The production structures of China and India are based on less efficient energy consumption patterns as compared with the advanced countries. Consequently, this affects sensitive goods as is the case of oil –a fact that was evidenced in 2004, when the quotation of its prices reached nominal figures that had never been attained before.

During the year, the economy of the United States was still the one that had the strongest influence on the global performance. It grew by an estimate of 4.3% due to the raise in private consumption and the recovery of investments for the second year in a row. Its growth perspective could be compromised if the growing deficit in the balance of trade reaching almost 6% of its Gross Domestic Product is not corrected in an orderly manner.

The adverse effects of this external unbalance lead to a strong depreciation of the dollar. Furthermore, the consequence of this depreciation on the world economy could further worsen if no agreement is reached in multilateral fora with respect to an orderly alignment of the exchange rates. In this respect, it is worth highlighting a probable increase of external pressures on China, so that it modifies its current foreign exchange regime that has a fixed parity of 8.3 Yuans per dollar.

The growing rate of expansion that has been evidenced in the world economy since 2001, led to an estimated rate of 5% in 2004. This accounted the maximum annual figure registered in 30 years.

Likewise, special mention was made of the beginning of a restrictive money cycle in the United States, so as to moderate the rate of internal economic growth and restrain the inflationary pressures that are associated to the energy component. This action was followed by other central banks -among them, even that of China. This country faced for the first time in 9 years a 4% domestic increase in consumer prices per annum, as compared to the 1.2% registered in 2003, due to restrictions in the supply brought about by scarcity of inputs.

The growth of the economies of the United States and China was not followed by the economies of the Eurozone and Japan. This was due to the fact that the exports of the former were affected by the strong appreciation of their currencies against the US dollar and the Chinese Yuan, as well as by the deceleration of the global demand during the second semester. In the case of the Eurozone, a 2.2% increase of the real GDP in 2004 as compared to the 0.5% registered in 2003, is forecasted. However, during the third quarter, the annual growth rate dropped to 1.9%. As to Japan, the forecasted 4.4% growth for 2004 versus the 2.5% posted in 2003 has been weakening due to a limited increase of 0.3% per annum in the third quarter.

The renewal of a bullish cycle in the interest rates of the United States, starting in June, has exacerbated the concern about the fiscal deficit due to the fact that its financing is founded on external savings derived from the external surplus in current account. On account of this, there are higher risks related to a possible outflow of foreign capital from the United States debt market, in case the dollar continues to fall. Hence, the Federal Reserve could increase the interests rates to levels higher than the current ones (250 base points up to a 2.25%), which would end by affecting the growth of the US economy and, consequently, of the global economy.

On the other hand, the improvement in the exchange terms within an environment of acceleration in the growth of world trade, fully favored the economic performance of the developing countries, estimating a 6.6% increase in 2004, the highest in 20 years, vis à vis the 6.1% reported in 2003. Likewise, it enabled the strengthening of its payment capacity, while at the same time facilitating the implementation of debt restructuring processes under more advantageous access conditions. Furthermore, it had an effect on the notorious drop of country risk levels within the framework of a greater degree of discrimination against the emerging countries by the investors and a clear decrease of risk aversion in the international financial markets.

The latter could be evidenced despite the fears that preceded the start of a new monetary restrictive cycle in the United States, due to unfavorable behaviors that had lead to this political action in the sovereign debt markets in the past. This was influenced by the nature of the increases in the interests rate in the United States; the strengthening of the banking sector in emerging countries; the increase of international reserves and an improvement in the perception of investors with respect to the implementation of structural progress; less vulnerable growth sources based on the in depth analysis of the regional integration processes, and a far more diversified world market.

It is worth mentioning that the EMBI+ -the global reference index of the country-risk behavior in emerging markets- reached its lowest levels in seven years. Consequently, besides the progressive decline of the foreign debt percentages and the debt service payment with respect to the exports of the group of countries of emerging markets and developing regions, which were placed in 92.9% and 14.9% in 2004, vis à vis 111.3% and 17.9% in 2003, respectively.

The improvement evidenced in the country-risk levels of the emerging markets could overcome the political uncertainty generated by the war against Iraq that was started in March, 2004 by the United States. During the recent past, this climate of war confrontation favored the advanced countries, on account of the condition financial haven, to the detriment of the merging countries. On this occasion, this element fostered the purchases of gold and the increase in Euro and Yen denominated positions without any declines in the financial currents that flow towards emerging countries.

The prolonged military stay of the United States in Iraq, the continuous attacks against oil facilities by the Iraqi insurgents, coupled to the political instability that has been taking ground in key countries in oil aspects, as is the case of Saudi Arabia, led to the consolidation of a psychological war premium of near US\$ 15 in the oil prices.

The reduction evidenced in the past 20 years due to the global capacity of oil production also had an influence on the nominal price reached by oil in 2004. This has restricted very severely the total additional supply in times where a progressive increase in the demand for energy is gradually being evidenced at this point in time.

Likewise, the sensitivity of participants in the futures market, when faced with a greater possibility of interrupting the global crude supply, always affected the price of oil because it increased the speculation activity vis à vis many adverse news, coming basically from Iraq, Saudi Arabia, Nigeria and Russia.

MAIN MACROECONOMIC RESULTS

The domestic economy recorded an important reactivation expressed in the growth of 20.4% in the GDP until the third quarter, with respect to the same period of the year before. This is coupled to the reduction of inflation and unemployment figures, along with a level of gross international reserves at the BCV of US\$ 23.392 million¹. The recovery that was evidenced enables us to anticipate that upon closing 2004, the favorable results in terms of economic activity will compensate for the experimented losses that were evidenced during 2002 and 2003.

The domestic economy recorded an important reactivation expressed in the growth of 20.4% in the GDP until the third quarter, with respect to the same period of the year before. This is coupled to the reduction of inflation and unemployment figures, along with a level of gross international reserves at the BCV of US\$ 23.392 million¹. The recovery that was evidenced enables us to anticipate that upon closing 2004.

¹ Al 20 de diciembre de 2004

Main Macroeconomic Variables

| | January/September | |
|--|-------------------|-----------------|
| | At 1997 prices | |
| | 2004 / 2003(*) | 2003 / 2002 (*) |
| Gross domestic product (Variation %) | | |
| Oil Activities | 18.6 | (9.9) |
| Non-oil Activities | 20.0 | (11.7) |
| Other net taxes on products | 28.8 | (22.4) |
| Total | 20.4 | (12.3) |
| Unemployment ^{1/} | 13.7 | 16.7 |
| Inflation ^{2/} | 17.3 | 24.8 |
| Inflationary core (Variation %) ^{2/} | 19.4 | 35.4 |

(*) Provisional figures

^{1/} Figures by October

^{2/} Accumulated by November

Source: BCV.

The reactivation was related to the considerable expansion of the domestic aggregate demand (28.9%), expressed in significant increments of public and private consumption and investment expenses. In fact, the fixed gross investment was recovered from a similar level to that of 1989 in order to be equipped with that registered in 2002.

With the growing fiscal income coming from oil exports, the increase of public expenditures, together with the increase of banking credit, we were able to foster the aggregate demand and the internal economic activity. Consequently, it was possible to observe a reduction of the idle capacity and the boom of imports.

Aggregate demand

(Variation %)

| | January/September | |
|---|-------------------|----------------|
| | At 1997 prices | |
| | 2004/2003 | 2003 / 2002(*) |
| 1) Final consumption | 15,0 | (4,7) |
| Public sector | 14,9 | (0,9) |
| Private sector | 15,0 | (5,6) |
| 2) Fixed gross investment | 49,4 | (42,7) |
| 3) Domestic aggregate demand ^{1/} | 28,9 | (15,4) |
| 4) Exports | 18,8 | (17,8) |
| 5) Minus: Imports | 59,5 | (31,3) |
| 6) Aggregate Demand (3 + 4 - 5) | 20,4 | (12,3) |

(*) Provisional Figures

^{1/} Includes stock variation

Source: BCV.

The greatest sectorial relevance of the economic expansion was evidenced in manufacturing, trade, and financial institutions. These are sectors that, on account of its own nature, contributed to a higher degree of job generation.

The sustainability of the long-term economic growth with positive effects on the income and employment will be determined by the evolution of the investment and the capacity of the banking system for efficiently carrying out the intermediation of the financial resources in the economy. The decreasing trend evidenced in the investment expenses as a proportion of the GDP during the last two decades has led to a contraction of the capital baggage per worker, thus limiting the capability to generate economic activities and new employment sources. The reversion of this trend requires the implementation of a policy aimed at reducing the general volatility of the Venezuelan economy under conditions of price stability. In this respect, the economic policy and the institutional strengthening must be aimed at consolidating the bases, so that the recovery is sustainable in time, by means of persistent increases in the investment rate -as the one that was evidenced in 2004. In turn, this consolidated the bases for a greater internal integration with less external dependence and continuous decrease of the inflation rate.

In fact, the drop of inflation by 7.5 percentage points in a year, is related to the use of the exchange rate as the nominal anchor of the economy and the price control regime, which enabled us to maintain the inflation expectations that came from the last period of political confrontation and drops in the demand for money. It is worth emphasizing that certain indicators -the inflation core and the dissemination index- point at the fact that really, during the second semester of the year, the inflation deceleration required a dynamic which is pertinent to that associated to the higher offer and trust in the strengthening of the economy.

On the other hand, the policy of using the appreciation of the exchange rate as an anti-inflationary instrument is sustainable at a short term, by virtue of the availability of international reserves. This gives way to higher degrees of freedom for the design and execution of the economic policies that are aimed at recovering macroeconomic stability and at fostering social inclusion.

In this respect, beyond the legacy of exclusion and inequality in income distribution, inherited from the growth crisis of the last two decades, the reactivating thrust of the expansion of demand and its effects on the product, will have to be supplemented with employment policies (maintenance and expansion of the physical and services infrastructure) and poverty reduction that will have an immediate incidence on the real income -as is the case with the investment expenses in housing, education and health.

In view of the fact that the long-term economic evolution will be sustained with an increase in investments, thus constantly expanding the production capacity and employment absorption, it is absolutely necessary to consolidate the institutions that guarantee the provision of stable financial resources. In this way, it is possible to eliminate the current volatility that is associated with the dependence on oil income.

In fact, the drop of inflation by 7.5 percentage points in a year, is related to the use of the exchange rate as the nominal anchor of the economy and the price control regime.

Hence, it is necessary to supplement the financial savings of the public sector in the Macroeconomic Stabilization and Intergenerational Savings Funds as a provisional savings of society as a whole, so as to count at a mid term on a mass of stable economic resources contributed throughout the working life of the workers that can be aimed, both at restructuring the economy, and at funding the long-term investment.

Currently, there is evidence in Venezuela that the income of the poorest strata is increasing directly and proportionally to the volumes of economic activity. Consequently, ensuring the growth and the conditions of equity will enable access to a society with growing levels of well-being for all.

LATIN-AMERICAN INTEGRATION

At the end of the year 2004, it is the adequate point in time to welcome the creation of the South American Community of Nations (SCN) within the framework of the III Meeting of the Presidents of South America that was held on December 8th this year in Ayacucho, Perú. On that opportunity, the heads of state and representatives of twelve countries (Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Guyana, Paraguay, Peru, Surinam, Uruguay and Venezuela), subscribed the Declaration of Cuzco, by virtue of which the above mentioned community was created. The purpose of this initiative is that of developing an integrated space in the political, social and economic arena, in order to tend to the basic elements of our nationalities, starting from a shared history; the recognition of the preeminence of human rights and cultural plurality; the concurrence of common interests for developing one's own capabilities and improving international insertion; the encouragement of economic development along with the fair equitable distribution of income and the struggle against poverty. All this in tune with their different government democratic systems, a stronger participation of the citizens and a full transparency in all the transactions.

There are three basic pillars of the South America Community of Nations. They are the following: the definition of common policies between multilateral organizations; the integration of the physical infrastructure, and the convergence of the existing integration blocks (the Andean Community of nations and the Common Market of the South).

In terms of its Gross Domestic Product, the South American Community of Nations will be the fifth world power with an approximate GDP of one trillion dollars (of the United States) and annual exports for the amount of US\$ 190 billion. Its consumption markets will account for the fourth position in the world and its population is larger than 311 million inhabitants. In fact, the region is self-sufficient in energy. It has eight square kilometers of forests and holds a 27% of the drinking water of the planet. Besides, it shares the two major oceans (the Pacific Ocean and the Atlantic Ocean) and has the largest biodiversity in the planet.

The integrationist vocation of the Central Bank of Venezuela makes us feel proud of this very timely decision made by our governments.

Currently, there is evidence in Venezuela that the income of the poorest strata is increasing directly and proportionally to the volumes of economic activity. Consequently, ensuring the growth and the conditions of equity will enable access to a society with growing levels of well-being for all.

In terms of its Gross Domestic Product, the South American Community of Nations will be the fifth world power with an approximate GDP of one trillion dollars (of the United States) and annual exports for the amount of US\$ 190 billion.

The closing of the a year of great efforts and favorable results for the well-being of Venezuela enables us to anticipate with optimism the excellent years we will have ahead of us.

By the year 2005, several trends of economic indicators already forecast that we will able to continue progressing and consolidating achievements in the path of human development.

At an international level, where Venezuela has countless relationships due to historical and structural reasons, it could be foreseeable that the world economy evidences a strengthening of the deceleration that started during the second semester of 2004, due to the effect that the restrictive monetary policies that were executed during this year will have on the demand. This is coupled to the impact of higher oil prices, specifically in the economies with the lowest relative development, because they have a lower level of efficiency in the use of energy with respect to the growth of the GDP, as compared with that of the advanced countries.

These factors, coupled to the corrective measures that are derived from pressures generated by the devaluation of the US Dollar and the growth of the deficit, and to a lesser extent, by the deceleration that eventually can be anticipated in the economic expansion of China, would lead to a global growth of 4% in 2005 vis à vis 5% in 2004.

Nevertheless, the growing influence of China in the world economy will not be undermined. Hence, its economic relations in all foreign investment sectors will continue to flow when the process of worldwide industrial relocation will further strengthen itself and expand. The same progress will be evidenced in the processes of regional integration when an external multilateral strategy is consolidated in the case of many countries, in order to counteract the harmful effects of unilateral political actions.

The deceleration that is expected in the global demand would weaken the prices of the basic products, thus reducing growth and this might affect the currents of capitals that flow towards the emerging markets in search for higher yields, taking into account, as well, the fact that the interest rates will go up in the international financial markets. Despite this fact, the emerging countries have strengthened their financial position. In turn, this will enable them to overcome some deterioration in the balance of payments and maintain a considerable domestic economic performance in 2005.

The climate of geopolitical uncertainty of the year 2004 can further deteriorate in 2005, thus exerting an upward pressure in the oil prices due to the fact that it has not been expected that the current additional oil production capacity would be considerably expanded. Besides, it has been estimated that the world demand for energy will continue growing, although a slower rate than in 2004.

The results observed -together with an international environment that will be favorable for oil exports and an internal climate of political consolidation- enable us to anticipate that the economic growth will continue as the trust based on the increase in real public expenses and the restart of investments

is maintained. Therefore, it can be expected that the growth of the products will fall within the range of no less than 5%-6%, thus maintaining the trend towards the decrease in inflation figures. As the economic growth progressively incorporates the excluded population to the labor market and production, the economy will acquire a dynamics of its own, characterized by the increase in the average income, based on which, it will be able to encourage a virtuous circle that enables funding the accumulation of physical and human capital in the production units, which will result in a higher level of social well-being.

In this my last message, I would like to express my deepest gratitude to all the institutions and people that have been so kind as to offer us their collaboration.

Specially, I would like to thank the directors of the Bank, because all of us made a great team with an experience of more than 250 years in central banking. This fact is maybe unique to contemporary management. Likewise, their support and cooperation have been of great value in order to maintain at a very high level the ethical, moral and technical values of the Institution.

At the same time, I express my recognition to each and every one of my workmates, employees and workers for the effective and emotional support that they had the kindness to offer me.

Diego Luis Castellanos E.

Caracas, December 22nd, 2004

Therefore, it can be expected that the growth of the products will fall within the range of no less than 5%-6%, thus maintaining the trend towards the decrease in inflation figures.