Governor: 'Political interests' behind PR's recent beating on Wall Street

By CB Online Staff
cbnews@caribbeanbusinesspr.com; cbprdigital@gmail.com

Gov. Alejandro García Padilla and top members of his fiscal team continue to try to blunt the beating Puerto Rico has taken from Wall Street investors and business publications despite tough steps by the government to improve public finances.

Investors pushed yields on some Puerto Rico bonds above 10 percent briefly on consecutive days this week. The selloff came in the wake of a negative front-page report on Puerto Rico's finances by Barron's that was picked up by or echoed a range of other high-profile business news outlets.

The governor pointed to Barron's, which he said ran a "reckless report" likening Puerto Rico to bankrupt Detroit after it published another signaling that the U.S. is on the same path as problem-plagued Greece.

"The U.S. isn't Greece and Puerto Rico isn't Detroit. And, by the way, we don't want to be Detroit," the governor said during a Chamber of Commerce economic forum in San Juan.

"There have been reports on our fiscal situation circulating in magazines and by commentators in the U.S. in recent days," García Padilla said. "Some of them I dare say were planted in bad faith by people with political interests in Puerto Rico."

The governor reiterated that Puerto Rico's liquidity isn't an issue and there is no risk of default.

"Puerto Rico pays its debt because it has a responsible government. Even if it didn't, the island Constitution requires it," he said.

Treasury Secretary Melba Acosta and Government Development Bank Chairman David Chafey, meanwhile, issued a joint statement highlighting the steps taken to shore up Puerto Rico's financial footing and safeguard its credit rating.

“In the past month, there has been considerable attention paid to the fiscal challenges faced by the commonwealth of Puerto Rico. Much of this attention ignores the significant actions that the new administration of Gov. Alejandro Garcia Padilla has taken to address Puerto Rico’s financial issues in the eight months of his new term,” they said. “Puerto Rico has made major advances since its debt was downgraded in December 2012, and is confident in its plan to grow the economy.”

In December, Moody’s downgraded the debt of various Puerto Rico issuers of municipal debt and assigned a negative outlook based on its perception that the commonwealth suffered from large structural budget gaps, high debt levels, lack of meaningful pension reform and weak economic growth prospects. Standard & Poor’s and Fitch followed suit and all three ratings agencies now peg Puerto Rico’s general obligation bonds at just one notch above noninvestment grade and have warned of potential downgrades to a junk rating.

“Recent press attention has drawn an unfair and inflammatory comparison of Puerto Rico’s fiscal situation with that of Detroit,” Aponte and Chafey said. “Comparing Puerto Rico’s per capita public debt vis-à-vis that of the 50 states is inaccurate, as the comparison fails to include each state’s portion of the U.S. federal debt.”

The total federal, state and local debt per capita in the states for fiscal year 2011 was approximately $57,000, which is more than three times the public debt per capita in Puerto Rico,” they said.

“We have addressed each of the concerns raised in the Moody’s downgrade write-up in a swift, decisive and unprecedented manner. The tough decisions made by this administration stand in stark contrast with the failure of many distressed municipalities in the states – particularly Detroit – to take similar steps to address their fiscal situations.”

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A growing number of analysts has signaled that the blow the island was receiving on Wall Street was “irrational.”

“It seems muniland has gone on a Puerto Rico default watch recently, as it searches the next domino to fall after Detroit,” said Christian Herzeca, an investor and attorney who practiced corporate finance and securities law for over 20 years at Wall Street law firms “This is misguided. Dominoes is a particularly inapt analogy to use in analyzing risk in muniland, and this Puerto Rico default watch too shall soon pass.”

“The principal difference between Detroit and Puerto Rico is that Detroit wanted to default and Puerto Rico doesn't want to default,” he added. “This is not to say that Puerto Rico doesn’t face significant economic development issues going forward, but muniland should regard Puerto Rico's successful pension reform that it concluded earlier this year as the best evidence that Puerto Rico not only needs public finance markets but that, unlike Detroit, Puerto Rico places great importance on having continued access to them."

"The dramatic selloff of Puerto Rico issues belies the strong fiscal measures taken by the new administration in a relatively short period of time," said Alan Schankel, managing director at Janney Capital Markets. "The island economy is struggling, and it remains to be seen if revenue projections will be fully realized, but the measures taken to narrow the fiscal year 2014 budget gap exceed any steps taken by states or local mainland municipal governments."

Dick Larkin, director of credit analysis at HJ Sims & Co., Inc., likened Puerto Rico's current market situation to that of New York City during its 1975 fiscal crisis.

"If you did not panic, your investment in NYC general obligation debt was rewarded; if you sold into a market which was in a panic, you lost big time. Puerto Rico investors should continue to invest in Puerto Rico commonwealth-backed bonds for the long term," he said.

Larkin also hailed the announcement by Government Development Bank interim President José Pagán that the commonwealth would limit its planned borrowing for the remainder of the year.

"At today's irrational yields, the decision to slow down issuance is a smart move, because of the high cost of borrowing in these conditions," Larkin said.

Pagán said that the GDB would keep borrowing for the remainder of the year in the $500 million to $1.2 billion range, rather than the nearly $3 billion that was originally planned.

"In light of the volatility in the market and the private transactions that we have recently closed, we expect to scale down our plan of financing for the rest of the year," he said.

The financing measures had included a $600 million GO issue planned for later this month and a $2.2 billion deal for the Puerto Rico Highways & Transportation Authority, according to Wall Street sources.

Given the challenging market for municipal debt, Pagán issued a statement Monday highlighting actions taken during the past months to strengthen the liquidity position of Puerto Rico and the GDB.

The issuance of bond anticipation notes amounting to $800 million with private banks during the past two months, along with privately-placed tax and revenue anticipation notes amounting to an additional $600 million, provide the GDB and the commonwealth additional liquidity to meet their ongoing obligations, he said.

Pagán stated that the GDB is currently evaluating all alternatives and that it expects to hold an event open to all investors in the next few weeks to discuss in detail the commonwealth's fiscal and economic plan, as well as the GDB's plan of financing. At such event, investors will be able to directly ask questions to the members of the commonwealth's fiscal and economic team.

Last month, the Puerto Rico Electric Power Authority raised $673 million in the municipal bond market, paying a yield of 7.12 percent on 30-year bonds. Since then, the value of those bonds has decreased from 10 percent to 15 percent, depending on their maturities, analysts said.

Because Puerto Rico bonds are exempt from local, federal and state taxes, they are widely held, and fund managers often fill out portfolios of specific state or municipal bond funds with Puerto Rico bonds because of their triple tax exemption. However, a series of negative reports on Puerto Rico's economy and fiscal condition have publicized this practice, increasing pressure on fund managers to sell island bonds.

The entire $3.7 trillion U.S. municipal bond market is performing badly, as investors are rattled by Detroit's bankruptcy and a proposed restructuring by Harrisburg, Penn., analysts said. There are other issues like an expected increase in interest rates as the Federal Reserve Bank winds down a U.S. Treasury purchase program that has kept rates down. However, Puerto Rico is getting hit the hardest over continuing fiscal concerns.