SYSTEMIC RISK AVERSE FUNDS

SPINNING HPERINFLATION AT 6.5 MILLION TURNS

Venezuela increased its monetary base 6,556,765 times while losing most of its international reserves, over the last 19 years and devalued its currency from VEB 577 per dollar then, to VEB 8.7 billion now.

Stating historic Monetary Aggregates in traditional bolivars (VEB) at a log scale, helps us compare August 2018's total of VEB 66 quadrillion (VEB 66,700,874,507 billion) vs. February 1999's VEB 10,000 billion. Which took the true FX Rate to VEB 8.7 billion/$ vs February 1999's 577/$, and respectively versus 1976's VEB 48 million, and VEB 4.30/$.

Whatever reasons justified applying such a ruinous economic policy, becomes harder to understand, when one expands the study to include the 23 years prior to 1999, when a currency debasement of 134 times cannot even relate to the15 million times of the past 19 years

ANALYSIS AND POSSIBLE SOLUTION

At every moment and place, the ratio between the total stock of a resource and the money in circulation determines its price.

In Venezuela, this price is governed by the total amount of bolivars in circulation versus the total number of units of any good.

Hence, if we do not increase the supply of goods and services, but we raise the number or denomination of our banknotes (red line in the graph), we automatically raise the proportion of VEF per unit of material goods. Thus, we raise the price in VEF per kg, m2, mg, cc, etc. of all existing products.

Once described, this dynamic becomes obvious, but we must admit that, without knowing the size of the monetary aggregates or which of them is rising, we might think it is product suppliers who are raising their prices.

Yet, over time, we would realize that 100% of the alleged price rise was a mirror effect of Bolivar depreciation. It would become obvious then, that by forcing us to increase the number of bolivars needed to buy the same number of items, the government is carrying out a covert, yet massive Bolivar devaluation to transfer the cost of its growing fiscal deficit to us.

Unfortunately, to the extent that intermediaries (importers, producers, distributors, bachaqueros, etc.) do not manage to increase the price of goods at the speed at which the government prints new bills, they are pushed to replace inventory at a loss, which drives them to reduce and ultimately suspend their intermediation function.

Meantime, intermediaries who manage to survive and thus, postpone scarcity and a much higher escalation of prices, are vilified for their efforts.

In short, when the users of a currency understand that monetary expansion is meant to continue expropriating their productivity, hyperinflationary expectations set in.

At this point, stopping hyperinflation requires implementing two critical steps:

First
Restoring faith in the currency, to decelerate money velocity (the speed at which currency changes hands)

Second
Announcing an economic reform plan that explains how much money is required to cover a non deficitary annual public spending budget and how to finance the transition to that budget.

At a minimum, this announcement must include: the steps required to achieve it, what justifies each of them and the time estimate (therefore committed) to implementing them.

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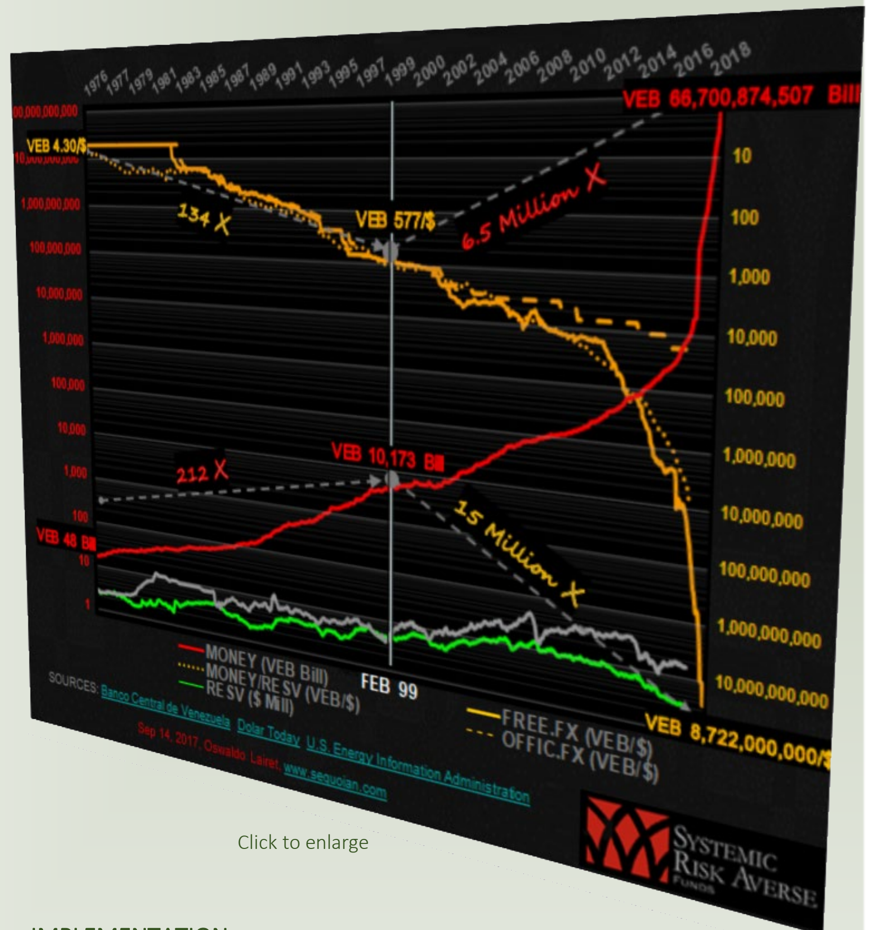

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IMPLEMENTATION

The only way to restore faith in the Bolivar is to make its convertibility to any currency and material resource unlimited. Succeeding with this announcement means convincing users prone to spend their bolivars as soon as they get them, to stop doing that.

Such an achievement implies a vote of confidence that would reduce money velocity long enough to implement the second step.

1st Step

There is only one solution to restore confidence in the currency: The model implemented by Bolivia in 1985 and by us in the late 80s: Slowing down money velocity by devaluing the Bolivar to an exchange rate low enough to be defensible with the amount of international reserves that truly exists in our central bank.

2nd Step

Along with the unlimited convertibility decree, the government team must develop the reform plan, by analyzing what exactly is the amount of funds required to finance long-term public spending and what are the immediate transition steps to achieve that arrangement:

- Giving priority to the poorest sector of the population
- Stimulating local and foreign investments in economic sectors prone to generate the highest amount of revenue in the shortest period
- Ridding itself of all state companies where private sector buyers can be subjected to carry the losses or to promptly pay all taxes on subsequent gains, while meeting all legal requirements, i.e., working conditions, health insurance, accounting standards, etc.

At the same time, the government should analyze any preferential financing offered by the global monetary-cooperation entities and their ability to certify to the Venezuelan people, the feasibility of its reform proposal plus monitoring its success/failure and timing vs. plan.