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VENEZUELA CURRENCY CRISIS: ANALYSIS OF THE CAUSES

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Abstract

Economic losses caused by currency crisis are spending the fiscal costs of restructuring the financial sector, a fall in economic activity, a distortion in distributable income, a decline in credibilityemphasize the importance of crisis prevention and the use of all available tools that can help in early identification of the financial weaknesses of the crises system. For this reason, some kind of systems could identify the vulnerability indicators or predict a currency crisis in order to take on time true measures to avoid the crisis.

The aim of the paper is underling the utilization of theoretical knowledge about currency crises and focusing on analyzing the causes for Venezuela currency crisis. the Evaluation of existing crises can explain the disruptions in the financial system or collapse of the exchange rate. Also, here we determinate the reasons and implications of Venezuela currency crisis, as the crucial role of the foreign exchange reserve for a country in such a circumstances.

Key words: currency crisis, factors, exchange rates, Venezuela.

1. Introduction

Currency crisis is a currency market disturbance where speculative foreign exchange strike leads to a devaluation or comes to a point when the authorities sell their foreign exchange reserves or raise interest rates to defend their exchange rate. Currency crises are usually defined in the context of the financial crisis, including a ban and debt crisis (Claessens and Kose, 2013). For the further analysis of currency crises, the definition of a banking and debt crisis is also important, which is mainly for two reasons. First, there are completely isolated cases of crises, since the characteristics of the currency crisis are often associated with other financial problems in the economy. For this reason, it is very difficult to isolate "same" currency crisis. Second, in many cases, some kind of crisis is developing into another type of crisis..

Utilizing theoretical knowledge about currency crises and focusing on the evaluation of existing theoretical models, over the last fifteen years, simultaneously were developed different theoretical models of currency crises in order to explain disruptions in the financial system or collapse of the exchange rate.

2. Literature review

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expectations and on a speculative attack on the basis of economic grounds. Therefore, the need to analyze political processes that lead to inconsistent policies and the currency crisis is crucial. Although these factors are often mentioned in the literature and are supported by empirical evidence (Eichengreen, Rose and Wyplosz, 1996; Bussiere and Mulder, 1999), the construction of the theoretical model is not yet satisfactory (Drazen, 1998).

3. Snapshot in the time of crisis

Foreign exchange reserves of the country have been reduced to $ 10 billion. The data from the Central Bank of Venezuela show that they have remained only $ 10.5 billion in their reserves. Combined with the fact that the country has a debt of $ 7.2 billion by the end of 2017. The oil-rich nation faces with enormous economic insecurity over the past 3 years in its currency- Venezuelan bolívar, went into a free fall as a result of hyperinflation caused by widespread corruption in government and the fall in the world oil price. In the fight against inflation, the Venezuelan government releases more bolivars into circulation, forcing civilians into money-laundered baskets to pay for basic goods. The country couldn't import food, drugs and other basic necessities.

In 2011, CNN announces that Venezuela's foreign exchange reserves are estimated at around $ 30 billion. In 2015, they are reduced to $ 20 billion. Recent reports show that about 3/4 of Venezuelan residents lose on average £ 19 as a result of a country's food shortage , and it seems likely everywhere no matter what economic future it is, citizens are prepared to suffer the most.

3.1. Reasons for facing Venezuela with currency crisis

Venezuela is home of the largest oil reservest in the world, even more then Saudi Arabia, but still faces with the largest social and political crisis in the world today. Around the 10th Century in acntient Venezuela, indigenous tribes discovered oil seeping through the land. Actual etxraction began much later. A huge oil well was discovered in 1922. When they drilled inside, oil came gushing out in a jet, rising more then 40 meters high, and it took them more then 9 days to contain it. Foreign oil companies rushed to the country to be part of all the action. The oil industry developed massively since then and soon began to overshadow the other sector in the country. By 1928, Venezuela became the largest oil exporter in the world.

The value of the Venezuelan currency increased rapidly, riding of the back on the single product, oil. But other industries i.e. their export suffered so much as countries found it very expensive to import from Venezuela. So, in this time global demand for oil was increasing, and during the Second World War, Venezuels were producing close to 1 milion barrels per day. Middle East began exporting large amounts of oil as well by 1950. Further, supply overshot demand and the prices began to fall. As a reaction, the oil producing nations of Venezuela, Iran, S. Arabia, Iraq and Kuwait met to decidewhat will be their strategy in future. So, these countries formed OPEC in 1960. The main aim of OPEC was to bring oil prices back up to reasonable levels by regulating the supplys. Export Quotars was placed on member actions to keep a check on overproduction. Oil prices continued to fall and in 1970 had reached the price of $3.4 per barrel.

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Next, war and internation turmoil the following decede changed this. In 1973 Arab Israeli war led to the Arab OPEC countries stopped trade with the US and other nations in response to their support for Israel.Then, global oil prices shot up to $34 per barrel by 1980 and the Venezuelans quadrupled their revenues. The oil industry was nationalized and people rejoiced, but for a short time. The OPEC members began breaking their production quota promises and produced more oil to take advantage of the high prices, but demand was decreasing as the world economy was slowing down.The effect from this was:led to and immense oversupply, or and oil glut and prices crushed again. By 1986, oil prices had reached a low of $14 per barrel and didn’t see a significant recovery until 1999.

Huge demand from developing countries such as India and China boosted global oil prices and gave the funds needed to pursue his economicstrategy. However, these strategies proved the be very unproductive in the long run.This time of Hugo Chavez began funding social programs with oil money which led to huge overspending. When he fell short he borrowed heavily.This was followed by Nicolas Maduro.Government regulations, takeovers, corruptions and rectricions on imports led to a hostile business environment and the death of private companies here. Oil prices have been falling since 2014 and Venezuela is facing one of the largest social crisis in the world today. The inflation rate here is the highest in the world and the country is heavely debt ridden. People have money, stores remain empty. There is a huge shortage of food, medicine and other daily supplies. Crime rates have gone up. The boon of the 20’s has turned in to a bane today.

4. Venezuela Crisis circumstances in 2017

In March 2017, Venezuela announces a new exchange rate due to resolving the crisis. Maduro reports that a living oil-rich country announce a new course which will increase the DICOM exchange rate, one from the two official Venezuelan courses. Residents buy most of the necessary goods on the black market. Venezuela is an example where she has had numerous foreign exchange rates over the years and none of them is in line with the black market.

After the DICOM exchange rate, the Venezuelan Bolivar trades around 710 US dollars, and 10 under the Dipro course that is the official exchange rate of Venezuela. Incredibly low foreign exchange reserves, high inflation, oil owed to China, 4- digit inflation and humanitarian crisis,are enough reasons to conclude that the problem hard to resolve soon. Venezuela has taken loans from Beijing in exchange for the belief in profoundly-directed exports of the oil. In 2016 Venezuela has reached inflation on unbelievable 800%. IMF predicts inflation of 1600% in 2017.

In Venezuela there are four types of exchange rates:

1. CENOEX (for basic food and medicine)

2/3. SICAD I
SICAD II provide dollars to companies which import all other goods.

Due to the fact that US Dollars are limited, coupons are auctioned temporarily ie weekly in the case of SICAD I and daily for SICAD 2.

Due to the poor crisis these two courses are not in use since 18 August 2015.

4. The latest and newest is SIMADI (200 bolivars per dollar).

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reserves, it receives a payment in the form of a domestic currency, which keeps it outside the turnover as a means. Also, the reliance on the exchange rate can not last forever, both in terms of the reduction of foreign reserves, as well as economic and political factors, such as the increase in unemployment. Devaluing the currency through an increase in the fixed exchange rate results in domestic goods being cheaper than foreign, which increases demand for workers and increases the output. In the short run, devaluation also raises interest rates, which must be settled by the Central Bank by increasing the money supply and increasing foreign reserves. As it is mentioned above, earlier the suspension of the fixed exchange rate can "eats" through the foreign exchange reserves of the country quickly, and devaluing the currency can bring back the reserves.

6. Conclusion

A currency crisis is brought on by a decline in the value of a country's currency. This decline in value negatively affects an economy by creating instabilities in exchange rates, meaning that one unit of the currency no longer buys as much as it used to in another. To simplify the matter, we can say that crises develop as an interaction between investor expectations and what those expectations cause to happen.

The economic theory did not encounter any specific definition of the currency crisis that is acceptable as universal definition. However, when we think about currency crisis the first thing we recall is a massive escape of investors from the currency for which they fear will depreciate thus affecting that this devaluation to really happen at a more financial repressive dimension than usual. In such a situation currency loses its stability and confidence, and if there are no sufficient international reserves then this can result in serious financial crisis.

The prediction when a country enters a currency crisis involves an analysis of various i.e. complex ranges of variables. There are several common factors that relate to recent crises: the countries borrowed a lot (current account deficits); the value of the currency is rapidly increasing; the insecurity associated with the Government's activities makes the investors nervous. The high level of public debt increases the cost of defending the exchange rate, but increases the dangers of speculative attacks. A high unemployment rate leads to difficulty in defending the exchange rate with a higher interest rate. The fact that the government will not tolerate a high unemployment rate may lead to currency depreciation (Lestano and Jacobs, 2007). When the expectations for the devaluation embedded in the nominal interest rate, the greater the interest cost of the debt will lead to an increase in the cost of maintaining the exchange rate. Speculative attacks can occur even when the currency is overvalued. The overvalued currency causes current account deficits, and in some cases deflationary pressure that leads the monetary authority to assess that the cost of defending the exchange rate is greater than the benefits.

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