November 20, 2014 - N°145

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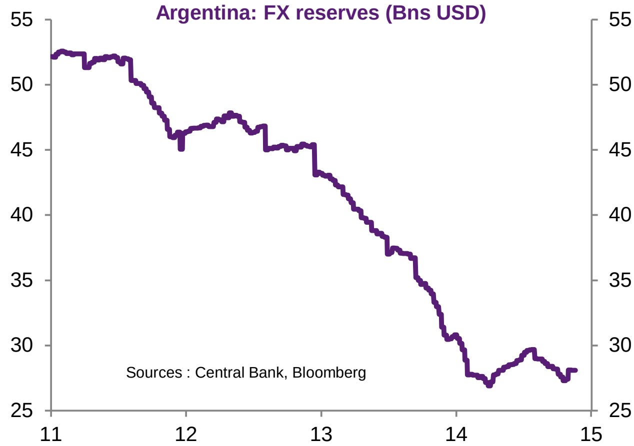
Argentina and Venezuela: should I PAY or should I not?

Argentina and Venezuela caught our attention this week. The level of foreign currency (FX) reserves increased miraculously in both countries thanks to China. Argentina's reserves rose by 500 Mns USD while those of Venezuela by 2 Bns USD. The levels of their FX reserves are a source of concern for the market. We try to assess the amount of time they can buy, if they use them to serve their international bonds. The main question in both countries is the magnitude of potential liabilities in front of relatively scarce resources. Argentina has the money but not the willingness to pay. With their current FX reserves they can serve 29 months of international bonds. But contingent liabilities could blow up this equation if they have to pay their debts in full. Venezuela on the other hand is able to pay 47 months of international bonds with its FX reserves but only 9 months if we exclude gold. As usual metrics are not very useful in case of social unrest or external shocks but you cannot say we did not warn you.

1/ Argentina: not willing to pay, but until when?

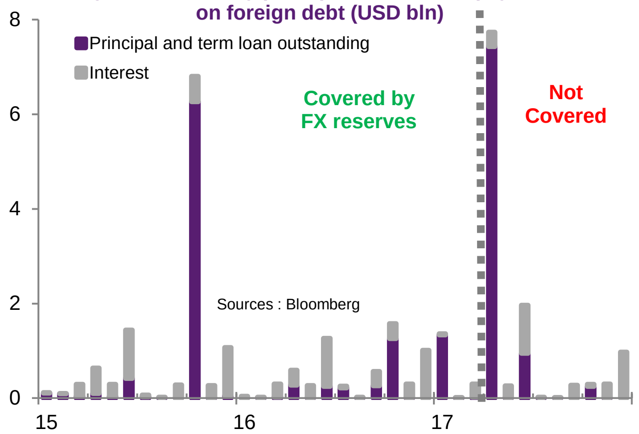
It is important to do the math correctly between reserves and debt in the case of Argentina. Liabilities are well known. For this piece we assume a 100% roll of local debt and the use reserves to honor international bonds. Argentina needs to disburse 11.4 Bns USD in 2015 (7.1 in capital and 4.3 in interests) and 6.0 Bns USD in 2016 (2.1 in capital and 3.9 in interests) to service its bonds in foreign currency.

Chart 1
Argentina: FX reserves (Bns USD)



The country's total FX reserves reached 28.1 Bns USD according to the central bank (Chart 1). **Argentinean authorities can therefore cover payments of international bonds until April 2017** (Chart 2). Besides FX reserves, it is important to bear in mind the recent 11.0 Bns USD swap agreement for 3 years with China from which Argentina borrowed 500 Mns USD this week after a first swap of 814 Mns USD on October 30th. Moreover, as the country is unable to sell bonds abroad, it has become more dependent on exports notably primary goods and manufactured agricultural products (59% of total exports). Soybeans prices have declined by 34%, corn by 27% and wheat by 29% since May.

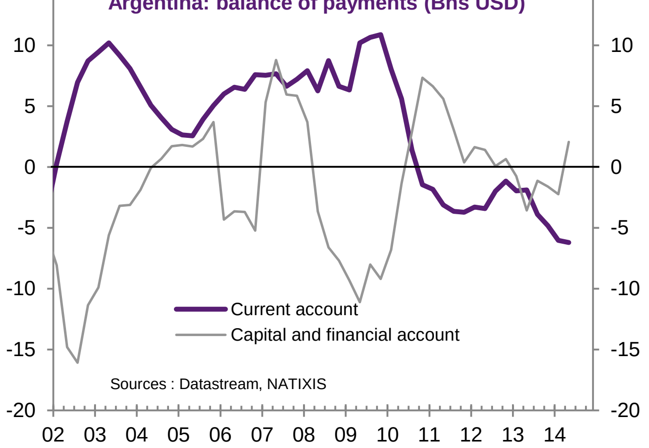
Chart 2
Argentina: monthly principal and interest payments on foreign debt (USD bln)



Argentina has the ability to pay but not the willingness. Authorities continue to blame the judge but as of today the country is in selective default (after missing a 539 Mns USD payment). Keep in mind that Judge Griesa ordered to freeze international bond payments unless the country honors NML capital and al. (1.6 Bns USD to 1% of the creditors). **The injunctions had created very negative collateral effects.** The ruling has triggered 25 new lawsuits from the rest of the holdouts an additional 4.4 Bns USD. So if the government pays the Hedge Funds and new lawsuits you can subtract one year of FX reserves

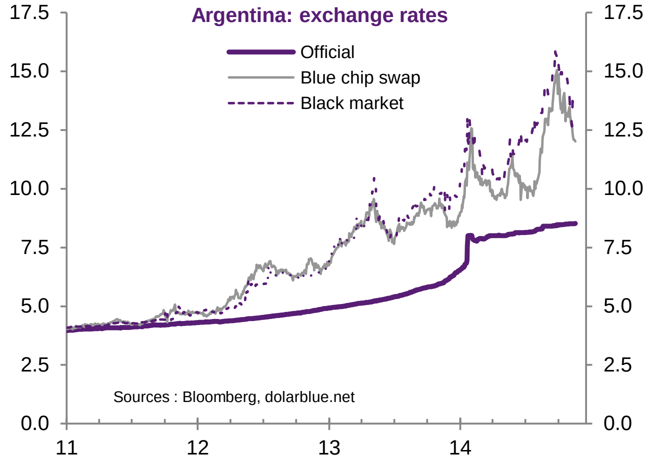
(2016). Many of the rest of the holdouts (6% of defaulted bonds creditors) and even holders of restructured bonds (92% of defaulted bonds creditors) are asking for a full payment. As a result litigations against Argentina have exploded. Mr. Axel Kicillof even mentioned 120 Bns USD of potential claims. **Argentina does not have the ability to pay them under the RUFO clause regime (equal treatment).** Even if the latter expires on December 31st, **it is difficult to see a solution given the country's current economic situation, low level of reserves and political calendar.**

Chart 3
Argentina: balance of payments (Bns USD)



The current account deficit is widening as the government keep subsidizing energy while agricultural prices are not supportive (Chart 3). Meanwhile, the fiscal deficit keeps worsening and inflation will remain high with its monetization. A new devaluation is very likely which should lead to capital flight and more pressure on reserves (Chart 4). A stable and sustainable solution will be difficult given the political calendar in 2015 (Presidential and Legislatives elections in October). **All in all, we do not buy Argentina willingness to pay story but things could quickly change if we have a market friendly President.** Buenos Aires province Governor Daniel Scioli has 24.9% intended votes vs. 24.3% for Buenos Aires Mayor Mauricio Macri and 22.6% for lawmaker Sergio Massa according to the latest poll (November 19th) released by OPSM.

Chart 4
Argentina: exchange rates



2/ Venezuela: willing but not able to pay?

Venezuela is also facing a rather complex debt profile. Reserves reached 21.5 Bns USD after 2 Bns USD were added from China's fund last Tuesday (Chart 5). The current level is enough to cover foreign currency bonds in 2015 (5.9 Bns USD), 2016 (5.2 Bns USD) and 2017 (6.5 Bns USD). **If we exclude gold (70% of total reserves), the country is only able to cover its foreign obligations until July 2015 vs. September 2018 including gold** (Chart 6). Venezuela's reserves are not as liquid as they seem. President Chavez brought back in 2011 11 Bns USD in gold reserves that were held in US and European banks. This gold is not very liquid in Venezuela as it will be difficult to find a lender willing to back a loan with it.

Chart 5
Venezuela: FX reserves (Bns USD)

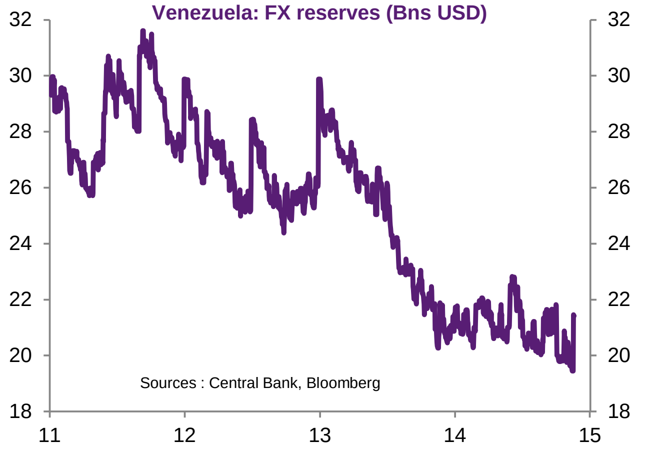
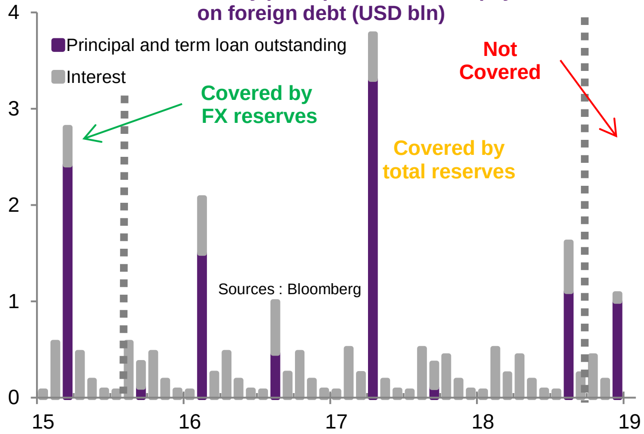


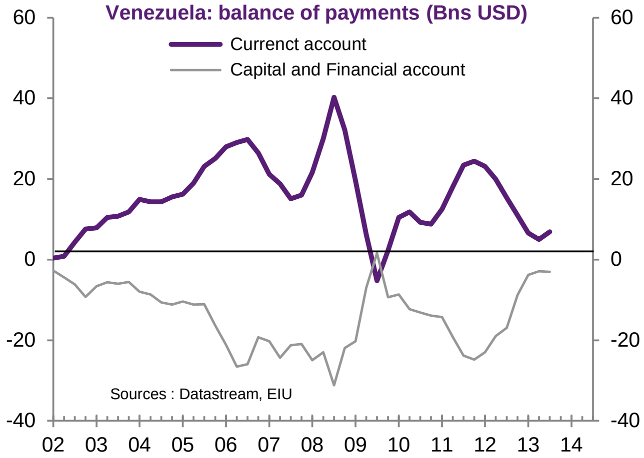
Chart 6
Venezuela: monthly principal and interest payments on foreign debt (USD bln)



The main point like in the case of Argentina is the assessment of reserves and liabilities. **Besides FX reserves, Venezuela has foreign assets in Fonden (2.0 Bns), China Fund (6.3 Bns) but could also sell CITGO (7-10 Bns USD) even if it is off the table for now.** The country has room to maneuver in order to reduce dollar constraints by increasing gasoline prices (the subsidy costs 12.0 Bns USD) or cutting PetroCaribe oil shipments (1.1 Bns USD). The question is whether the government has the political courage to do it. **A major adjustment is unlikely with general elections in December 2015.**

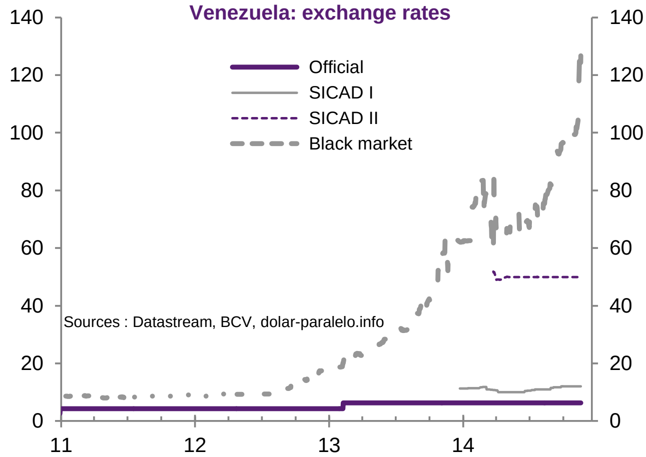
On the liability side, the oil-backed debt from China (50 Bns USD), can be a source of constraint or relief depending on the mood of Chinese authorities. There were rumors that Venezuela was unable to ensure oil shipments (330 000 b/p/d) to China and negotiated in order to extend the loan payment. The agreement which is not public gives Venezuela more room to maneuver but also show the lack of dollars that the economy is facing.

Chart 7
Venezuela: balance of payments (Bns USD)



The latter is also reflected by the arrears vis-à-vis domestic creditors (21.1 Bns USD) notably food importers (2.4 Bns USD), airlines (3.5 Bns USD), pharmaceutical importers (3.5 Bns USD), automobile sector (3.0 Bns USD) among others as Professor Hausmann signaled it in his famous article on the Wall Street Journal "Should Venezuela default?". **Venezuela cannot pay domestic claims and external bondholders due to the low level of its reserves**. Moreover, macro and political factor should be taken into consideration. Falling oil prices, dollars scarcity, high inflation and social unrest can deplete reserves more quickly than under normal circumstances (Chart 7 and 8). **Very often economists forget that it can go very quickly in case of social distress and external shocks.**

Chart 8
Venezuela: exchange rates



Bottom line: Argentina has the money but not the willingness to pay. With their current FX reserves they can serve 29 months of international bonds. But contingent liabilities could blow up this equation if they have to pay their debts in full. A resolution of the debt saga is unlikely given the political cycle and weak fundamentals but things could change if we have a market friendly President.

Venezuela on the other hand is able to pay 47 months of international bonds with its FX reserves but only 9 months if we exclude gold. Venezuela has also many swords of Damocles namely the oil-backed debt from China and domestic arrears that will eventually be paid. Everyone knows that with the most important oil reserves in the world, the upside is clear if oil prices rebound. **But as usual metrics are useless in case of social unrest or external shocks and you cannot say we did not warn you.**

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