

Fixed Income Weekly

FOR PROFESSIONAL INVESTORS

My cousin Vennie

November 6, 2017

By L. Bryan Carter
Head of Emerging Markets Fixed Income
bryan.carter@bnpparibas.com



Key takeaways

- On Thursday evening, in a televised state address, President Maduro announced that Venezuela was restructuring its debts.
- The timing caught the markets off-guard, and Venezuelan debt prices fell sharply on Friday.
- Recent events have raised more questions than answers, and there are significant uncertainties surrounding Maduro's real intentions.

Full commentary

Like it or not, the US is intertwined with Venezuela to a familial degree. The US imports \$15 billion worth of oil annually from Venezuela, providing nearly half of the country's hard currency earnings. The country's oil company, Petroleos de Venezuela, owns significant assets in the US, including the CITGO brand. Further, there are an estimated 250,000 Venezuelans living in the US.

Given the dependency, it is no surprise that Venezuelan President Nicolas Maduro this week used US sanctions and seizures as an excuse to announce a debt restructuring. Indeed, the country is crimped, with liquid reserves having dwindled to near zero and its access to foreign financing now exhausted. Venezuela's imminent default has been long expected by economists and prepared for by investors, which is why the country's longer dated bonds were trading at about a third of face value on the eve of the announcement (see Figure 1). The only unexpected part of this is Maduro's proactiveness, the fact that he has communicated this clearly and announced a deliberated and orderly process when we know the country and its tradition of policy execution to be anything but.

If Maduro is serious, this act precipitates the debt endgame for Venezuela. Investors can finally place their bets on recovery scenarios, and we will no doubt see hedge funds and distressed players descending on the credit. If the country engages early and intensively with creditors, this could possibly not turn out to be the chaotic mess most of us assumed was inevitable. That is the best case interpretation.

Still, many complications exist. The legal shakeout from this is likely to be convoluted and protracted, given the sheer size of the debt, the lack of consistency in the different bond issues over time, and the importance of bilateral loans in the restructuring — China and Russia are significant creditors to Venezuela, and there is little transparency on these contracts. Further muddying the outlook is that much of the debt is held through Petroleos de Venezuela, which possesses significant assets outside of Venezuela and has used some of these as collateral on its debt. We do not expect this restructuring to be easy or fast. There is also the risk that the benchmark provider (JP Morgan) decides to remove Venezuela from the index during this period, in which event many investors would become forced sellers. But do we trust our cousin Vennie? US restrictions prohibit most international firms from engaging with Venezuela on the restructuring and certainly from transacting in anything that looks or smells like new debt. It's difficult to envision how Maduro will pull this off, given the potential freezing of oil shipments to the US and lack of bridge financing for a bond tender. We know relations with the IMF are so cold that months of thawing would be required before a bailout could be mobilized. Maduro's move could simply be a bluff, a chess play executed in order to up the ante on the US and improve his popular approval at home. As long as he can continue exporting oil to the Russian and Chinese buyers that fall outside of the sanctions network, the move could be hugely profitable for Maduro and his cronies.



Last week's market developments

Monday, October 30

- Japan's unemployment rate remained at 2.8% s.a for September
- Japan industrial production decreased to -1.1% m.o.m for September

Tuesday, October 31

- France GDP remained at 0.5% q.o.q for Q3
- France CPI increased to 1.a% y.o.y for October
- Eurozone GDP increased to 2.4% s.a. y.o.y for Q3
- US consumer confidence increased to 125.9 s.a. for October

Wednesday, November 1

- Markit UK Manufacturing PMI Index increased to 56.3 s.a. for October
- Markit US Manufacturing PMI Index increased to 54.6 s.a. for October
- US Census Bureau construction spending decreased to 0.3% m.o.m s.a.a.r. for September

Thursday, November 2

- Markit Eurozone Manufacturing PMI Index decreased to 58.5 s.a. for October
- Markit France Manufacturing PMI Index decreased to 56.1 s.a. for October

Friday, November 3

- US employees on nonfarm payrolls increased to 261k s.a. for October
- US unemployment rate decreased to 4.1% s.a. for October

Source: Bloomberg, data as of November 6, 2017



BNP PARIBAS
ASSET MANAGEMENT

The asset manager
for a changing
world

Here's what we know for sure

Venezuelan governance is poor, its capacity and institutions are weak, and its growth and economic fundamentals are dreadful. The current situation is untenable and something must change. Although we are guarded on the potential success this announcement, we are pleased to see things moving, for the sake of the Venezuelan people and the future prospects of the Venezuelan nation.



Chart of the Week
Figure 1. Price of Venezuela 7% 03/31/2038



Data as at November 3, 2017. Sources: Bloomberg, BNP Paribas Asset Management.



This week's market developments

Monday, November 6

- No data to report

Tuesday, November 7

- Germany industrial production is expected to decrease to -0.9% m.o.m. s.a. for September
- UK Halifax House Prices Index is expected to decrease to 0.2% m.o.m. s.a. for October

Wednesday, November 8

- Japan core machine orders are expected to decrease to -2.0% m.o.m. s.a. for September

Thursday, November 9

- US wholesale inventories is expected to remain at 0.3% m.o.m. for September
- Japan Tertiary Industry Activity Index is expected to increase to -0.1% m.o.m. s.a. for September

Friday, November 10

- UK industrial production is expected to increase to 0.3% m.o.m. s.a. for September
- UK manufacturing production is expected to decrease to 0.3% m.o.m. s.a. for September
- US University of Michigan Sentiment Index is expected to increase to 100.8 for November

Source: Bloomberg, data as of November 6, 2017



Central Bank Watch

	Last move	Date of move	Current policy rate	Implied 3-Month Rate on December 2017 Interest Rate Futures Contract	Next meeting
Fed	+25 basis points	June 14, 2017	1.00% - 1.25%	1.28%	December 13
ECB	-5 basis points	March 10, 2016	0.00%	-0.17%	December 14
BoJ	-20 basis points	February 16, 2016	-0.10% - 0.00%	0.06%	December 21
BoE	-25 basis points	August 4, 2016	0.50%	0.54%	December 14

Source: Bloomberg; data as of November 6, 2017

Disclaimer

Bloomberg is the source for all data in this document as of November 6, 2017 unless otherwise specified. This document is issued by BNP PARIBAS ASSET MANAGEMENT, USA, Inc. (BNPP AM USA), a member of BNP PARIBAS ASSET MANAGEMENT ("BNPP AM"), the brand name of the BNP Paribas group's asset management services. This document includes information obtained from other investment management companies within BNPP AM and is produced for information purposes only and does not constitute: 1. an offer to buy nor a solicitation to sell, nor shall it form the basis of or be relied upon in connection with any contract or commitment whatsoever or 2. investment advice. Any opinions included in this document constitute the judgment of the document's author at the time specified and may be subject to change without notice. Such opinions are not to be relied upon as authoritative or taken in substitution for the exercise of judgment by any recipient and are not intended to provide the sole basis of evaluation of any investment. The value of investments and the income they generate may go down as well as up and it is possible that investors will not recover their initial outlay. Investing in emerging markets, or specialised or restricted sectors is likely to be subject to a higher than average volatility due to a high degree of concentration, greater uncertainty because less information is available, there is less liquidity, or due to greater sensitivity to changes in market conditions (social, political and economic conditions). Some emerging markets offer less security than the majority of international developed markets. For this reason, services for portfolio transactions, liquidation and conservation on behalf of funds invested in emerging markets may carry greater risk. The contents of this document are based upon sources of information believed to be reliable, but no warranty or declaration, either explicit or implicit, is given as to their accuracy or completeness. BNPP AM USA, to the extent permitted by law, disclaims all responsibility and liability for any omission, error, or inaccuracy in the information or any action taken in reliance on the information and also for any inaccuracy in the information contained in the document which has been provided by or sourced from third parties. Past performance is not necessarily indicative of future performance. This document may not be copied, distributed, or passed on, directly or indirectly, to any person without the express consent of BNPP AM USA. Investors should consult their own legal and tax advisors in respect of legal, accounting, domicile and tax advice prior to investing in the financial instrument(s) in order to make an independent determination of the suitability and consequences of an investment therein, if permitted. Different types of investments, if contained within this material, involve varying degrees of risk and there can be no assurance that any specific investment may either be suitable, appropriate or profitable for an investor's investment portfolio. Given the economic and market risks, there can be no assurance that the financial instrument(s) will achieve its/their investment objectives. Returns may be affected by, amongst other things, investment strategies or objectives of the financial instrument(s) and material market and economic conditions, including interest rates, market terms and general market conditions. The different strategies applied to the financial instruments may have a significant effect on the results portrayed in this material. BNP PARIBAS ASSET MANAGEMENT USA, Inc. is registered with the U.S. Securities and Exchange Commission as an investment adviser under the Investment Advisers Act of 1940, as amended.