



DEBIT

VENEZUELA'S “HUNGER BONDS”

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(Critique by J. Zettelmeyer – PIIE)



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VENEZUELA'S DEBT CRISIS

Venezuela is in deep crisis; and has been in this condition for over two years.

- A debt stock that is estimated somewhere between \$100 and \$150 billion (depending on what is counted)
- Capital Reserves are likely in the under \$10 billion range

Sooner rather than later, there will have to be a restructuring of a stock of debts that have been issued as far back as 20 years ago.

AGE OLD QUESTION IN SOVEREIGN DEBT - ODIIOUS DEBTS

- Does the nature of the regime that issued the debt matter to whether it has to be repaid?
- This is relevant, since the current *Maduro* regime has been widely condemned by other governments as illegitimate.
- When the restructuring occurs, assuming there is a new government, will the new government repay *Maduro* bonds on the same basis as its bonds?

INTERNATIONAL LAW V. DOMESTIC LAW

- Traditional answer from international law: The nature of the regime is irrelevant.
 - E.g.: Apartheid South Africa's Debt was paid in full by ANC government.
- Why should the people of the country pay the debts of a despot who oppressed them?
 - Yet, for over a century, the rule has not budged
 - Does Venezuela in 2017 present a way out?

HUNGER BONDS, GOLDMAN SACHS & PROFESSOR HAUSMANN

- **May 23, 2017:** GSAM's purchases \$2.8 bn in PDVSA bonds (at deep discount - \$865 mil).
- **May 26, 2017:** Ricardo Hausmann blog post on *Hunger Bond* idea.
- **May 29, 2017:** Reuters reports that opposition leader Borges has written to GS and others that they will not pay the bonds.
- **May 26, 2017 on:** Protests outside GS offices.

“Given the unconstitutional nature of Nicolas Maduro’s administration, its unwillingness to hold democratic elections and its systematic violation of human rights, I am dismayed that Goldman Sachs decided to enter this transaction.”

Julio Borges



SHOULD THERE BE AN EFFECT OF THE FOREGOING?

- Bonds are under NY law.
- The law of state succession is clear and strict – stinkiness of the prior government's behavior is not a basis on which a future one can avoid payment.
- So, the yield on stinky regime bonds should be the same as sweet smelling ones.

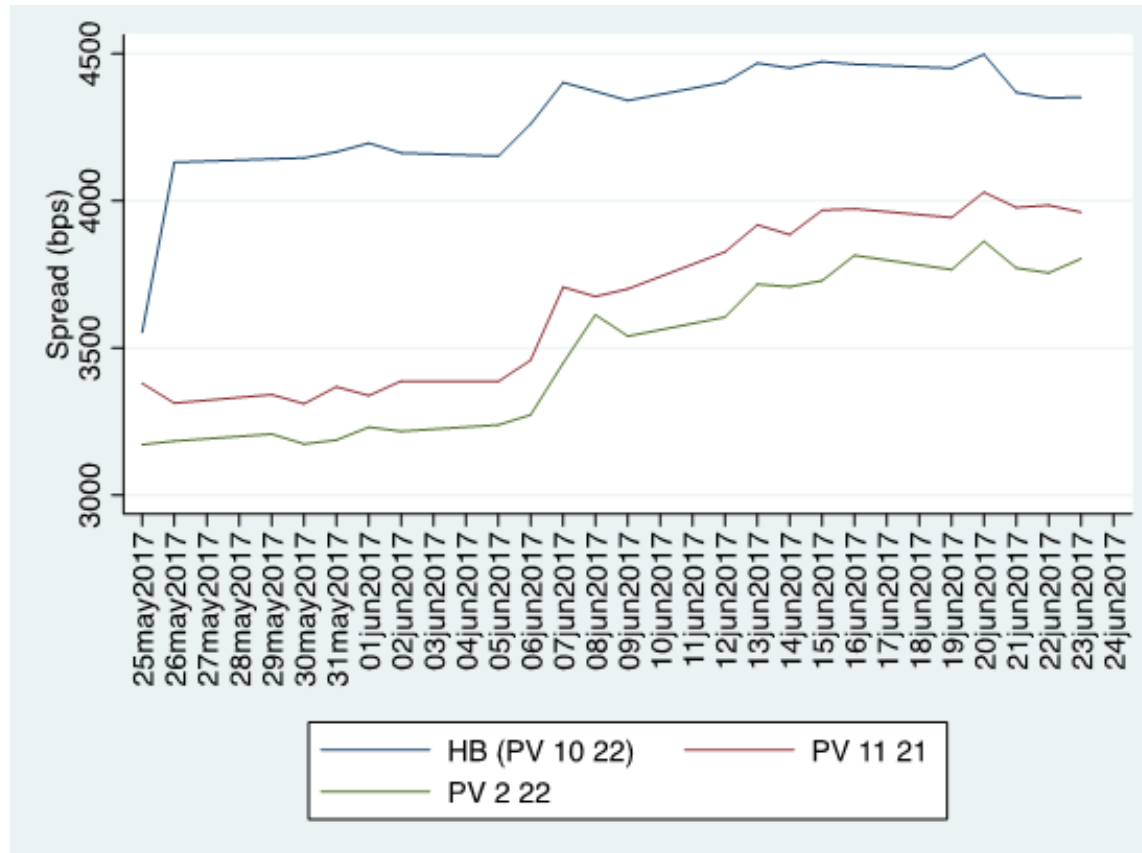
HISTORY OF HUNGER BONDS

- The Hunger Bond was issued at a discount (400 bps) over a PDVSA bond with similar maturity. This discount widened to nearly 1000bps in the first week of trading (not driven by differences in liquidity, in fact the HB had a smaller bid-ask spread than the comparator)

Date	Hunger Bond PDVSA 2014 6% 28/10/22 REG.S			Control PDVSA 2011 12.75% 17/02/22 REG.S		
	YTM (bps)	Spread (bps)	Bid/Ask	YTM (bps)	Spread (bps)	Bid/Ask
05/25/17	3,720	3,551	0.09	3,329	3,171	0.3
05/26/17	4,299	4,130	0.09	3,341	3,183	1
05/29/17	4,313	4,142	0.09	3,366	3,207	0.75
05/30/17	4,312	4,145	0.09	3,329	3,173	0.85
05/31/17	4,332	4,166	0.09	3,341	3,187	1.0
06/01/17	4,363	4,195	0.09	3,387	3,231	1.1
06/02/17	4,325	4,162	0.09	3,369	3,216	1.0
06/05/17	4,317	4,151	0.09	3,394	3,239	0.6

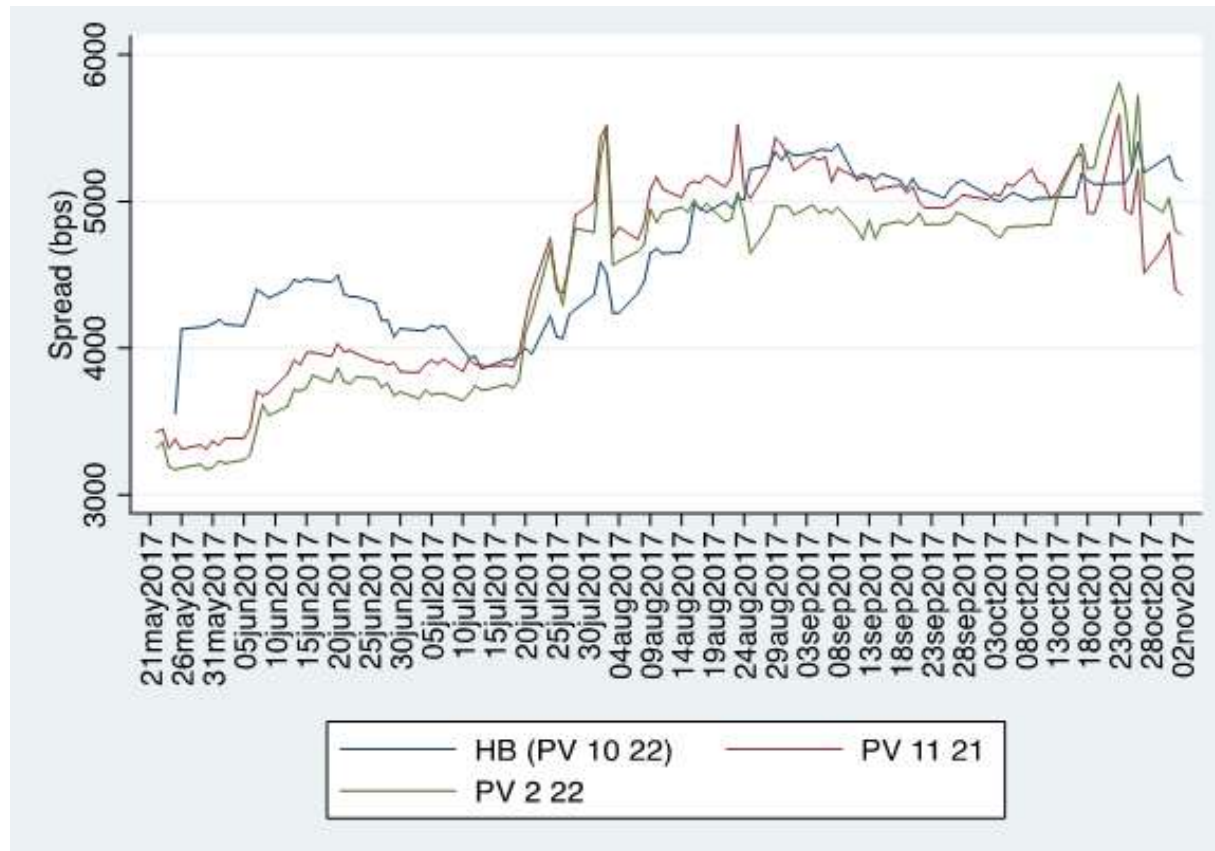
HISTORY OF HUNGER BONDS

- The gap between the Hunger Bond and two PDVSA comparators started closing after 30 days of trading:



HISTORY OF HUNGER BONDS

- In mid-July the Hunger Bond started trading at a spread similar to the spreads of PDVSA bonds with similar maturity:



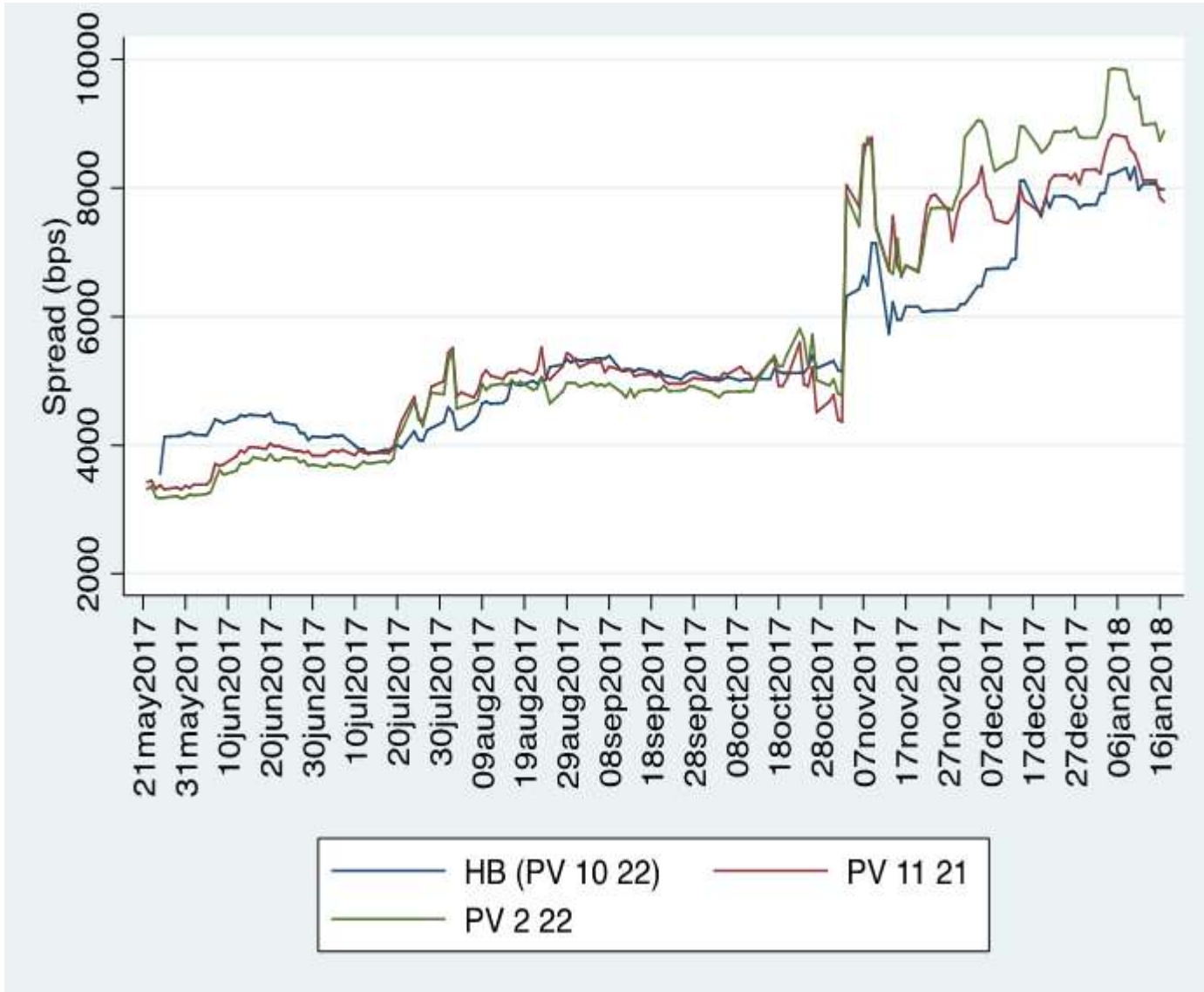
HISTORY OF HUNGER BONDS

- When, in early November 2017, PDVSA spreads skyrocketed to 8000bps, the Hunger Bond had a smaller increase in spread
- Until the end of December it traded at a premium over other PDVSA bonds with similar maturity.
- That was when Mr. Maduro announced that a restructuring was in the offing, and Venezuela began to miss coupon payments



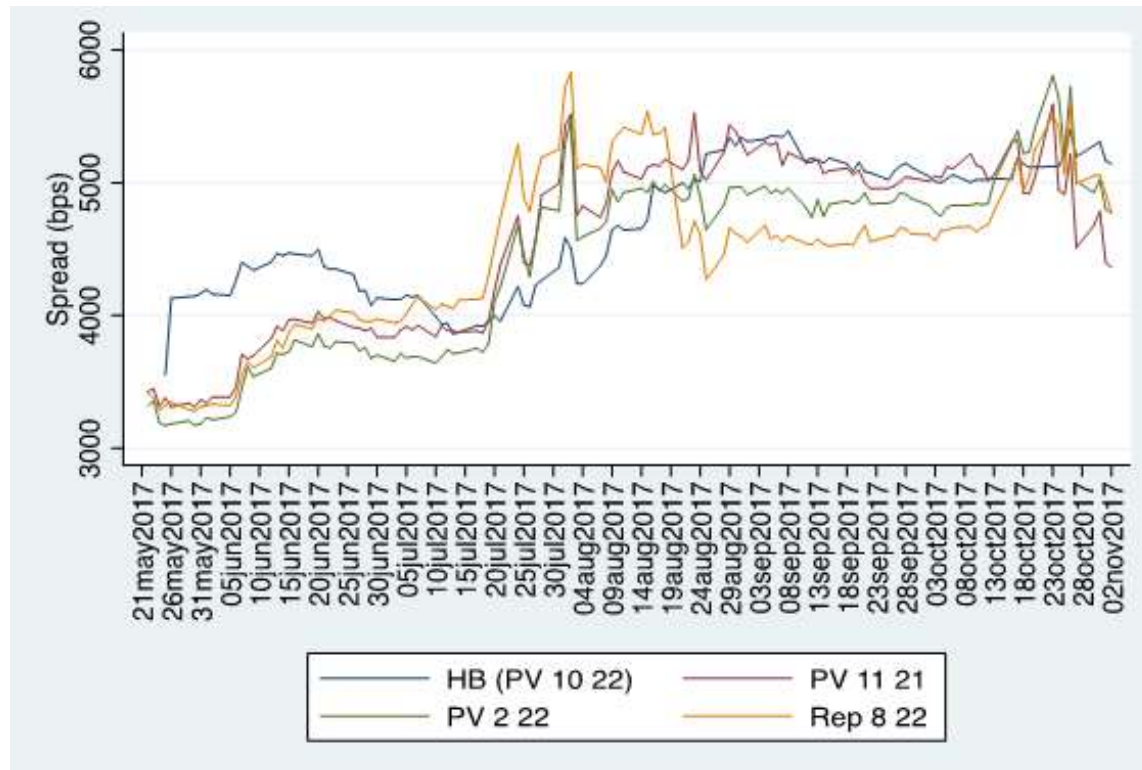
IMPLICATIONS/INTERPRETATION

- There was a big effect - compare it to the effect of a 100% vote requirement versus a 75% vote requirement on Venezuelan sovereign bonds (about 5 bps). This was 500 bps.
- Why? Temporarily, the cost of capital rose significantly - no more such sales were attempted.
- Domestic Law matter? (talk that this was an illegal or legally questionable issuance under Venezuelan law)
- Or Reputation based? No one wanted to touch - for a little while - this contaminated bond?
- But, after some months, the penalty disappears
- Perhaps because the likelihood of regime change diminishes or because this kind of crowd sourced penalty cannot last?



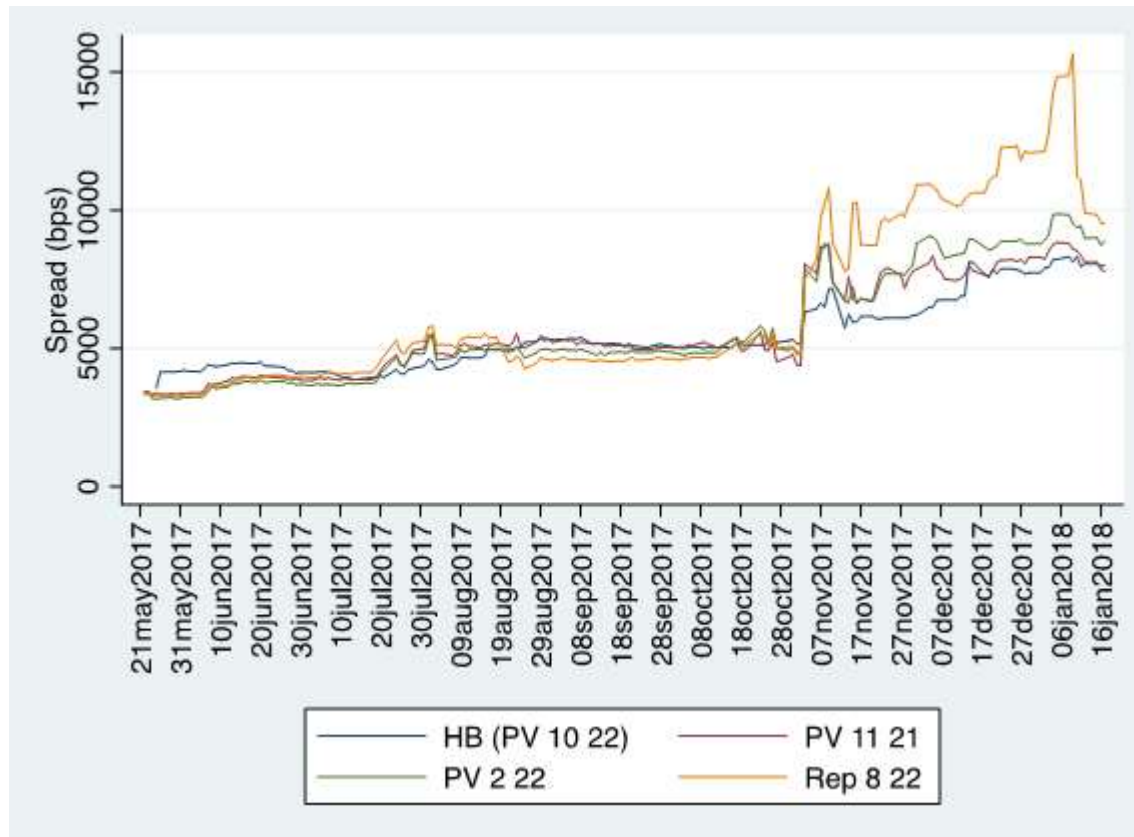
IMPLICATIONS/INTERPRETATION

- The other puzzle is the behavior of Republic bonds. They normally trade at a premium over PDVSA bonds, but when spreads jump, they trade at a discount. This happened in July 2017:



IMPLICATIONS/INTERPRETATION

- But the big divergence started in November 2017.
It then started to close in January 2018:



**Thank you
for your
attention**

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