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Hyperinflation in Venezuela

Gerhard Winzer

Venezuela is in a difficult situation. Hyperinflation describes the economic environment best. For 2017, the IMF estimates a consumer price inflation of 650% y/y, and for 2018, the estimate is 2,300%.

Since 2007, the cumulated inflation amounts to an incredible 41,000%. This comes with consequences: according to the IMF, real GDP will shrink by 12% this year. Since 2007, real GDP has slumped by an impressive 25%. Per capita income has even fallen by 36%. Foreign exchange reserves have declined by USD 9.7bn. In 2008, they had peaked at USD 42bn.

Bad governance

The most important reason for this disastrous development is the bad governance. When it comes to the indicators published by the World Bank on freedom of speech, political stability, quality of public administration, and rule of law, Venezuela is at the bottom of the list. The country is rife with corruption. The Corruption Perception Index by Transparency International has Venezuela ranked 166th, which is not far ahead of Somalia, the country that is 177th and last.

High likelihood of state bankruptcy

Accordingly, the country risk has increased drastically. The rating agency Standard & Poor’s has continuously downgraded the rating of Venezuela in recent years. In 2006, the country was rated BB-. On 3 November, it was downgraded from CCC- to CC. This means that bankruptcy is all but certain, it is just not clear when it will happen.

Unclear announcement

The downgrading on 3 November was triggered by unclear announcements made by President Nicola Maduro last week, according to which about USD 60bn of external debt was to be restructured. For 13 November, foreign creditors have been invited to the capital city, Caracas. This invitation does not constitute bankruptcy, legally speaking. President Maduro said he was going to service the debt, albeit in a restructured form.

Losses

Outstanding bond prices have accordingly fallen. For example, the price of VENZ 9 ¼, maturity in 2027, fell by 39% on 2 November. By 7 November, it had plummeted to 28%. This equals a loss of about 31%. It is unclear, whether the current scenario has been fully priced in yet.

US sanctions

The existing US sanctions prevent new bonds from being issued under US law. This makes both the refinancing of the old debt and the issue of new debt in case of a restructuring impossible.

Also, the government officials of Venezuela, who have been tasked with the negotiations on 13 November, are affected by US sanctions. Their appointment could be regarded as provocation.

Alternatives

This leaves two alternatives. Venezuela could try to issue bonds in other currencies. This is seen as unlikely to be successful. New loans from Russia or China are only slightly more likely. Why should these two countries grant loans only for bond creditors to get their money. Geostrategic interests have also entered the picture here: after all, Venezuela holds the biggest oil reserves in the world, and the Latin American country is not far from the USA.

Only a question of time

The incentive for Venezuela to avoid bankruptcy is mainly to avoid the seizing of their oil shipments. Still, the rating by Standard & Poor's suggests that bankruptcy is only a matter of time.

Legal note:

Prognoses are no reliable indicator for future performance.

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He holds a degree from a polytechnical college and studied economics and business at Vienna University with a special focus on financial markets. He holds a CFA charter and participated from 2001 to 2003 in the doctoral programme for finance at the Center for Central European Financial Markets in Vienna.

From July 1997 to June 2007, he worked in research at CAIB, Bank Austria Creditanstalt, and UniCredit Markets & Investment Banking. His last position was as Executive Director for Fixed Income / FX Research and Strategy. He was responsible for research on asset allocation at Raiffeisen Zentralbank (RZB) in Vienna from July 2007 to February 2008.