

## Venezuela Trip Notes

**No Whiskey. No Food. No Bond Payments?**

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David Austerweil recently returned from a trip to Venezuela where he met with government officials in order to assess the current political, financial, and social environment. While the country has been a long-term area of investment for VanEck, concerns surrounding Venezuela's debt service, trade balance, and ability to feed its citizens have become more pronounced.

- Venezuela must choose between paying bondholders and feeding its citizens. It seems the decision has only been so difficult for this long because the government is one of the largest holders of its own debt and is afraid of creditors' attempts to seize exports in the event of a default.
- A default on the February maturity is not priced into markets. While it remains unlikely, it is no longer impossible even as it carries tremendous direct (mark-to-market) costs to the government. The Petr leos de Venezuela, S.A. (PdVSA) pension fund reportedly owns the majority of this maturity in face value.
- President Nicolas Maduro's government continues to exercise almost complete control over domestic institutions even as it attempts to place some burden of responsibility on the opposition-controlled National Assembly. Meanwhile, the opposition remains divided over who among its ranks will ultimately rule Venezuela as the country descends into profound instability.
- It is difficult not to feel extremely sad over the acute humanitarian crisis that is developing. Recovery values, although they could be high, may be a long time coming.

The vast majority (currently 90%) of Venezuela's exports are oil while more than 75% of Venezuela's food is imported. The value of exports in 2016 will be approximately \$20B (based on \$25 oil) with expected 2016 imports valued at \$30B, although there may be room for \$5B of additional import compression. Debt service payments will be approximately \$10.1B in 2016 plus \$2.3B in likely enforceable International Center for Settlement of Investment Disputes (ICSID) payments that cross default. The government sold assets in 2015 to plug the gap but outside of domestic gold reserves, the cupboards are now bare.

Quite literally, Venezuela today exchanges oil for food. Importers stressed frequently during the trip that there was just no hard currency left to import food. For the first time, there were hints the government could prioritize food purchases over debt payments. The fear is that once store shelves are completely empty, there could be a social explosion accompanied by riots and desperate, hungry people will loot the homes of the middle and upper classes (virtually the only places stocks of food can be found). In this scenario the military could feel compelled to restore order and if successful, either call for presidential elections or take power themselves.

Maduro's government has aggravated the situation further by relying on socialist dogma and inaction to guide its economic policy, thereby leaving huge opportunities to unscrupulous rent seekers. This has contributed to inflating import costs. The most recently appointed economic team, led by Vice President of Economy Luis Salas, has a ministry to appease every government faction but no one appears to have clear ownership of a policy portfolio. While there were rumors of an imminent devaluation and gas price hike (just like last year), the most likely outcome is more indecision. Meanwhile, the opposition-led National Assembly has given up its supermajority and is ostensibly neutered following the court-mandated removal of three congressmen from Amazonas.

We expect two basic scenarios for what comes next. In the first, Maduro stays in power until 2019 and the economy becomes like Cuba, isolated and subsistence oriented in nature. In the second, there is a social explosion where the military restores order and is the arbiter of some future government arrangement. In both cases, bond prices will likely not fare well initially and future potential recovery values are polar opposites: either basically worthless paper in the first scenario or almost par in the second.

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