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Venezuela-X-Press

Daniela Blancas
+1 416 862-3908
daniela.blancas@scotiabank.com

Joe Kogan
+1 212 225-6541
joe.kogan@scotiabank.com

Currency devaluation

Event

On February 8, 2013, Venezuelan authorities devalued the currency, for the fifth time since 2003, from 4.3 Venezuelan bolivares per US dollar to 6.3, representing a 32% depreciation. Additionally, the government closed the Foreign-Currency Bond Trading System (SITME).

Significance

Amid uncertainties regarding the health of Hugo Chavez and a possible government transition in Venezuela, the authorities devalued the currency in order to address economic imbalances, particularly on the fiscal front.

Financial Market Reaction

Venezuelan local financial markets were closed on Monday and Tuesday, due to Carnival holidays, though the currency adjustment instilled a slightly positive tone into Venezuelan debt assets. The five-year sovereign credit default swap decreased by 25 basis points (bps) to 602, while the 10-year government benchmark bond yield fell by 16 bps to 9.05%, in line with the improving trend in place since mid-2012.

Analysis and Outlook

Although we have been expecting the devaluation announcement since the end of 2012, the magnitude of the change was above our initial forecast. We maintain our view that Venezuela will grow by a modest 2.0% in 2013-14. We anticipate that headline inflation will accelerate to the 25% y/y mark in the coming months (having reached 22% y/y in January). The Venezuelan authorities will receive higher fiscal income from crude oil exports, which account for more than 90% of total exports, thereby reducing their current fiscal deficit position (estimated at 5.5% of GDP for 2013-14). However, given the persisting political uncertainty and the possibility that elections could be called in 2013, government expenditure may increase again. The country's authorities have not announced any other source of foreign exchange for the private sector other than the Foreign Exchange Administration Commission, CADIVI, and the central bank, once the SITME has been shut down. This will reduce foreign exchange liquidity, putting more pressure on importers—which already face domestic price controls—and creating supply constraints in consumption goods.

Notwithstanding the small rally in fixed income assets, the bond markets are not expected to rejoice too much. First, the government administered devaluation had been expected for a while, delayed briefly by Chavez´s illness. In fact, most economists take into account a possible devaluation as one way the government could save on bolivar-denominated government expenses, especially since the nation has devalued before. Second, this devaluation is not a solution to long-term structural problems; public expenditures will slowly creep up because inflation is already high, and likely to climb substantially higher. In the long-run, Venezuela's ability to pay its US dollar-denominated debt is closely linked to the government's primary source of hard-currency revenues—oil exports—which of course are not affected by this change.

Investors will focus on how the devaluation will affect sovereign and PDVSA bond issuance. Venezuela issues debt to finance public spending, and also to feed the government-regulated foreign exchange system. Issuance in past years has posed a negative technical factor and has also increased Venezuela's overall debt burden. As yet, no replacement for the SITME system has been announced. If the policymakers could bring the official exchange rate closer to the unregulated exchange rate, it would both reduce capital flight and diminish the need for excessive bond issuance to some extent. The shock of such a move would be too much for the authorities' popularity to bear, however. The government will have to continue rationing foreign exchange to feed the needs of importers and consumers, and bond issuance may again play a role in future exchange rate systems.

INTERNATIONAL RESEARCH GROUP

Pablo F.G. Bréard, Head
1 (416) 862-3876
pablo.breard@scotiabank.com

Daniela Blancas
1 (416) 862-3908
daniela.blancas@scotiabank.com

Sarah Howcroft
1 (416) 862-3174
sarah.howcroft@scotiabank.com

Tuuli McCully
1 (416) 863-2859
tuuli.mccully@scotiabank.com

Estela Ramírez
1 (416) 862-3199
estela.ramirez@scotiabank.com

Scotia Economics

Scotia Plaza 40 King Street West, 63rd Floor
Toronto, Ontario Canada M5H 1H1
Tel: (416) 866-6253 Fax: (416) 866-2829
Email: scotia.economics@scotiabank.com