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Strategy Flash – El Salvador

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El Salvador Strategy Flash

ELSALV 30 came out at a 12% yield, collecting USD1bn

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Finally, the issuance of the ELSALV30 priced with a 9.25% coupon, albeit the implicit rate was of around 12%, as the administration prioritized size over yield, collecting UD1bn. After significant speculation, the Central American nation returned to international markets with a relatively successful showing, collecting a significant amount of capital, even if it had to sacrifice a lot of ground in terms of the rate. While the coupon was finally closed at 9.25%, the administration issued the bonds at a discount, pricing them at 89.92, which resulted in an implicit yield of 12%. In our estimate, the final yield would be determined by the fair value of the bond, which was close to the 11.25% mark, given the Salvadoran sovereign yield curve, plus an issuance premium that hovered around the 75bp mark, somewhat higher but still in line with the one exhibited in the other most recent issuance, the 2052s, in 2020, which amounted to 60bp, and the price of the option, which depended significantly on the market's view on the underlying probability of the government failing to achieve either of the two conditions required to maintain a low coupon on its interest-only macro-linked security, ie. Entering a deal with the IMF in under 18 months or improving its credit ratings to at least a B in the same timeframe. In this context, it seems the administration pushed for the USD1bn mark, and being more aggressive in the size of the issuance had its drawbacks, as it had to practically gift the option away in its pursuit of additional cash, putting the final rate at 12%. All in all, even if the final rate was very high for a sovereign issuance, the administration was able to reopen its access to the market and has now the chance to aggressively buy back its bonds outstanding maturing in 2025, 2027, and 2029, especially as these bonds now compete with the maturity profile of the new issuance, which is bound to pay its sinkings in 2028, 2029 and 2030. The official purposes that justified the issuance were repurchasing the 2025's, paying for the remaining outstanding of the 2025's post-buyback, and finally financing general treasury needs. With the results of the repurchase coming out on Monday, the jury is still out regarding the success of the LMO. For more information on the operation, please check our reports, here and here.

The transaction leaves some mixed feelings regarding its financial aspects, as the substantial size points to success, while the inflated rate suggests otherwise. Still, the key issue going forward is the additional commitments the administration decided to take, which will probably result in an agreement with the IMF, which has the potential to alter both the role and seniority of the country's creditors.

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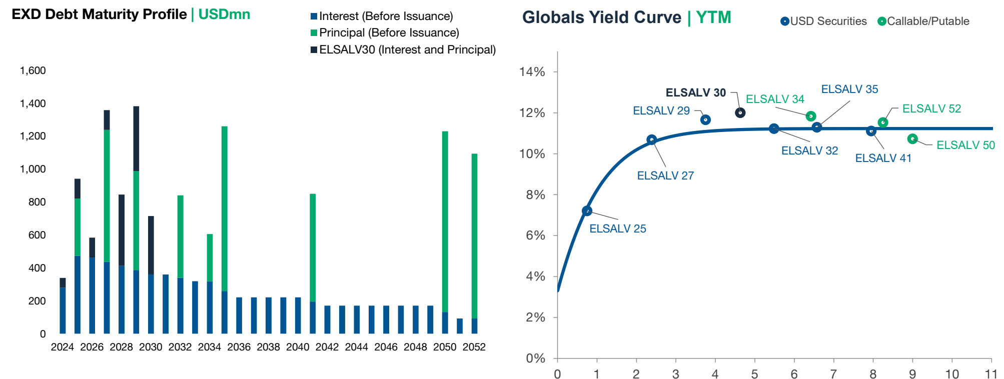
refinance its maturities. However, if it does not, this issue will surely brew additional trouble for El Salvador.

Figure 1: The new issuance came at a 12% yield, while loading the late 2020's maturity schedule



Source: TPCG Research based on TPCG Trading Desk

However, the largest roll of the dice came from the side of investors, as this deal, and the conditions attached to it have the potential to derail one of the main theses sustaining the investments in the Salvadoran curve. This is the fact that Eurobond holders were senior creditors to all other debts El Salvador had to face. And while money was always an issue, bondholders were the first to receive their share. With the introduction of an IMF deal, Eurobond holders will no longer be the first in line to cash in, at least after 2025. With the country being in significant distress financially in the aftermath of the pandemic, there were serious doubts about whether it would be able to face its obligations. However, bondholders time and time again were able to cash their coupon and principal payments. This was not due to the fact that the government always found liquidity to satisfy all their creditors. Rather, it was because eurobonds were percieved by the Government as the most senior obligation, and all the available monies first passed through them. Both local debt and the pension system were rerouted to provide funding for the administration, in order to pay and buy back the Eurobonds. So, while there were creditors who had their debts restructured (ie. the pension system) Mr. Bukele always ensured his senior creditors were well attended to. With the introduction of an IMF deal, this changes substantially. With debts outstanding to the IMF being senior to international debt payments, an agreement with the country displaces bondholders from the highest-seniority creditor, placing them second to the fund. Therefore, the issue is that, while the specifics of the deal are still to be determined, it is likely that a significant chunk of the payments to the IMF will fall in the early 2030's period, which is a sensitive time for the sovereign curve, as it accumulates significant maturities, which will then have to compete for funding against the IMF payments, which have seniority. And while money has always been an issue, bondholders never got the short stick of the financial stress, as it was always endured by creditors less senior to them. Now, in all likelihood, there will be a larger fish in town, which will have priority over bondholder payments. So, if things go south, and financing is scarce (which won't be soon especially if the government collects monies from the IMF), then that time around Eurobond holders might experience what being in the lower part of the food chain feels like. In this context, we find that the issuance, via the conditions of the macro-linked security, has started to tamper with the condition that, in years of scarce funding, ensured bondholders always got their share, displacing them from the position of most senior creditor, which in our view, is an event that can have massive significance going forward.

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