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El Salvador Flash Report

22 September 2022

Bonds rally as government favours repurchase of 25s over 23s

- **The government repurchased 16.6% of the 23s and 54% of the 25s…**
- **…Maximising fiscal savings and against political opportunism**
- **President Bukele committed to launching another buyback in November**
- **Reported government savings could be below actual levels**

El Salvador announced yesterday the results of the buyback for the 2023 and 2025 notes. The authorities repurchased USD133mn of 23s and USD432.6mn of the 25s, equivalent to 16.6% and 54% of the principal amount of each bond, respectively. The total size of the transaction was USD360mn in line with the offer launched on 12 September. This amount was divided into USD122.7mn for the 23s at 91 cents on the dollar and USD237.3mn for the 25s at 54 cents. Participation was low in the case of the 23s, with bids from only 22.4% of bondholders. In contrast, 54.1% of 2025 investors tendered their bonds. The government took in all bids for the 25s but only 74.1% of the 23s.

The government maximised fiscal savings by deciding to repurchase the entire tendered amount of the 25s. This was the right decision from a liability management perspective since it allowed for a more significant reduction of outstanding debt. The transaction narrows debt servicing by USD634.4mn until January 2025, while generating savings of USD274.4mn after excluding the cost of the operation (USD360mn). The choice reinforces the idea that the government could be aiming at regaining market access in 2023, although we see this as unlikely in the absence of a major fiscal policy overhaul. It is also true that authorities refrained from behaving opportunistically. From a political point of view, it would have been better for Bukele to reduce short-term financing needs by favouring the repurchase of the 23s over the 25s. This would have narrowed the probability of a costly default in the run-up to the February 2024 presidential ballot, where Bukele will stand for re-election.

Other views considered that buyback intended to benefit investors linked to the crypto world and with strong connections with the President, who would have sought to lighten their portfolios of 25s at convenient prices. These "conspiracy" theories undoubtedly find support in the opacity surrounding external financing sources and the deterioration of governance indicators. **Even if uncertainty remains, we think that market valuations are still awarding an excessively high probability to a hard default and/or an aggressive restructuring that does not fully internalise its costs** (see El Salvador Economics and Strategy: Trip Notes: More than Meets the Eye, 19 September). Nevertheless, while not fully abating, hard default concerns seem to have moderated somewhat yesterday, judging from the price rally in the belly and long end of the Salvadoran curve.

Finally, in the wake of the press release, **President Nayib Bukele wrote on Twitter that the government will launch another buyback for the remainder of the 2023 and 2025 bonds**. The repurchase would be at market prices and would take place in the second week of November, commanding USD808mn if we consider the total amount outstanding of 23s and 25s at current valuations. It is unclear where the funding would come from. However, after reviewing BoP statistics for the past few years, we think that there is a **non-negligible probability that flows underestimate reported government savings**.

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