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Fears of Venezuela Default Grow Amid Drop in Oil Prices

Country's ability to pay creditors seen as increasingly in doubt



Oil accounts for 96% of Venezuela's export earnings. Above, drilling rigs at an oil well operated by Venezuela's state oil company, PdVSA, in the oil-rich Orinoco belt in Monagas state. *PHOTO: CARLOS GARCIA RAWLINS/REUTERS*

By **SARA SCHAEFER MUÑOZ** and **ANATOLY KURMANAEV**

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The plunge in the price of oil is causing more investors to bet that Venezuela will default on its \$120 billion pile of foreign debt, an event that would trigger a messy battle over the country's oil shipments and deepen its economic and political crisis.

Despite Venezuela's worst economic slump since independence from Spain, the socialist government has continued to pay bondholders on time. President Nicolás Maduro this week reiterated the country's intention to honor its debt.

Few investors doubt Venezuela's willingness to pay. In recent years, it has paid bondholders partly by drastically reducing the amount of dollars it uses to import

goods, adding to widespread shortages. What's increasingly in doubt, however, is the country's ability to pay.

"Venezuela is in an economic hole; the oil prices are just aggravating the mess," said Anders Faergemann, who manages \$20 billion of emerging-market fixed-income debt, including Venezuela's, at Pinebridge Investments in London.

The price of oil—which accounts for 96% of Venezuela's export earnings—recovered slightly on Thursday to nearly \$30 a barrel, but it is still down sharply on the year. Oil futures signal the price will remain at about \$32 a barrel for the foreseeable future. That's a far cry from the \$100-plus levels that Venezuela enjoyed for years.

Venezuela's heavier oil fetches even less on international markets and is down to about \$23 a barrel, near its break-even production point of about \$17 to \$18 a barrel.

A default in 2016 "is becoming increasingly difficult to avoid," said Barclays economist Alejandro Arreaza in a report on Venezuela this week. If oil stays at \$32 per barrel, Mr. Arreaza estimated that Venezuela will need to use 90% of its oil income this year just to meet its obligations, including sovereign debt and money owed to China.

The cost of insuring Venezuelan sovereign debt has jumped in recent months, signaling a growing fear of default. It's currently 63 percentage points above the cost of insuring benchmark U.S. Treasuries, up from 35 percentage points at the end of November. That means investors are pricing in a roughly 80% chance of default in the next year.

Mr. Maduro acknowledged this week that the price drop is hitting Venezuela's main industry hard.

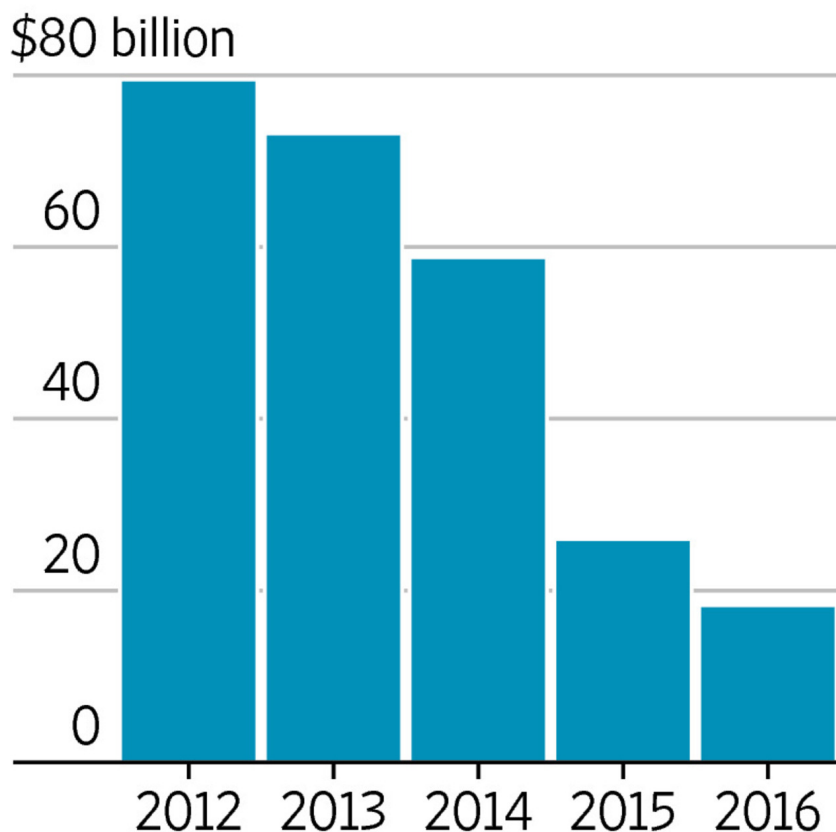
"How many countries of the world can sustain oil production at \$22 a barrel? Few, or almost none," the president said in a national address Tuesday night. Yet he sought to calm worried investors, saying: "Venezuela has ethics, morals and commitments, first with the people and the fatherland, but also has the commitments that the republic has honored and will continue honoring."

Venezuela has worked to avoid a default, which could open the door to seizure of its oil exports, the only source of the foreign currency it counts on to purchase food and other basics. A default could also mean that other assets linked to its important oil sector, such as tankers and refineries, end up in the hands of creditors.

Next month, the country owes some \$2.2 billion in principal and interest. On Thursday,

Down to a Trickle

Venezuela's oil-export revenue is falling. Estimated net earnings:



Source: Barclays

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Mr. Maduro's government has aggressively pushed back against the opposition's efforts and reforms have stalled.

"You're seeing a very messy political situation. On top of that, you have very low oil prices. Investors are starting questioning whether this strong historical willingness to pay is beginning to erode," she said.

Investors deem Venezuela the riskiest bet in the developing world and charge it the highest borrowing rates, according to J.P. Morgan's Emerging Market Bond Index Global. Venezuela has to offer investors 37 percentage points more in yield than

those bonds traded in the secondary markets for 92 cents on the dollar, which indicates nearly a 10% probability of default—a high figure given the maturity is just a few weeks away.

Sarah Glendon, a sovereign economist at Gramercy Funds in Greenwich, Conn., which manages \$6 billion worth of assets including Venezuelan debt, said the government will likely make its February payments but will struggle beyond that. Venezuela's next major payment is in October for around \$1 billion, followed by about \$2 billion due in November.

Ms. Glendon said investors had hoped the opposition's parliamentary win in December would lead to sweeping economic reforms that could put Venezuela on stronger financial footing. But

comparable U.S. Treasuries, well above war-torn Ukraine and frequent defaulter Argentina.

In reality, payments on its foreign debt have been just about the only ones Venezuela has honored in recent years.

The government owes more than \$50 billion to private companies that service its economy, ranging from oil contractors and airlines to supermarkets that need dollars to import everything from flour to toilet paper. Major airlines have halted flights to the country and auto manufacturers and others have shut plants after the government was unable to pay for imports of needed parts and materials.

Evidence of Venezuela's cutback on imports is seen in hourslong lines outside supermarkets as people await rare shipments of necessities like milk and disposable diapers.

Venezuela's central bank reported that the country's foreign-currency assets stood at \$35.5 billion in the third quarter of 2015, and Barclays analysts estimate they fell to \$27.6 billion in the final quarter of last year. Barclays estimates the financing gap this year will be \$30 billion, meaning Venezuela will use up all its dollar assets or figure out some other way to cover the gap.

—Kejal Vyas contributed to this article.

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