Venezuela/PDVSA Monthly Report
March 2016

The month of March was a positive one in the Venezuelan debt market. Relative calmness in global markets, combined with the positive trend in oil prices, generated a reduction in PDVSA and the Republic's perceived credit risk. This translated into an average total return of around 3% in the complex during the month yet returns varied by a wide margin, both among curves and terms of the bonds.

The first three weeks of the month posted positive returns in both curves, in line with the move in oil prices. WTI crude oil futures reached their YTD closing high of 41.45 $/bbl on march 22nd, a day after OPEC Secretary-General Abdallah Salem el-Badri stated that Iran might be willing to join the cartel member's intention of freezing oil output at current levels. Market sentiment turned sour on the following day when Bloomberg started to show indicative quotes for the PDVSA 6% 22, a bond issued in October 2014 through a private placement to the Central Bank. As a result, bonds fell sharply, driven by the threat of upcoming supply on the secondary market.

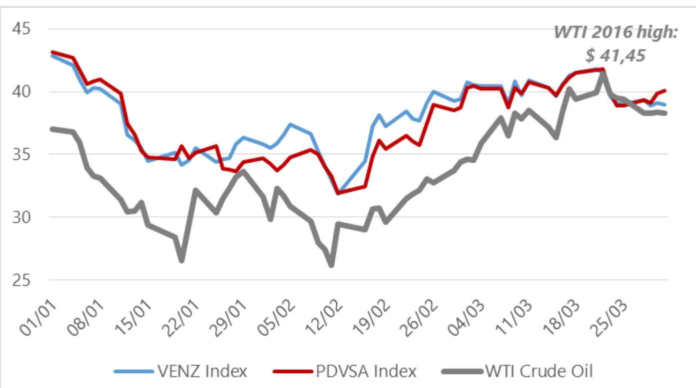

Chart N°1: VENZ and PDVSA avg. Bond prices vs prices of WTI Oil. *Source: Bloomberg BGN, own calculations.*

The last sessions of the month were characterized by a marked reduction in trading volumes and a range-bound behavior in bond prices, as the market awaited more information about the "new" PDVSA 6% 22, and their possible entry to the secondary market. Furthermore, the relationship between these securities and the DICOM FX System, whose formal start is expected during April has yet to be formalized.

Exchange rate Regime: From SIMADI to DICOM

On March 9th there was a press release by the Executive's economic team, led by Economic VP Miguel Pérez Abad giving initial details about the upcoming FX regime. The two "new" official rates are ***DIPRO*** ('protected exchange': VEF 10/USD) and ***DICOM*** ('complementary exchange': a floating rate that is set to start at the former SIMADI rate). This system is envisioned to be different to previous government efforts in two key points: the search of a "real" flotation of the DICOM rate, according to supply and demand for dollars in the system; and the intention to progressively unify both exchange rates.

Market impact from news of this new FX regime has been limited as investors have opted to take a "wait and see" approach, avoiding taking positions before having concrete evidence that the DICOM would function as VP Abad has promised. So far, the government's response in this front has been restricted to allowing a 27 percent depreciation on the SIMADI rate, going from 200 in late February to 276 VEF/USD to this date.

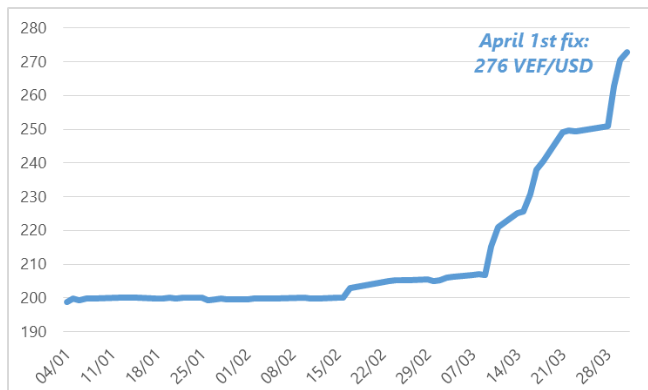

Chart N° 2: SIMADI Exchange rate, mid prices, year 2016 (Source: Venezuela Central Bank).

There's a key aspect of the upcoming DICOM that hasn't been revealed yet: where is the FX supply going to come from? This will very likely lead the Government to sell bonds to generate dollar supply for the system, in a similar manner to former exchange mechanisms (SITME and most recently SICAD). There haven't been any official communications about this, but analysts speculate that the new PDVSA 22 is going to take this role, and supply of this bond is going to show up in the market soon. To learn more about this "new" bond, we recommend reading the following note from news site Caracas Chronicles: http://www.caracaschronicles.com/2016/04/05/52492/

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Performance in the month

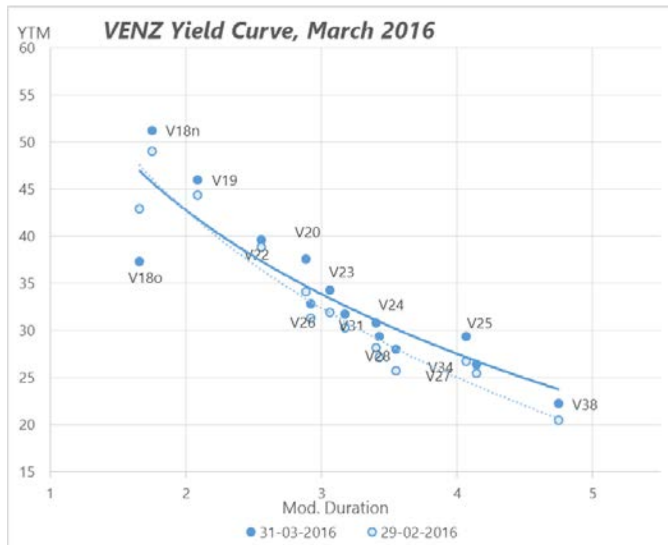
Venezuela and PDVSA bonds end March with an average 1% increase in prices and an average total return of +2,66%. However, the behavior between both curves differed substantially. Most of venezuelan bonds ended the month down (VENZ 24 closes -6,20% down in the month), while all PDVSA bonds ended the month in the green, save for a <1% loss in PDVSA 24/26 (affected by fears of upcoming new PDVSA 22 supply). The outperformance of the short end of the curves was the highlight of the month: The top 3 performers were PDVSA 17 5,25% (+11,15%), VENZ 18 13,625% (+10,60%), and PDVSA 17 8,50% (+7,29%).

Bono	29-02-2016	31-03-2016	Var. %
VENZ 13 5/8 08/15/18	58,00	**64,15**	**+10,60%**
VENZ 7 12/01/18	39,90	**40,65**	**+1,88%**
VENZ 7 3/4 10/13/19	36,85	**38,05**	**+3,26%**
VENZ 6 12/09/20	35,85	**34,10**	**-4,88%**
VENZ 12 3/4 08/23/22	42,80	**43,80**	**+2,34%**
VENZ 9 05/07/23	36,70	**35,50**	**-3,27%**
VENZ 8 1/4 10/13/24	36,45	**34,20**	**-6,17%**
VENZ 7.65 04/21/25	35,70	**33,85**	**-5,18%**
VENZ 11 3/4 10/21/26	40,25	**40,00**	**-0,62%**
VENZ 9 1/4 09/15/27	40,25	**40,10**	**-0,37%**
VENZ 9 1/4 05/07/28	36,90	**35,55**	**-3,66%**
VENZ 11.95 08/05/31	40,35	**40,00**	**-0,87%**
VENZ 9 3/8 01/13/34	37,25	**35,85**	**-3,76%**
VENZ 7 03/31/38	35,10	**33,70**	**-3,99%**
PDVSA 5 1/8 10/28/16	74,80	**78,05**	**+4,34%**
PDVSA 5 1/4 04/12/17	45,75	**50,85**	**+11,15%**
PDVSA 8 1/2 11/02/17	49,40	**53,00**	**+7,29%**
PDVSA 9 11/17/21	35,75	**37,25**	**+4,20%**
PDVSA 12 3/4 02/17/22	42,60	**45,35**	**+6,46%**
PDVSA 6 05/16/24	31,20	**30,95**	**-0,80%**
PDVSA 6 11/15/26	31,10	**30,90**	**-0,64%**
PDVSA 5 3/8 04/12/27	31,00	**31,50**	**+1,61%**
PDVSA 9 3/4 05/17/35	36,65	**37,95**	**+3,55%**
PDVSA 5 1/2 04/12/37	31,10	**31,60**	**+1,61%**

Table N° 1: Price performance of Venezuela and PDVSA bonds, March 2016

Evolution of the curves

Graphs N° 3 and 4 below plot the changes in VENZ and PDVSA yield curves during the month. In the case of Venezuela, the most significant movement during the month was an almost 600bps fall in the yield of VENZ 18 13,625%, against the rest of the curve shifting up 50-250bps.



Graph N°3: Venezuela Yield curve changes, March 2016. *Source: Bloomberg CBBT.*

The PDVSA curve is, on the other hand, showing a downward movement across the entire complex, save for a 30bp hike in the yields of PDVSA 24/26. The top performer was the PDVSA 17 5 25% "old" (-635bps in the month).

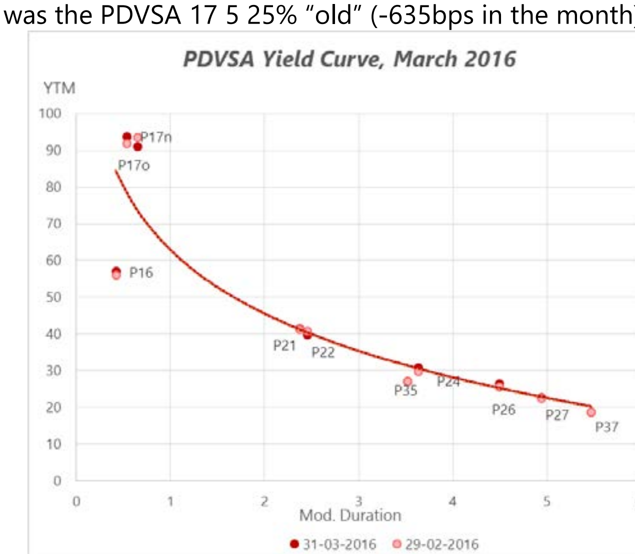


Chart N° 4: PDVSA Yield Curve changes, March 2016. *Source: Bloomberg CBBT.*

Looking ahead

The confrontation between the Legislative and Executive/Judiciary powers is escalating with each new draft bill from the National Assembly. The most recent example happened during the last week of the month where the Supreme Court's Constitutional Chamber stamped its unconstitutional sign over a reform of the Central Bank Law, which had been approved by majority of the Assembly in March 3. The reform project endorsed by the opposition bloc had been designed as a mean to show the Supreme Court's partiality. Aside from minor changes in specific articles, the proposal was a carbon copy of the previous Central Bank Law. This is why the refusal of the TSJ to approve this bill suggests that the government is seeking to block all opposition-led initiatives without regards to their own institutional framework, as the Constitutional Court just outlawed the legal provisions that governed the BCV for the last 14 years.

The impact of the aforementioned political scenario in Venezuela and PDVSA debt could hardly be considered positive, more so in a context of sustained economic deterioration and (except for the most recent developments on the FX front) a condition of general paralysis in public policy. However, the soon-to-trade PDVSA 6% 22 brings with them a series of risks and opportunities that are worth taking into account during the following weeks. If they effectively end up being sold through the DICOM system, the excess supply would impact prices all along the curve, but especially on similar notes like the PDVSA 24/26. Even though one could argue that this effect is already priced in (as these bonds currently have the lowest prices on the curve), we can't rule out a market reaction similar to the one experienced early this year, where the notes traded as low as 26 cents on the dollar. That being said, the PDVSA 6% 22 could show a very attractive risk/reward profile. Not only would they be offered at very low nominal prices, minimizing the downside risk in the case of a default; but also the maturity of the bond would only be six years. This would make them the shortest tenor in the "low-dollar-value" segment of the PDVSA curve, and thus the bonds with the most upside potential of the bunch in a credit-positive scenario, on which the state oil Company is able to avoid a credit event in the near and medium term.