



This week has been eventful for Venezuela. President Nicolas Maduro inaugurated a second 6-year term which was secured in the 2018 May elections, although his latest term has been rejected by the Lima Group, US and EU as being illegitimate through rigging. Instead, those countries have chosen to recognise the leader of the “Unidad” opposition coalition, Juan Guaido. To add weight behind its support for Guaido, the US are likely to apply further sanctions on Venezuela’s oil industry, thus further destabilising the country and risking higher oil prices.

Nicolas Maduro’s fall into autocracy:

Maduro succeeded Hugo Chavez, an extraordinarily popular and charismatic leader whose success depended on high oil prices, has invested in education, healthcare and food subsidies. Assuming office the same time as falling oil prices in 2013, Maduro’s government could not simply sustain the expensive social welfare programmes his predecessor implemented to gain popular support and frame himself as a combatant against economic inequality.

As a result, Maduro quickly lost on political ground. The December 2015 legislative elections led to the victory of the opposition group which became the majority in Parliament and subsequently increased its share of seats in the Supreme Court. To curtail the opposition, Maduro sacked “Unidad” judges from the Supreme Court and attempted to scrap legislative powers of the opposition party in March 2016 – a move which he later backtracked from as a result of popular dissent. Nonetheless, Maduro created the National Constituent Assembly in July 2017, thus antiquating traditional Parliament. The later popular vote to pick the new parliamentarians was heavily manipulated.

Although the President claims that 8 million Venezuelan voted, unbiased polls indicate that only 3.6 million actually participated in voting – just 17% of the entire adult population.

After the ousting of the Prosecutor General Luisa Ortega Diaz in August 2017, the opposition put their hope behind Juan Guaido, the 35 year old President of the National Assembly, Venezuela’s initial Parliament.

Guaido recently called upon the army, a key powerbroker in the country, to break ranks and offer a blanket amnesty for the alleged corruption and human rights abuses of the Maduro regime, as long as the latter accepted to step down. On Monday, two dozen national guardsmen followed that call and led a mutiny in West Caracas, the capital city. They were soon arrested, along with 400 other people



this week, sparking nationwide protests which have led to the deaths of 26 people so far.

An unprecedented economic crisis:

During Maduro's first term, Venezuela's GDP was halved as the country lost 12% incrementally per year since 2014. Since then the crisis has worsened exponentially as the GDP deficit increased to 18% in 2018, and the rate of inflation reached 2.5 million per cent. While that rate was only 40.6% when Maduro took power, it is predicted to reach an unprecedented level of 10 million per cent in 2019. The national currency, the Bolivar, has experienced a free-fall that has not been adequately dealt with by the government as a result of mismanagement, corruption and US-led financial sanctions. While the official rate of the Bolivar to the USD is 10:1, Venezuelans on the black market currently suffer rates as high as 248,487:1.

Unfortunately, due to hyperinflation this rate is unlikely to stabilise. In August 2017, that rate was around 12,163:1. Devaluations, the printing of money, oil-backed cryptocurrencies and even re-evaluations made by the government are now worthless. In August 2018, Maduro introduced the "sovereign Bolivar", equal to 100,000 old Bolivars - however this currency has not yet found its ways to the streets of Caracas.

Consequently, 80% of the population is now poor. Venezuelans have now switched to a barter economy while working multiple jobs just to put food on their family table. The Catholic NGO Caritas Venezuela estimates that a family currently needs 100 times the national minimum wage to satisfy its most basic nutritional needs. With an increase of 234% in emigration since 2015, there are now 2.3 million Venezuelans who have fled their home nation for neighbouring states. To add fuel to the fire, as of 2017 the domestic crime rate has been one of the highest in the world with 91 crimes per 1000 people. The government has sought to defuse the situation, but the country's prison system is struggling to cope, and the 300% increase of the minimum wage has not led to any economic improvement. Farmers do not have enough to purchase the necessary seeds for agriculture, and many have left the countryside altogether, thus exacerbating social and agricultural crisis.

(Data collected from El Pais)



Unable and unwilling to decrease public spending, Maduro has had to turn toward China which has lent \$70 billion over several instalments along with Russia which lent as much as \$17 billion up to 2017, especially through its biggest oil firm Rosneft. As a result, public debt has reached 36% GDP and is expected to surpass 50% by 2020. National companies, such as oil giant PDVSA are gradually falling into Chinese control with most of the oil proceeds allocated to pay off the interest on debt. The government and its companies owe more than \$8 billion in unpaid interest and principal as Maduro has halted interest payment on some \$50 billion of publicly-traded debt in 2017.

Venezuela has one of the least diversified global economies. Oil alone accounts for a whopping 98% of the export proceeds and this revenue is likely to decrease as a result of the crisis and probable US sanctions that loom over the country. 48% of Venezuelan crude is exported to the US. The EU, likely to follow the US on oil sanctions, also account for 31% of Venezuelan refined crude exports, which account for only 20% of crude production. When Hugo Chavez came to power in 1999, Venezuela was producing 3.5 million bpd of crude. Today its production levels have fallen to around 1.38 million, reminiscent of the 1940's.

(Data collected from tankertrackers.com)

International Pressure:

Maduro has for long been a target of US sanctions as President Obama already imposed sanctions on individuals linked to corruption scandals in 2015. However, the pace and strength of those sanctions have been significantly increased since Donald Trump took office. The US Office of Foreign Assets Control (OFAC) targeted 8 Supreme Court members in August 2017 as a consequence of their usurpation of legislative powers. In July 2017, the US assets of Maduro were frozen and from September 2017 to January 2018 a dozen government officials, including the Major General of Army,



Minister of Culture, first & second Vice Presidents were added to the list of sanctioned individuals. Venezuela is believed to be the 17th most corrupt country on earth.

Those individuals, entrenched in both the top echelons of the military industrial complex, and the political elite, have been enmeshed in corruption scandals involving state institutions at the highest levels, such as the Venezuelan Institute of Social Security, the National Treasury and the National Bank of Housing and Habitat. On the 8 January 2019, OFAC also targeted 7 individuals linked to a corrupt currency exchange scheme involving the grant of official foreign exchange rate to close allies of Maduro, who would then use those assets to cheaply import goods and make a fortune in the domestic market. It is believed that close to \$2.4 billion have been diverted this way by individuals such as Media Mogul Raul Antonio Gorrin Belisario and former National Treasurer Claudia Patricia Diaz Guillen.

Countries such as Argentina, Brazil, Canada, Chile, Columbia, Costa Rica, Guatemala, Honduras, Panama, Paraguay, Peru, the US & UK recognise Juan Guaido as the legitimate President and are now likely to increase the pressure on Maduro. The Lima group, a multilateral body of twelve Latin American countries partnered with Canada having met in August 2017 to establish a peaceful exit to the Venezuelan crisis, could possibly use more leverage on Maduro and try to co-opt his political and military allies. Elliott Abrams, the new U.S. Special Envoy for Venezuela is set to solidify international opposition against Maduro tomorrow during the UN Security Council meeting on the Venezuelan crisis. He is also planning to travel to Latin America to reinforce pressure on Maduro and make sure that the \$8 billion of Venezuelan overseas reserves will never reach Caracas so long as the regime does not change. The Bank of England has already announced it would not allow Maduro to withdraw \$1.2 billion in gold from London.

The recent election of Jair Bolsonaro in Brazil, a politician who strongly opposes socialism on his continent, is likely to lead to further pressure on Maduro. In Europe, Spain has started to lead calls for new elections in Venezuela. Pedro Sanchez, the left-leaning Spanish Prime Minister has warned Maduro that his country would recognise Guaido as the legitimate head of the executive if the former did not announce new elections in the coming eight days. Other EU countries like France and Germany are following suit.

Left-leaning Latin American countries such as Bolivia and Cuba, along with countries stuck in a self-styled "economic war" with the US, such as Iran and Turkey, and more surprisingly Mexico - have, for



now, shown support for Maduro. Mexico, now led by the left-leaning Andres Manuel Lopez Obrador is seeking to play the middle ground while simultaneously benefiting from the crisis while it continues to be the US Gulf's top supplier of crude. Countries supporting Maduro are likely to sustain pressure from Washington. Traditional American allies such as Mexico and Turkey, are likely to be contacted by American lobbyists to scrap their support for Maduro – but especially Turkey since it has become a major destination for freshly minted Venezuelan gold.

Donald Trump is said to have met with American heads of oil companies to discuss further sanctions on Venezuela's oil industry and the repercussions such sanctions could have on them. Being the US Gulf's third or fourth supplier depending on differing accounts, Venezuela is set to lose out immensely from an oil embargo. Yet, US refiners are likely to be in the same predicament. When OFAC imposed financial sanctions against Venezuela and more particularly PDVSA in August 2017, US -based refiners like Total SA and Motive Enterprises LLC cut intakes by more than half, while Royal Dutch Shell Plc and Phillips 66 cut imports altogether.

Outlook for the future:

Surprisingly, markets have positively received the current turmoil in the country. Venezuelan sovereign bonds maturing in 2024 and 2034 are at their strongest level in several months. Even the country's highly leveraged PDVSA's 2035 bonds have hit their highest level in 9 months. This is mainly due to the hopes of investors that Guaido's parallel government might take power and turn the country's fate around.

Indeed, unified international pressure and a candidate consolidating the opposition have been perceived as good signs for the future of this Latin American country which houses the world's largest oil reserves. If Guaido manages to bring in power-brokers such as the military – which lately pledged allegiance to Maduro – and the political elite, by showing that supporting Maduro will impoverish them, Venezuela might have a chance at ousting the incumbent President and launch a huge uptick in its oil sector (the country once planned to reach 10 million bpd of oil production). On Sunday, Guaido is set to signal his future plans for the country and explain his amnesty policy to politicians and the military. It is then likely that Guaido will call for further popular mobilisation in the streets for next week. The President of the National Assembly has already clarified that he looked to stop Maduro's "usurpation of power", create a transitional government and eventually call free and fair elections. Dialogue with the regime has been rejected by Guaido, as well as propositions of mediation from



Mexico.

Surprisingly, oil prices are set to increase in the short term as a result of the current turmoil. The WTI barrel saw an increase of 1.28% on the 25 January, thus reaching \$53.81. American refiners hooked on the cheap and unique Venezuelan heavy crude are likely to have difficult times coming around. In particular, the Venezuelan-held (and potentially soon-to-be sanctioned) Citgo, Valero and Chevron, which combined an annual import of 131,906,000 barrels last year, will be particularly affected.

There is also the concern that the Venezuelan crisis will worsen tensions between the US and countries like Russia and China. Indeed, if Washington applies an oil embargo on Caracas, Beijing and Moscow will lose on their loan interest payments from Venezuela – And so any involvement from North America in the domestic affairs of a South American country could also be perceived in a negative manner in their respective capital cities.

China, Russia and even India are likely to increase their intake of Venezuelan oil while territories like Europe & the US will take measures to ban it. Despite Guaido calling Moscow and Beijing for support, it is highly unlikely that those two key supporters of Maduro will change their policy. Maduro being one of their biggest debtors, losing him would be a disaster. Reuters broke the story that two charter flights holding 400 Russian mercenaries from the private military firm Wagner have been flown to Caracas via Cuba. According to Yevgeny Shabayev, the head of the Union of the Committees of Russian Soldiers, such militiamen have been ordered to protect Maduro from any military coup.

Finally, there is a risk that in the coming months, events in Venezuela have a propensity to become a lot more grievous than they have been lately. The Russian Foreign Ministry warned that “foreign interference” could lead to bloodshed in the country. Indeed, the international contest between Maduro and Guaido might lead to sporadic clashes that could culminate in an armed conflict, leading to yet more emigration, poverty and disrepair in the oil industry. This would in turn lead to higher oil prices that could financially help Maduro’s political survival as he would be able to continue co-opting the military.

Sources:

Bloomberg, 20 December 2018, Matt Levine, “Venezuelan Debt Might Ruin Some Holidays in Finance”

Bloomberg, 23 January 2019, Lucia Kassai, Jennifer A Dlouhy, David Marino, “Venezuela Oil Sanctions



Likely to Hit Some US Refiners”

Bloomberg, 25 January 2019, Patricia Laya and Ethan Bronner, “Venezuela Want \$1.2 Billion in Gold Back From Bank of England”

CBS News, 25 January 2019, “What are the economic and security implications of Trump’s Venezuela policy?”

CGTN America, 26 December 2018, “Geoff Ramsey discusses the economic situation in Venezuela”

CNBC, 24 January 2019, “1-Venezuela bonds hit highest since 2017 on hopes for political change”

El Pais, 24 January 2019, Antonio Alonso and Yolanda Clemente, “Indicadores económicos y sociales de Venezuela”

El Pais, 26 January 2019, Francesco Manetto, “La oposición a Maduro se despliega en los barrios para difundir su plan entre los militares”

El Pais, 25 January 2019, M.R. Sahuquillo, “Paramilitares rusos viajaron a Venezuela para proteger a Maduro”

Quartz, 24 January 2019, Daniel Wolfe, “The countries that support Venezuelan president Nicolas Maduro or opposition leader Juan Guaido”

The Guardian, 25 January 2019, Tom Phillips, “Guaido made his first public appearance since declaring himself Venezuela’s interim president in place of Nicolas Maduro”

US Department of the Treasury, 8 January 2019, “Treasury Targets Venezuela Currency Exchange Network Scheme Generating Billions of Dollars for Corrupt Regime Insiders”.

Copyright © Shutterstock