

MARCH, 2018

## VENEZUELA UPDATE

### SUMMARY

**Venezuela is facing a difficult economic situation.** GDP growth has been contracting; inflation has been very high, net international reserves have declined to historic lows, the fiscal deficit has been widening and crude oil, the major export earner for the country, has experienced a consistent decline in production and output over the last decade or more. These factors have combined to weaken Venezuela's ability to pay its debt obligations on time and in full.

**US sanctions** preventing Venezuela from issuing any new bond further exacerbates the situation. It is difficult for a country to take money from its coffers to pay out all of its outstanding debt. Hence countries normally pay down some of their debt at maturity from their own resources and issue new bonds to help to finance the remainder. With US sanctions currently in place the option to issue new debt has been severely constrained.

**Willingness to pay is also an issue;** ongoing political polarization, street protests, suppression of citizens' rights and the refusal to hold free and fair elections by international standards weighs heavily on the government. This has led to anger and annoyance among the populous with the leadership blaming the United States for the current instability.

The above mentioned factors have combined to put pressure on the government from all angles. **This has resulted in a track record of inconsistent and untimely debt payments since November 2017.** President Maduro announced on state television that after the payment of the maturing 2017 global bond on November 2, 2017, the country would be entering into negotiations with external creditors regarding a restructuring of debt obligations.

It should be noted that while the government has spoken publicly about default on external debt, we are of the view that there is a high probability that local currency denominated debt will also come under similar default pressures.

**The political situation is therefore difficult and the government's actions have led to widespread condemnation and sanctions from many countries and international organizations.**

The political situation is a bit more difficult to call as protests have been ongoing for some time. The ruling **Partido Socialista Unido de Venezuela** (United Socialist Party of Venezuela or PSUV) has used its power to effectively water down the strength of the highly fragmented opposition parties. The opposition parties won

Congressional elections in December 2015; however the PSUV utilized its executive and judicial powers to circumvent the Congress.

The law was used to reroute power from the congress to the National Constitutional Assembly (NCA) which is now in the process of rewriting Venezuela's Constitution. Further, in instances where the opposition has withdrawn from elections due to allegations of fraud (October 2017), the court has ruled that those parties who did not participate in the elections would be barred from participating in any upcoming elections.

## **WHILE THE SITUATION IS DIFFICULT IT IS NOT IMPOSSIBLE FOR A TURNAROUND TO OCCUR**

The recent upward movement in oil prices to "US\$60+" per barrel from a low of US\$39.30 in January 2016, is a major plus for economic stability and needed revenue inflows. Venezuela continues to negotiate with Russia, India and China for alternate sources of financing and crude oil sales. Additional financing may also be sourced from other private or official creditors though this step would require a turnaround in the stance of the ruling administration.

## **CONCLUSION**

Venezuela is facing significant challenges at this time. The country has defaulted on its debt by missing interest payments in the January to March 2018 period. The government met with creditors / lenders on November 13, 2017 to discuss a possible restructuring. However, at that meeting no details were suggested or offered to lenders. The government did not suggest if they would extend maturities, reduce coupon/interest payments, issue new bonds, reopen exiting long dated bonds or offer creditors a choice of a combination of all four options.

As noted previously, we believe that private discussions involving China, Russia and India may be ongoing. Alternate arrangements to remove the US as the major purchaser of Venezuelan oil is likely being negotiated and with oil prices climbing to US\$60+ per barrel, the dark clouds could have a silver lining. The problem however is that there is no communication coming from the government.

Given the political challenges domestically coupled with upcoming presidential elections scheduled for April 22, 2018, it is unlikely that a lot will be done on the debt management side until after the elections.

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