

Making change

By Girish Gupta

Venezuela's financial woes are plain to see on arrival at Caracas' Maiquetía international airport. Hawkers vie for hard currency, offering more than three times the official exchange rate of 6.3 *bolívars fuertes* (VEF) per US dollar.

But it's not only the hawkers who are after foreign currency. Venezuela's government faces a severe shortage of dollars.

In February, Venezuelan authorities devalued the *bolívar fuerte* by 31.7% to bring down a budget deficit that had been forecast by analysts at more than 9% of GDP this year. But the concern is that the action will do little to meet growing demand for hard currency to pay for imported goods – and could stoke yet more inflation, already at rates of over 20%.

"It's very worrying that with oil at over \$100, the country hasn't managed to put in order its fiscal situation in a very distorted economy," says Carlos Bellorin, oil and gas analyst at Petroleum Economics and Policy Solutions for IHS in London.

Last year, Venezuela's president Hugo Chávez won his third six-year term with a spending spree that nearly tripled the budget deficit. Despite his return to Venezuela in February from Cuba, where he had been undergoing two months of treatment for cancer, whether he is able to return to the presidency remains in doubt. Fresh elections would ensue should Chávez be declared permanently unable to govern.

Outperformer

Venezuelan bond yields in part reflect a view on the socialist president's future. When Chávez announced in December that his cancer had returned, the yield

Despite devaluing the *bolívar* in February, Venezuela's chronic dollar shortage continues. Another devaluation may well be on the cards



A bird in the hand: Venezuela devalues

on Venezuela's dollar-denominated 2027 benchmark bond fell to a five-year low. Investors, hoping for a more market-friendly government, pushed its price up to nearly 103 cents on the dollar. Venezuela's bonds have been the third best performing of any emerging market over the past 12 months, after the Ivory Coast and Belize, according to the JPMorgan EMBIG index.

"There's a morbid inverse relationship between Chávez's health and bond prices," says Kathryn Rooney Vera, senior strategist at Bulltack Capital Markets.

But an end to Chávez's presidency does not guarantee an end to the country's economic policies. "Chavismo will probably last generations. It will not

die," says Alberto Ramos, head of Latin America economics at Goldman Sachs. "The death of Perón was not the death of Peronism in Argentina."

The high yields on Venezuelan bonds, especially compared to developed markets, have long been attractive to investors. The Chávez administration has not defaulted on a payment. Nevertheless, some analysts are starting to caution against buying Venezuelan bonds now they are trading above par.

"We recommended this bond back in early December with the view that there was going to be imminent regime change," says Rooney Vera. "At that point it was trading below par. We're not recommending entry at current levels."

Issuing bonds would be one way of bringing in more dollars to the country. In 2011, Venezuela sold \$17.5 billion of debt, the largest issuance in Latin America that year. In 2012, it sold none. “We expect bond sales during 2013,” says Ángel García Banchs, director of Caracas-based consulting firm Econométrica.

Dollars are hard to come by for both individuals and companies, who have limits on exchanging currency officially.

To ease the pressure, a bond-mechanized exchange known as Sitme (Transaction System for Foreign Currency Denominated Securities), lowered the effective exchange rate. But that was scrapped with February’s devaluation, worrying some. The only supply of hard currency to the corporate sector will be through official channels, further centralizing foreign exchange, says Ramos.

Venezuela has devalued the *bolívar* five times since Chávez first introduced currency controls to prevent capital flight. More announcements could be ahead. Another devaluation could further

mitigate the dollar shortage, but it would be politically unpopular — and elections may be ahead.

“Another 20%-plus devaluation later this year or early 2014 is definitely in play as inflation is expected to reach 30% this year, which will erode the gains from this [recent] devaluation,” says Ramos.

The underlying factors behind the *bolívar*’s weakness have not been addressed, he says. Central bank data indicated that inflation in 2012, while down from 27.6% in 2011, was still at 20.1%. However, others believe that much of the effect of the weaker currency has already occurred. Michael Henderson, Latin America economist at Capital Economics in London, says the inflationary impact of the devaluation will be limited. “This will certainly put upward pressure on inflation, but for those thinking it will sky-rocket above say 30%, I’d tend to disagree.”

Oil wealth

In any event, the government still has

access to hard currency through its substantial oil revenues. “[PDVSA] pay people in *bolívares* and they get paid in dollars,” says Dallen. “They could easily provide more dollars to the [black] market to drive it back down if they wanted to.”

The devaluation is also a boon for PDVSA: the state-owned oil exporter will have more *bolívares* to pay its bills and to invest, without having to increase debt issuance. PDVSA’s chief oil minister Rafael Ramírez in January announced a shakeup in Venezuela’s oil windfall tax. This will add \$3 billion to central bank coffers.

“There is enough foreign currency to sustain the national economy,” he insists.

Confident that any other government will be more market friendly than Chávez’s, investors are likely to continue piling into Venezuelan debt. But some fear that risk may soon outweigh the rewards. “Put simply, the government has two years to eliminate the imbalances and change the path of the Venezuelan economy,” says García Banchs. “Otherwise, things could get really bad.” **LF**



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