VENEZUELA'S DEFAULT PROBLEMS

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"*States have no principles, only interests*"----Cardinal Richelieu

INTRODUCTION

On 11/13/17 There were 2 meetings in New York City and one in Caracas that are likely to affect the future of Venezuela and its beleaguered government for many years to come; not in a good way for the government. The first NYC is an informal meeting of the UN Security Council, convened by the USA and Canada under "the formula Arria", over the human repercussions of Venezuela' s collapsing economy and its effect on the regional stability of its neighbours most of which do not have the resources to absorb the enormous influx of Venezuelan immigrants through their borders, estimated at over 2 million and counting. The USA, Canada, and now Europe have all sanctioned by name high level Venezuelan officials they know are corrupt. Luis Almagro, the Secretary General of the OAS and a staunch defender of Venezuelan democratic attended and spoke on this meeting. As expected, Russia and China, permanent members of the UN Security Council defended the Venezuelan government but not because they deny any of the above, but because they are heavily invested in Venezuela's oil and want assurances their positions will be honoured should all of this escalate confrontationally, as threatened by President Donald Trump.

The second NYC meeting, perhaps as important, is by the International Association of Swaps and Derivatives (ISDA) to discuss the delay of payments from PDVSA and Venezuela to its international creditors which sum to about US$960 Million for the remaining of 2017 and about $8Billion for 2018 (Standard and Poor has already classified Venezuela in technical default status because Venezuela missed 2 payments worth US$200 million after the 30 day grace period expired; Venezuela was also overdue on 4 payments worth US$420Million with a 30 day grace period underway—until Russia threw them a lifeline on November 16th to refinance US$3.15Billion of the debt; although the guarantees that Venezuela offered are mysterious. This of course does not even count that PDVSA already has years of unsettled payment delays to its contractors, suppliers and partners).

Finally the meeting in Caracas between the Government and some of the mayor bond holders and investment bankers like Goldman Sachs, Black Stone and Fidelity Management were the government was suppose to lay out plans for a payment schedule, only lasted 25 minutes and adjourned without conclusions (not surprise there) given the fact that the problem is not the debt itself, but of open advanced macro-economic policy which this government is not prepared to do mostly because of its ingrained ideological blocks that impede them to declare Chavism-its quasi religion-for what it is; a total failure. Curious, this meeting in Caracas was led by Tareck El Aissami, the vice-president who early this year was sanctioned by the US Treasury Department for his alleged role in a narco- traffic ring, which makes it illegal for any US citizen to deal with him. At least one of the attendees walked off the meeting. Simon Zerpa, the countries Finance Minister and also an attendee in this meeting, is also in the sanctioned list which number about 60. Further complicating things, these sanctions prevent any US entity from purchasing Venezuelan government securities, which of course make any re-financing or re-structuring debt deal much more difficult.

The focus of this **EnergyNomics** paper is the Default problems, because it falls right into the core essence of its failed political and economic model.

Venezuela's total external debt-including PDVSA- is about US$130 billion (excludes debts to Russia, China and CIADE Law suits in the World Bank) of which about $66 billion are in outstanding bonds (3/4 of the bond holders live in North America). Between now and the end of 2018 Venezuela owes about $9.Billion, $8Billion before 2018 ends and $0,96Billion before it begins of which about 608million are undergoing a 30 day grace period some of which (PDVSA27; VENZ19; and VENZ24) were not paid on time; which caused Standard and Poor to classify Venezuela in "*selective default*" and the Government of Venezuela to call S&P "*agents of imperial aggression*".

Oil prices, Venezuela's only cash cow, are on the way up but way too low to cover this (see why here[1]) as are the international reserves (now about $9.1Billion) and imports have been cut to the bare minimum; down 63% between 2014-2016 to about $20Billion which has contributed in no small manner to 4 (four) digit inflation rates (or 12% per week according to an MIT site that tracks price increases in the necessary items people buy at the market place). The decline of the GDP is in the magnitude of over 1/3 its total since 2014 and oil production has fallen to 1.9MBD, a 29 year low (according to OPEC) representing a 26% and 18% decrease from their 2015-2016 levels respectively. In fact, OPEC on 11-21-2017 demanded Venezuela to provide real oil production figures; because they have serious doubts the ones they received are true.

The parallel dollar rate, which ended on 12/31/2016 at BS2,500 per 1U$, has depreciated in just over 11 months over 3,140% to over Bs 81,000 per US$. Industrial production is down to 34.8% capacity rate from 56% in 2012 (Because of: A- Lack of spare parts; B-Dollars to buy them; C-Economic depression; D-hyperinflation; E-Outrageous mandated salary increases and F-Price controls). Poverty rates are over 82% and counting—well beyond the rate Hugo Chavez found it when he was elected in 1998 (50%).

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[1] http://www.energynomics.com.ve/wp-content/uploads/2013/04/Abstract_OilScenery.pdf

ABSTRACT

On November 2 Venezuela's President Nicolas Maduro issued a statement that was first seen as ambiguous: *" I have ordered that at first working hour of the morning of tomorrow, Friday November 3, the PDVSA Bond 2017 start to be paid; but after this payment, I decree a refinancing and restructuring of the external debt and all (future) payments of Venezuela*" --Maduro was referring to the disbursement of the US$1,121 million Dollars PDVSA Bond that is due this year, but still on November 10th the amount had yet to be transferred.

In this statement Maduro let it be known to bond holders that he is willing to pay but can't; that he acknowledges Venezuela`s debt commitments but just cannot fork out debt service out of PDVSA's regular cash flows (which harbours 96% of the entire country`s foreign exchange earnings); nor can he get it any more from other pockets like its besieged international reserves nor from other's peoples pockets, like Russia and China, without selling out to the rest of the countries money making assets over and beyond what would be acceptable to the military establishment (which own PDVSA through a decree that will likely boomerang on the government-see below).

Luis Vicente Leon, colleague and President of Datanalisis, said that Maduro's dilemma is to choose between its people and its creditors; and that whenever other countries have faced a similar dilemma they have chosen the people. But Venezuela's ultra dependency of foreign exchange for the imports of everything from food, medicine, inputs and spare parts overwhelms this choice forcing him to look out for its creditors first, because a default will severe its dollar income already at bare minimum leading to no food. Curiously, Chavez predecessor Rafael Caldera was in a similar position in the mid 1990's, when a financial crisis forced his government to take over 50% of all the nations banks assets. The difference is that Caldera's crisis was internal, taking over 17 of the biggest banks. But he too chose banks over people and his government paid dearly for it as poverty levels sky-rocketed fertilizing the ground for Hugo Chavez.

What has bewildered investors and bond holders alike is that they seem to believe that Venezuela's economic potential far exceeds its performance and that the latter is only held down by wrongheaded statist model and incompetent corrupt mismanagement that impedes foreign investment in the country-especially its oil sector- but that it all can be fixed with deep measures and fine tuning that restores enough positive cash-flow to pay off debt service (see graph below)

It has also perplex them that Maduro´s designation of El Aissami seems to conjure a Machiavellian plot that Venezuela is simply trying to drive the discount of the nation's debt as low as possible to purchase it at a fraction of its face value (PDVSA27 Debt bonds traded in the default mode when Maduro made his ambitious "decree" as low as 30%; VEN27 Bonds at 27.4%; while the Debt Yields of YTM PDVSA22, YTM VENZ27 and USLT10Y at 54.4%, 37.7% and 2,4% respectively-meaning that many people in the investment banking community are loosing lots of money and just hope to recover something).. If true, if Maduro is playing this game, **EnergyNomics** believes this to be

deeply short-sighted strategy because when investors loose money it inhibits future creditors from lending to a regime that purposely treats them as a hostile force.

The main purpose of this paper is to argue that while the first part of this belief is correct-the potential and performance part-that the rest is wrong. Chavism cannot credibly employ any "fine tuning" to its economic model because it goes against (anathema) to the core of its ideology-philosophy and especially against the monetary interest of those in power (Maduro and the PSUV); as well as against the interest of some countries and narco-terrorists organizations that are bent on keeping all these afloat for their own natural survival. I.E. Debt restructuring necessarily involves an overhaul of the cash-flow model of a country which means a dramatic change in its economic doctrine, which by definition entails an equal radical change in philosophy and ideology which is something Chavistas cannot, by definition, accept to do.

CONCLUSIONS

1) Wrong-headed ideology is Venezuela's chief stumble block that has derailed the nation into economic disarray and has put it in a position of financial default with its survival needed creditors.

2) Deep inside their philosophy (as all philosophy) is their belief that their ideology is infinite, eternal and unchangeable. Meaning that (as the laws of physics) it has always been true and will always be true and that nothing can change it.

3) This of course has been proven wrong because many things can change a mode of thinking and beliefs, technology and education chief among them. I.E. What was right yesterday may not be right today religion excepted. **EnergyNomics** believes that Chavism, far from being an economic doctrine to Venezuela's regime, is a form of religion. I.E. Failure is impossible.

4) But failure is exactly what has happened to Chavism, and the statistics in all of its indicators overwhelmingly prove it. Beyond philosophy however, there is also the monetary interest of those in power who see infinite cost in their livelihoods (incarceration, expropriation of their ill gotten wealth) if they are ever deposed from power. They hold on like a lion's bite on a giraffe's jugular vein, and will never let go short of force.

5) Because of Venezuela's vast oil reserves and the overwhelming importance of these to the World's industrial prosperity, Venezuela is deemed by western international players "too big to fail"-its government however is **not**.

6) Venezuela is also "too big to fail" by its two big super-power investors, China and Russia, but again **not** the government. **EnergyNomics** believes that both these countries are not only fed up with Venezuela's incompetence and corruption (of their money too); that they believe the government to be incorrigible, but, on a deeper issue, they are increasingly mad that Venezuela's government calls itself “socialist” like them, when in effect its policies resemble something out of John Dickie`s 2004 mafia book “*The Cosa Nostra*” than anything that Marx, Lenin, or Mao ever wrote.

7) Nonetheless, both these countries are lending Maduro’s regime a life-line to protect their investments and secure positions in the largest World oil reserves. They are in effect using Venezuela as blue chip in high stakes oil diplomacy vs the United States, Canada and Europe (UK-Italy-France-Spain-Holland) and their privately owned companies. **EnergyNomics** believes that-center-paribus-this all should be a solvable through amicable diplomacy. Not with the current Venezuelan regime and its suicidal ideology.

8) Needed for the above to come to good fruition is a pragmatic democratic Venezuelan government with a viable energy-macro-economic-institutional-social-agricultural and renteer plan that rights Venezuela’s path towards prosperity. **EnergyNomics** is working on that right now.

9) Venezuela is far beyond refinancing. This term implies that the cash-flow model is generally ok but unforeseen events impedes it to pay off debt service in time due to temporary setbacks and thus needs a new contract with more time allotment, possibly more money, and higher rates and guarantees to make it attractive to creditors. But that the general income generating structure is fine.

10) This is not the case of Venezuela because its cash-flow model, the ideology/philosophy that underpins it as well as the incompetence and corrupt administrators that manage the country are all so wrecked that no one with a superficial knowledge of the country would consider extending it a refinancing life-line of any sort without demanding a solid permanent base incursion into its only relevant cash generating asset, its oil fields. This may go beyond what the military and its own inner political establishment may agree.

11) Debt Restructuring is different from re-financing because it implies that the cash flow model is permanently incapable of generating enough surplus to service debt and a 180° overhaul is needed in everything relating to income and expenses. It usually implies a large loan from a multilateral organization like the IMF and the World Bank which would in all likelihood come with stringent macro-economic conditions in all its pertinent areas (fiscal, monetary, exchange rate, prices, trade and energy-although not as stringent as in the 1980’s-because they have learned from those mistakes).

12) Debt Restructuring is not possible however in a country that treats economic modelling as a quasi-religious doctrine because it excludes failure in its underpinning philosophy and ideology; the only one they know (not withstanding its corrupt distortions). I.E., we believe debt-restructuring is not possible in Venezuela with the current political status quo in place.

13) The rules of the Paris Club on sovereign debt apply vis a vis corporate debt, but it is the opinion of **EnergyNomics** that in Venezuela's case should a default occur that creditors will not see any distinguishable differences between Venezuela and PDVSA. This is because PDVSA is 100% owned by the state of Venezuela and because on February 10th last year Nicolas Maduro issued the Camimpeg decree that in essence folds PDVSA under the rule of Venezuela's military establishment. For example, a few days ago a tragic traffic accident happened were the Chief of Venezuela's Faja del Orinoco sadly perished. His name was Hector Aular Crespo (RIP), a Brigadier General of Venezuela's FANB armed forces.

14) A default will expose the extreme vulnerabilities of Venezuela's cash flow model. Since its oil ships anchor abroad and since PDVSA owns off shore assets (like CITGO), its income from oil exports maybe subjected to partial seizure by international courts daunting ever more the prosperity indexes of the country.

15) If PDVSA counters the move by shipping its oil elsewhere, probably Asia (principally China and India), these countries will likely require it to sell at unfavourable deep discounts with long term conditions.

16) Social unrest will in all likelihood spontaneously explode, not withstanding the fact that the government now (by electoral fraud) controls all of the central and southern states of the country, including the police, and that it just recently approve a "hate law" to be used to clamp down and arrest street protests.

17) This social unrest will in most likelihood lead to anarchy, chaos and further repression, given the fact that the opposition is divided, leaderless and discredited for its past recent mistakes and haphazard un-unified performance.

18) However, the social unrest will also in all likelihood lead to a fracture of the military FANB with the government. So far this fracture has been held back by 2 fronts:

A) The division of the opposition into 20 different political parties with no credible leader and

B) No discernable solution plan to its Economic/Energy/Social/Institutional/and Rentism problems**.** (As said, **EnergyNomics** in my person is working on the right now in the economic-energy-social-institutional model). <u>We are currently seeking financial support.</u>

19) Although **EnergyNomics** thinks that deliberate scorched earth policies that would further affect its oil production and/or its non-oil economic underpinnings are unlikely, it cannot be ruled out completely.

ANEX: THE RELEVANT GRAPHS

There are 29 relevant graphs, charts, tendencies and correlations on Total Debt, Bonds, Assets-Liabilities, Oil Production, World and Venezuela Oil reservoirs, Oil shipments, PDVSA debt, investment, CAPEX-OPEX, marginal costs, and why PDVSA is too big to fail-its government is not.

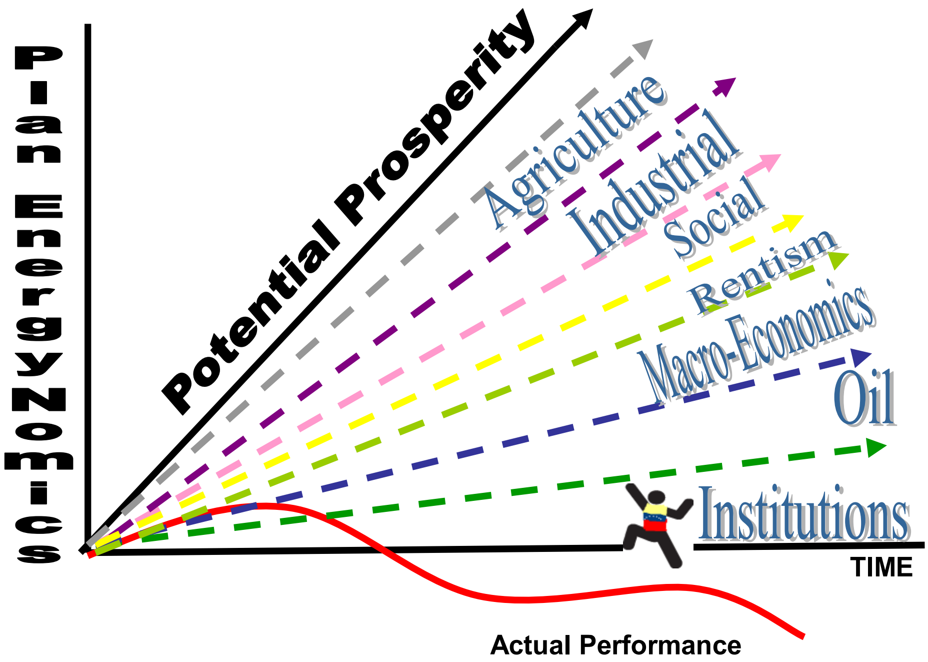
Also graphs and analysis on Venezuela's severely torn misery economy are presented as the only possible result of its failed ultra statist ideological backdrop, its incompetence, mismanagement and corruption that has broken down the productive sector, dragged down PDVSA, and with it increased the misery levels in all prosperity indexes imaginable, including absolute poverty.

More importantly, EnergyNomics has solutions for all these; and we are seeking financial support to develop this plan. These will follow, in this order:

A) A comprehensive economic plan that includes solutions for the sectors of Petroleum, Institutions, Social (welfare, education, housing, labor training, health, no-poverty program), Rentism, Macro-Economics, Non Oil economy, (Agriculture, Industrial).

B) With (A) at hand, we can then proceed with serious removal of political obstacle with international and national support.

Venezuela's Potential can be Recovered in a Short Time



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