Venezuela: Sliding into a Generalized Default

*By Arturo C. Porzecanski**


Venezuelan bonds from 1896. / icollector / Creative Commons

The Venezuelan government is now officially in default – per the leading credit-rating agencies (Fitch, Moody's, and S&P) and the International Swaps and Derivatives Association (ISDA) – and seems to have no viable way out. It has been three months since interest payments on various dollar-denominated bonds issued by the government and the state-owned oil company, PDVSA, have been late or not paid, with the total of coupons currently in arrears exceeding $1 billion.

- In early November, President Nicolás Maduro announced that he would seek to restructure debt obligations, while suggesting the country would keep making payments during negotiations. As proof of his good intentions, he soon after paid a hefty $1.1 billion redemption payment on a PDVSA bond. However, since a perfunctory meeting with some bondholders in mid-November, investors have not heard anything.
- The government has blamed its precarious financial position on technical difficulties arising from financial sanctions imposed by the U.S. government – "the ongoing aggression, permanent sabotage, blockade, and financial persecution to which our people have been subjected" which "are in fact hurting the bondholders in international financial institutions."

Once attempted, Venezuela's debt restructuring – some $37 billion in government debt and $28 billion in PDVSA debt – could potentially become the world's fourth largest, according to Moody's. A future restructuring could encompass $65 billion (plus interest arrears), compared to Greece in 2012 ($262 billion), Argentina in 2001 ($83 billion), and Russia in 1998 ($73 billion).

- Restructuring negotiations with Venezuela will be difficult because the country owes at least another $65 billion to domestic bondholders, lenders from China and Russia, foreign airlines, banks and foreign suppliers, as well as foreign investors waiting to be compensated for nationalized properties. Another complication is that the validity of some debts could be challenged, especially by an eventual successor government, because not all received proper authorization (e.g., from the National Assembly). Also, investors will be reluctant to grant meaningful debt relief unless the country's capacity to honor the new obligations is substantially augmented, such as by taking drastic actions to revive the crumbling oil industry. Finally, current U.S. sanctions would need to be relaxed to enable American investors to take possession of new government bonds from Venezuela incorporating the agreed-upon concessions (e.g., on maturity and coupons), in exchange for retiring the existing bonds – as per standard practice in debt restructurings.
- An outbreak of disruptive litigation against Venezuela is a significant risk because the indentures of outstanding bonds specify that any disputes that arise are to be settled by U.S. rather than Venezuelan or international courts. Impatient creditors with favorable court judgments could make it difficult for Venezuela to keep repatriating oil export earnings home. As the Argentina-related litigation and arbitration saga demonstrated, it is possible, though not easy or quick, for private investors to collect from a deadbeat government.

Maduro's widening default is but the latest casualty of his and Hugo Chavez's maladministration of the economy and public finances. Government revenues relative to GDP are now less than half their level in 2013-14, while government spending is still running well above the levels of four or five years ago. As a result, the fiscal deficit is now a whopping 25 percent of GDP and is financed mainly by the Central Bank, feeding hyperinflation. A drop in oil production to its lowest level in three decades – a mere 1.8 million barrels per day as of late 2017 – and lower world prices have caused oil export earnings to shrivel up from almost $95 billion in 2012 to less than $30 billion in 2017 – a $65 billion drop. Not even a drastic cut in government dollar sales for import purposes, which has provoked an unprecedented $50 billion compression of imports (from $65 billion in 2012 to about $15 billion in 2017) has been able to offset the calamitous fall in exports. The default is also rooted in Venezuela's gradual loss of its ability to sell new bonds abroad to replace maturing obligations and to help cover the interest bill. Without the benefit of raising any fresh bondholder financing during 2017, last year the government would have had to come up with $10 billion out of pocket in order to cover all debt-service obligations to bondholders. The equivalent debt-service figures for this year and next are on the order of $9 billion each – realistically, a "Mission Impossible" absent much higher oil production and prices. The Trump Administration's sanctions, forbidding U.S.-based investors to purchase new Venezuelan government bonds from August 25 on, were just the last nail in the external financing coffin.

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