

Expansion of the monetary cone: a cash crisis in a Venezuela under hyperinflation

This note explains the new monetary measures carried out by the Maduro regime to alleviate the payment crisis suffered by Venezuela in its fourth consecutive year of hyperinflation in a context of greater uncertainty and worsening of the economic crisis due to the COVID-19 pandemic.

In November 2017, for the first time in its history, Venezuela went into hyperinflation by registering monthly inflation rates of 56.7% between October and November, reaching an annualized inflation of 1,350.3%¹ compared to the same month in 2016. The implementation of the exchange control system, which the predecessor Chavez regime put in place in 2003, is an important contributing factor to this phenomenon. This system allowed public companies (especially the state oil company PDVSA) to contract large deficits², later financed with money issuance by the Central Bank of Venezuela. The situation was aggravated as oil prices dropped in 2014 and oil production started to collapse in 2016, limiting the ability of the oil industry to create the necessary revenues and increasing its dependency on the monetary financing from the Central Bank. As larger shares of the deficits were financed by money creation, inflation started to significantly increase, and the government's financing needs further increased, leading to an unsustainable macroeconomic process that culminated in the hyperinflation from which Venezuelans have been suffering since late 2017.

In this situation, the access of Venezuelans to cash has been negatively affected. Consequently, Venezuelans not only face the challenge of a currency with no purchasing power but also a currency that is scarce, affecting simple transactions like taking public transportation. By 2020, according to the data provided by the Central Bank of Venezuela, only 2.2% of monetary liquidity was represented by the coins and banknotes put into circulation, while 86.6% were transferable savings deposits³. Another aspect to highlight has been the increase in operations carried out in foreign currency (especially in US dollars), which for March have reached 67.1% in 10 of the most important cities in Venezuela⁴.

The same problems, the same remedies, even worse results

In June 2019, the Central Bank of Venezuela announced the expansion of the country's monetary cone by adding three high-denomination banknotes, with the aim of "making the payment system more efficient and facilitating commercial transactions"⁵. At that time, given the drastic decrease in aggregate demand and low economic activity due to prolonged power blackouts throughout Venezuela, the speed of inflation had slowed significantly, registering in that month 24.8% compared to the previous month, which in turn was about 117 percentage points lower than at the end of 2018⁶. At the end of that year, as can be

¹ Source: Commission of Finance and Economic Development of National Assembly of Venezuela.

² Guerra, J. Las cinco grandes hiperinflaciones en América Latina. In Vera, L. & Guerra, J. (2019). *Inflación alta e hiperinflación: miradas, lecciones y desafíos para Venezuela*. Universidad Católica Andrés Bello. Caracas, Venezuela.

³ Source: Central Bank of Venezuela, own calculations.

⁴ See: <https://www.americaeconomia.com/economia-mercados/finanzas/crece-la-dolarizacion-informal-en-venezuela-el-67-de-los-pagos-de-bienes>.

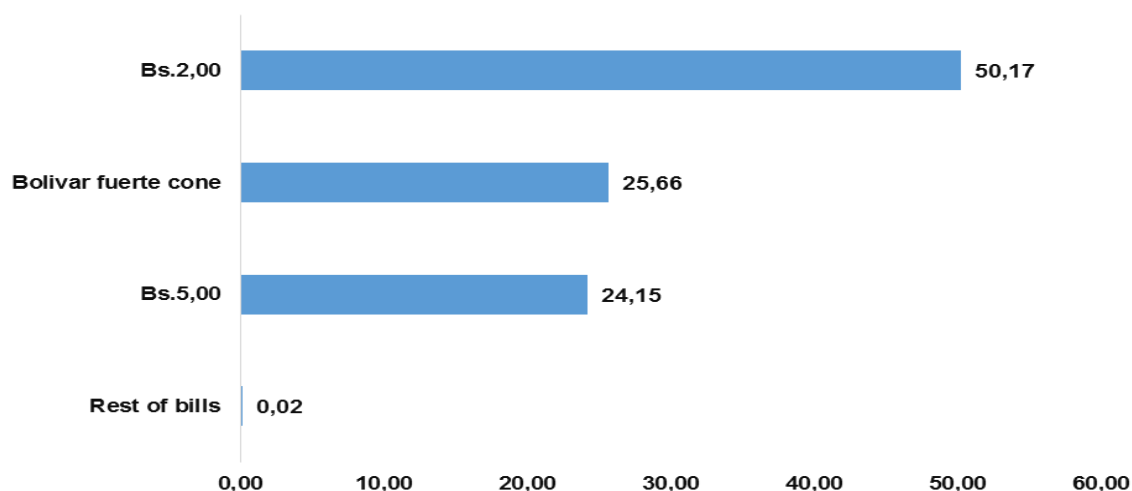
⁵ See: <https://www.bbc.com/mundo/noticias-america-latina-48618549>.

⁶ Source: Permanent Commission of Finance and Economic Development of National Assembly of Venezuela, own calculations.

seen on Figure 1, the banknotes of lower denomination (those of Bs. 2 and Bs. 5) represented more than 70% of the total of banknotes in circulation in the Venezuelan economy in contrast with those corresponding to the new monetary cone, which represented less than 1% of the total. This change did not solve the basic problem of cash availability and the Venezuelan population continued to use deposits as means of payment (representing 92.36% during 2019). In addition, the new value notes lost their purchasing power very quickly, given that in 2019 inflation closed at 7,347.4%⁷.

Chart 1

Percentage of banknotes of the monetary cone for year 2019



Source: Central Bank of Venezuela, own calculations.

By early March 2021, on the eve of the first year of the pandemic in Venezuela, the Central Bank of Venezuela (which is controlled by the Maduro regime) announced that it would introduce three new higher face value pieces in the Monetary cone, with the largest of these having a value of Bs.1,000,000 (the equivalent of about US \$ 0.54⁸). These changes were like those introduced in Zimbabwe during the Mugabe regime when in 2008 the Central Bank of Zimbabwe issued a bill whose face value was ZW \$ 100,000,000,000 in the context of an aggressive hyperinflationary process⁹, where prices reached an average growth of 156.964%¹⁰ at the end of that year compared to the previous year.

In other words, the introduction of new bills to the monetary cone is just another indication that the hyperinflationary outbreak that Venezuela is going through is not close to ending. Among the reasons is the lack of credible policies by the Maduro regime, due to a combination of lack of technical knowledge and lack of political will to stop the monetization of fiscal deficits. Even though monthly inflation during March stood at only 9.1%¹¹, this does

⁷ Source: Central Bank of Venezuela, own calculations.

⁸ Source: Central Bank of Venezuela, Federal Reserve Economic Data, own calculations.

⁹ See: <https://www.theguardian.com/money/2016/may/14/zimbabwe-trillion-dollar-note-hyperinflation-investment>.

¹⁰ Source: International Monetary Fund database.

¹¹ Source: Venezuelan Observatory of Finance.

not represent a response to a policy of revitalization of the domestic supply or a significant increase in the purchasing power of the bolivar, but rather stems from purely seasonal factors¹².

The most likely scenario is that inflation will resume its growth path¹³ in the coming months, due to the monetary expansion to finance increases in wages and salaries (which are expected for the coming month of May via presidential decree), leading to an accelerated devaluation of the local currency.

To conclude, the changes in the monetary cone will not contribute to the deceleration of hyperinflation in Venezuela, since there are still no indications that the Maduro regime is willing or able to carry out the set of measures necessary to stabilize prices and reactivate the economy. In addition, as it has happened since 2019, the new currency denominations will not be enough to compensate for the lack of means of payment in cash in local currency for the population, as well as the progressive disappearance of the rest of the banknotes that make up the monetary cone.

¹² In this case, the payments of Income Taxes in Venezuela, which are made during the same month.

¹³ For example, in the same year as the introduction of the new monetary cone, inflation recovered its growth path until reaching a maximum of 65.2% inflation in August (source: Permanent Finance Commission of the National Assembly of Venezuela, own calculations).