

OCEAN WALL

VENEZUELA: RIPE FOR RECOVERY?

December 2022

EXECUTIVE SUMMARY

Venezuela, sitting on the largest oil reserves in the world, was able to build one of the most prosperous Latin-American economies. While years of US imposed sanctions have crippled the economy, the current geopolitical and economic environment favours the possibility of a rapprochement between two nations who have a great deal to benefit from one another.

The political situation we see in Venezuela today perfectly reflects the chaos of its history. Two parties each recognised as the country's leaders depending on which country you ask. On the one hand, you have a government led by Nicolás Maduro which is widely unrecognised by the world's leading economies due to the 2018 elections which are believed to have been corrupt. On the other, you have the opposition, led by Juan Guaidó, who had promised to inject a new lease of life into the morale of the Venezuelan people. Guaidó's party is, in turn, recognised as the leadership by around 60 countries globally (including the US) whilst being increasingly distanced from national support, adding another layer of difficulty to an already complex political climate. Both 'governments' have failed to catalyse any material change in what has been described as "the biggest political and humanitarian crisis in the Americas".

Venezuela - the most oil-rich nation globally - sitting in close proximity to the largest consumer of oil in the world (the US) – sounds like a compelling recipe for economic and social prosperity. However, through complete overreliance on a single export, political mismanagement and corruption, Venezuela has quickly become one of the world's poorest nations, with debt currently standing at ~\$150bn.¹ Since 2007, sanctions against Venezuela – mainly imposed by the United States in an attempt to effectuate political change – have crippled the South American state. Maduro has indicated that he would like to restructure the country's debt but until US sanctions are removed this is impossible to do. International and National pressure is growing on the US to reconsider its position.

The bolivar, the Venezuelan domestic currency, is one of the weakest globally and this weakness has created a record-breaking hyperinflationary environment that has made consumer purchasing nearly impossible. This, coupled with widespread food and consumer product shortages, has created intolerable living conditions. These, in turn, have led to one of the most extreme emigration cases in history, which has seen, since 2014, around six million (20%) Venezuelans flee the country seeking a better quality of life abroad. More recently, there has been a move towards dollarisation rendering the bolivar essentially worthless. Domestic vendors are increasingly accepting alternative forms of currency. This switch is rekindling economic activity and bringing with it a degree of price stability.

Additionally, there are increasing discussions around potential restructuring deals which would look to relieve Venezuela of its significant foreign debt. By utilising the country's oil industry efficiently, Venezuela has the

¹ <https://www.law.ox.ac.uk/business-law-blog/blog/2021/10/venezuela-prospects-restructuring-sovereign-debt-and-rebuilding%20>

chance to restore relationships with nations whom they have been indebted to after years of defaulted loans. We have already seen Venezuela forge strong relations with Russia, China and Iran who are exchanging billions in credit for oil - which has largely kept the country afloat in the face of the heavy US sanctions.

The shock in global commodity markets accelerated by war in Ukraine, has the potential to put Venezuelan oil back on the map. Oil production is starting to recover having been in decline since the early 2000s. The state-owned oil company, Petróleos de Venezuela SA, PDVSA, is a key obligor in Venezuela's debt pile and is the obvious focal point around which to base a potential sovereign debt restructuring. The price of oil, following the world's energy crises is increasing – with production doubling during the last few months of 2021 - and market analysts, believing that the post Covid recovery will fuel demand, and see prices being pushed higher. The US is the world's largest consumer of oil and so its sensitivity to price rises is significant. Some analysts believe this financial pressure could be the trigger for the removal of sanctions.

In addition, war returning to Europe has also forced global governments to re-evaluate energy security measures, with Venezuela presenting a potential solution to the growing international desire to remove Russian influence from global energy supply chains. Russia accounts for approximately 10% of global petroleum production, producing 10mb/d of crude.²

US sanctions have been imposed on Venezuela for over 15 years, limiting the country's exports but also US investor involvement in Venezuelan debt, creating a creditor base of trapped holders as they can sell but not buy instruments. The end result is that there are a significant number of sellers with the natural buyers (US distressed debt funds) unable to access the market, resulting in an artificially low price for many bonds. In July 2021, Biden removed sanctions on Venezuela importing liquified petroleum from the US, a key condensate in converting tar-like crude into serviceable oil. This might be another early indication that times are changing, and that the US are willing to find a solution to ongoing tensions between the two countries.

Maduro has started to show some willingness to cooperate. Guaidó's opposition party were finally able to participate in local elections last year, ending three years of boycotts by the Maduro regime. In January 2022, Guaidó had his tenure extended by one-year despite facing a decrease in local support and a backlash from influential figures within his own party. With Guaidó being widely viewed as Interim President, the opposition will, for now, want to maintain the status quo in order to project a stable image in order to keep pressure on Maduro.

For real change to be realised in Venezuela, lifting sanctions is vital. Despite everything, Maduro has managed to keep a tight grip on power. Anti-Maduro economies are now faced with a difficult decision; step in and fund a historically corrupt Maduro regime with the hope of effective redistribution or sustain sanctions on Venezuela designed to force him out, something which has, so far, proved ineffective. The reality is that those suffering, as a result of these restrictions, have always been the Venezuelan people.

² <https://www.dallasfed.org/research/economics/2022/0322>

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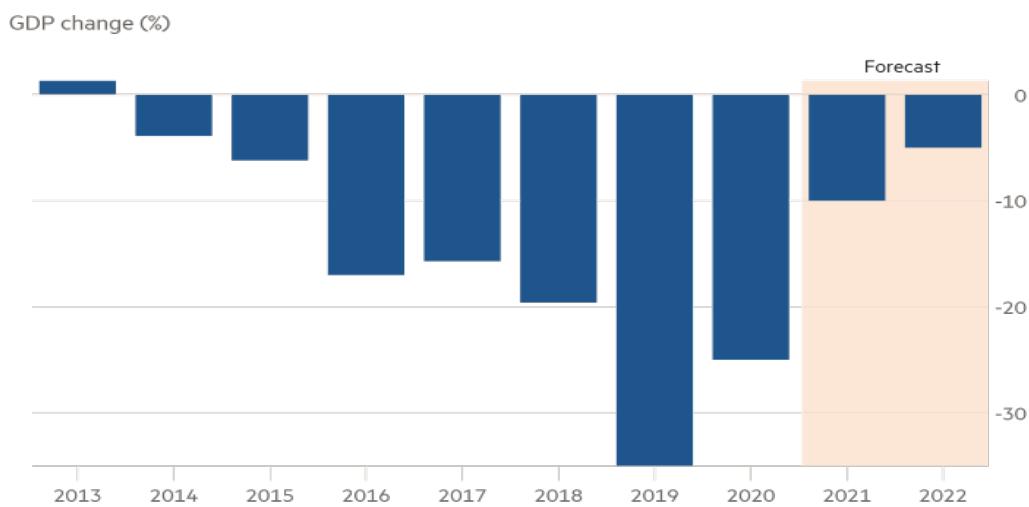
COUNTRY PROFILE

Located on the northern coast of South America and with a current population³ of 28.4 million people, Venezuela (officially the Bolivarian Republic of Venezuela) consists of a continental landmass as well as a host of islands in the Caribbean Sea. Territorial extension consists of 916,445 km², making it the sixth largest nation in South America. Caracas is the largest city and the country's capital.

Venezuela has a market-based economy, dominated by the petroleum sector which accounts⁴ for roughly a quarter of GDP, ~99% of export earnings, and more than half of government revenues. In addition, it is a leading producer and exporter of iron ore, gold, coal and bauxite, with estimates⁵ that Venezuela has over \$14.3 trillion worth of unused natural resources.

GDP shrunk from ~\$300 billion in the mid-2010s to \$42 billion⁶ in 2021. The economy shrank⁷ 80% between 2014-2020 and saw GDP per capita fall 700% in the same time period. Today, estimates show⁸ that over 95% of households live in some sort of poverty, while 64% live in extreme poverty. These intolerable economic and social hardships have caused nearly six million⁹ Venezuelans to flee the country since 2014, one of the most extreme examples of emigration in history.

Venezuela's economy has been shrinking for years



Source: IMF
© FT

Source: FT¹⁰

³ <https://data.worldbank.org/indicator/SP.POP.TOTL?locations=VE>

⁴ https://www.opec.org/opec_web/en/about_us/171.htm

⁵ <https://www.worldatlas.com/articles/countries-with-the-most-natural-resources.html#:~:text=8.,their%20minerals%20are%20state%2Dcontrolled.>

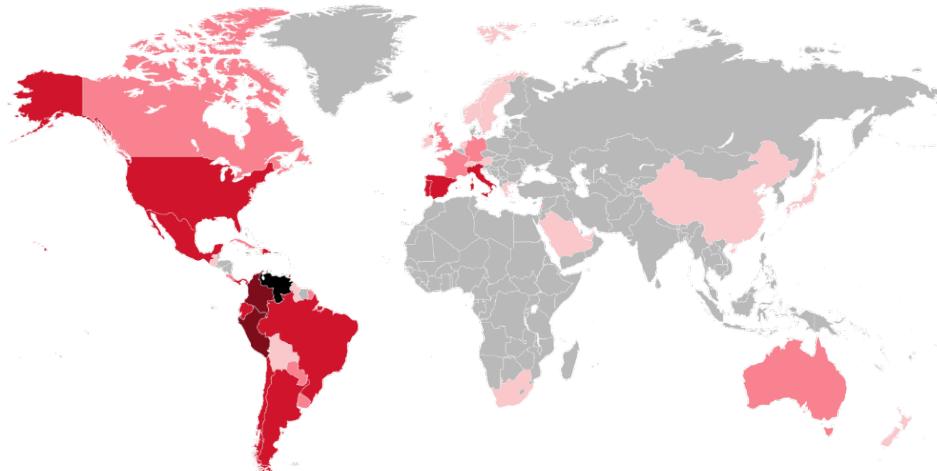
⁶ https://www.imf.org/en/Publications/WEO/weo-database/2021/April/weo-report?c=299&s=NGDP_RPCH,NGDPD,PPPGDP,NGDRPPP,NGDPDPC,PPPPC,PCPIPCH,LUR,LP,&sy=2018&ey=2023&ssm=0&scsm=1&ssc=0&ssd=1&ssc=0&ic=0&sort=country&ds_=&br=1

⁷ <https://www.americasquarterly.org/article/dollarization-cant-save-the-venezuelan-economy/>

⁸ <https://www.statista.com/statistics/1235189/household-poverty-rate-venezuela/>

⁹ <https://www.r4v.info/>

¹⁰ <https://www.ft.com/content/789bedb2-27c7-4b20-a30d-a5669ffc06ce>



Venezuelan diaspora in the world | Venezuela | + 1,000,000 | + 100,000 | + 10,000 | + 1,000

Source: Pew Research¹¹

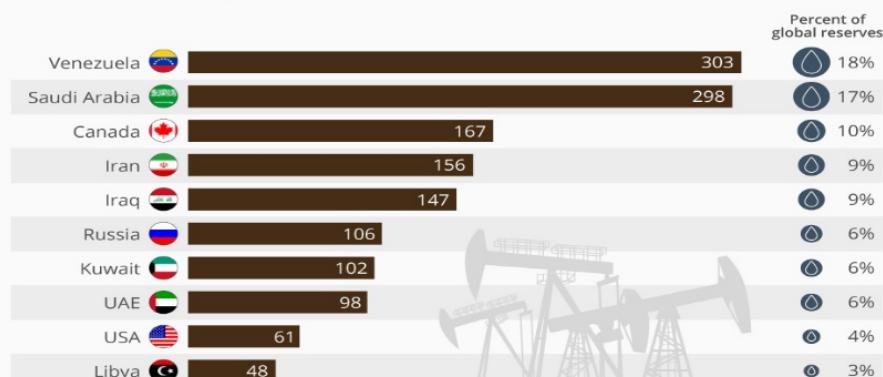
OIL

Oil has been both the making and breaking of Venezuela. When a country becomes all but solely reliant on both the price and demand for a single resource – a ‘Petrostate’ – economic stability is impossible. Dutch Disease describes a country that has exploited and become completely reliant upon a single natural resource, and the negative repercussions that come with this dependency. Venezuela is a textbook example of this disastrous economic path.

Venezuela has the largest oil reserves globally, more than the United States, Canada and Mexico combined. It has long been the currency with which it trades internationally, and the lifeblood of the Venezuelan economy since it was discovered in 1914¹².

The Countries with the Largest Oil Reserves

Countries with the largest proved oil reserves in 2018 (in billion barrels)



@StatistaCharts Source: BP

statista

Source: Statista¹³

¹¹ <https://www.pewresearch.org/global/interactives/global-migrant-stocks-map/>

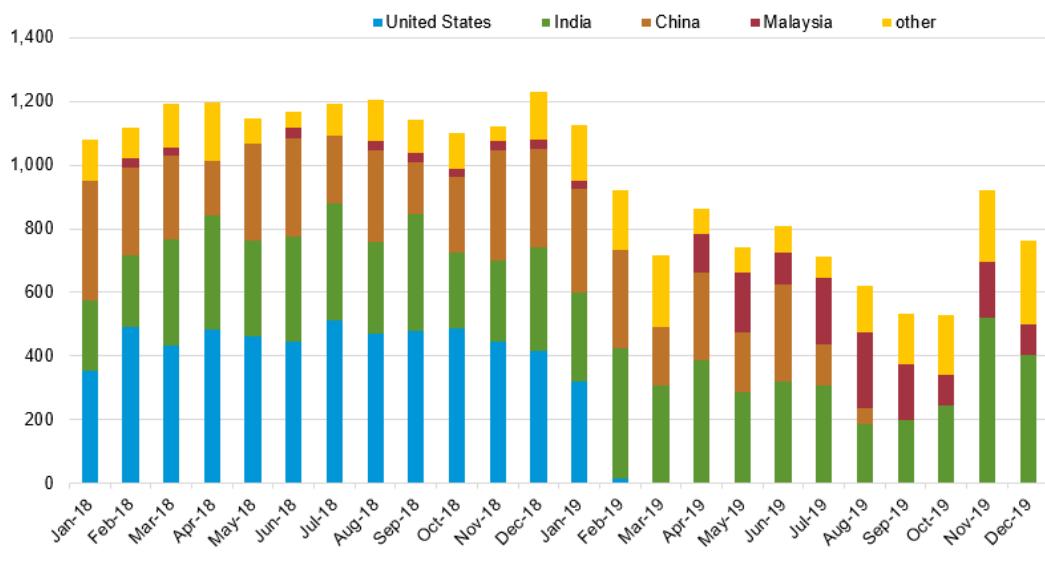
¹² https://www.opec.org/opec_web/en/about_us/171.htm

¹³ <https://www.statista.com/chart/16830/countries-with-the-largest-proven-crude-oil-reserves/>

At its peak, Venezuela was producing over three million barrels per day, and has ample oil reserves to support long-term sustainable production north of 5 million barrels per day. In 2020, Venezuela produced less than 600,000 barrels per day, and similar volumes in 2021¹⁴. There are, however, signs that a recovery in production is starting - with the South American state doubling¹⁵ its oil production in the last few months of 2021 close to one million barrels per day.¹⁶ This was primarily due to new partnerships with Iran¹⁷ and strong trade relationships with Russia and China. Venezuela has been forced to look for alternative trading partners in light of US sanctions. The relationship with Iran, established in 2021 and extended by 20-years in June 2022, involves exchanging Venezuelan heavy oil for Iranian condensate that it can use to improve the quality of its tar-like crude.

As oil production shows the first shoots of a possible recovery, the economic benefits are once again becoming apparent. Many analysts still predict negative growth in Venezuela for the foreseeable future and the main driver of this is the complete lack of transparency regarding US imposed sanctions. Prior to these oil-specific sanctions being imposed, the US had been the largest importer of Venezuelan oil.

Figure 3. Venezuela's exports of crude oil, January 2018-December 2019
thousand barrels per day



Source: U.S. Energy Information Administration based on data published by Clipper Data Inc.

Note: since Venezuela came under sanctions, loadings have become more difficult to track. Clipper export data does not match EIA US import data as a result of timing issues.

Source: EIA¹⁸

However, considering global energy crises, war returning to Europe, and a surge in oil demand post-covid, prices have risen significantly. As oil productivity in Venezuela increases in line with elevated oil prices, oil revenues have the potential to return to historic levels.

It is estimated that it could cost up to \$250bn to restore the Venezuelan oil industry to its former glory. This has naturally kept US petroleum companies with one eye on Venezuela given the potential growth of its oil industry.

¹⁴ <https://www.forbes.com/sites/christopherhelman/2022/12/02/could-a-controversial-chevron-deal-be-a-prelude-to-venezuelas-oil-renaissance/?sh=55979c0113ae>

¹⁵ <https://www.aljazeera.com/economy/2021/12/27/how-venezuela-this-year-almost-doubled-its-oil-output>

¹⁶ <https://www.reuters.com/markets/commodities/venezuela-halts-free-fall-its-oil-exports-output-recovers-2022-01-05/>

¹⁷ <https://www.reuters.com/business/energy/exclusive-under-us-sanctions-iran-venezuela-strike-oil-export-deal-sources-2021-09-25/>

¹⁸ <https://www.eia.gov/international/analysis/country/VEN>

THE HISTORY OF VENEZUELA

VENEZUELA – 1958-1998

On January 23rd, 1958, a successful coup d'état saw the country overthrow the decades old military dictatorship. Romulo Betancourt, who would become known as the 'Father of Venezuelan Democracy' was elected president in 1958 and a new political era was born. Leaning on its abundant oil reserves, Venezuela became richer and richer in the 1960s and 1970s. When the 1973 OPEC embargo was instigated against the US and other countries the price of oil quadrupled almost immediately. It seemed like the good times would go on forever and Venezuela started abandoning other exports and becoming increasingly reliant on oil – leaving it extremely exposed to both oil price and demand.

In the 1970s, economic and energy crises¹⁹ around the world severely decreased the demand for oil at a time when oil prices were at a peak of \$35/barrel (equivalent to \$110/barrel in 2020). By the beginning of the 1980s the resulting glut of oil started to drive prices down and by 1986 they were around \$10/barrel (equivalent to \$24/barrel in 2020).



Source: macrotrends²⁰

This signalled the beginning of the end for Venezuelan prosperity. With no money left in its reserves and an uncertain timeline on oil profits, by the late 1980s the government found itself deeply in debt (~\$33bn). This led to Venezuela both removing price controls on gas, transportation, and other utilities, while also slashing social programs to the bare minimum. These events caused the riots and looting period known as the 'Caracazo' in 1989, where the government reported the death of nearly 300 people at the hands of police and military forces, although some estimate the death toll to be as high as 3000.

During this time, Venezuela had been negotiating a relief package with the IMF and, in July 1996, entered a twelve-month SBA²¹ for a total of US\$1.4 billion²² which demanded the implementation of the following guidelines:

¹⁹ <https://www.theguardian.com/environment/2011/mar/03/1970s-oil-price-shock>

²⁰ <https://www.macrotrends.net/1369/crude-oil-price-history-chart>

²¹ <https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/20/33/Stand-By-Arrangement>

²² https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2091204

- Deregulate
- Cut Welfare
- Privatise Everything

The government's response was to inflate the price of the Venezuelan bolivar in order to reduce the price of imported goods, which essentially started the inflationary environment that we see today, making daily life in Venezuela immediately more expensive and generally difficult. The reality of this meant that the rich had a chance to protect themselves from the ongoing economic crisis by buying up USD and setting up foreign bank accounts, allowing them to steer clear of inflationary headwinds. However, the poorer majority of the population had no such safe haven and, by the 1990s, were taking the full force of the political and financial environments, creating widespread poverty and inequality.

HUGO CHAVEZ – 1998-2013

Hugo Chavez, a former lieutenant colonel in the military, was already a well-known figure in Venezuelan politics and had previously tried to overthrow the government in a coup attempt in 1992. Chavez was elected President in 1998 pledging to help solve the country's issues, particularly pulling on the heartstrings of the poor and working-class. This was the birth of what would become known as the 'Bolivarian Revolution' which implemented socialist and populist policies again using the country's oil profits. Chavez spent millions on social programs which saw poverty fall by 20% and while popular, created even greater dependency on oil.

While he undoubtedly had positive social impacts, Chavez spent no money improving infrastructure, particularly in oil facilities, which led to reduced productivity in the country's most essential operations. Chavez made no effort to diversify the country away from oil and started seizing private wealth especially from those who opposed him, while expanding the military's power and control. In 2010, after seeing a global drop in the price of oil, Chavez declared an economic war against private companies and the rich. He also further devalued the bolivar in an attempt to reduce the budget deficit, but instead what followed was years of hyperinflation where consumer prices skyrocketed, and poverty worsened.

Chavez remained in power until dying of cancer in 2013. He left behind a disastrous economic, political and social climate.

NICOLÁS MADURO – 2013-PRESENT DAY

Maduro was another figure well-known in Venezuelan politics, having been vice-president to Chavez from 2012-2013 and sworn in as his successor prior to his death. His Presidency has been described by many as a dictatorship, watching over as the Venezuelan economy entered freefall, exacerbated by his own political mismanagement and corruption. Throughout his tenure, Maduro has arrested opposition leaders and journalists and promoted the theory that those who opposed him were part of an international conspiracy to ruin Venezuela.

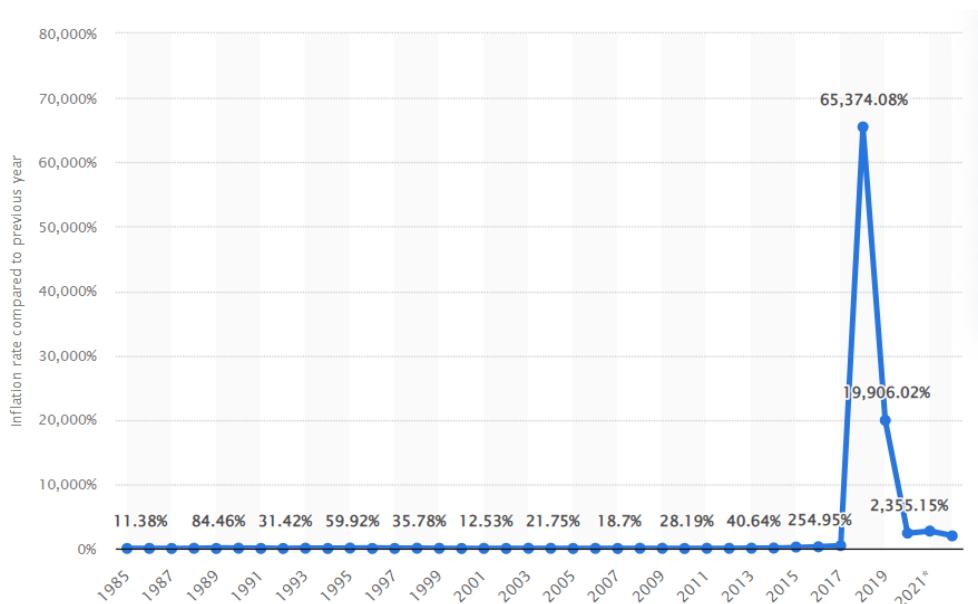
By 2016, the economic and social state of Venezuela was dire, with inflation at 800% for the year, the country experienced shortages in nearly all consumer products, including food. A study at the time found²³ that 75% of Venezuelans had lost weight due to a lack of food. By 2017, Venezuela was declared to be in default regarding debt payments by credit rating agencies. Under this catastrophic environment, outsiders assumed Maduro would lose the election in May 2018, but he won with 67.8% of the votes. Clearly riddled with corruption, the UN described the election as "an insult to democracy".

²³ https://en.wikipedia.org/wiki/Shortages_in_Venezuela

In 2019, the Venezuelan National Assembly (one of the few political bodies overseeing presidential power in the country) declared the 2018 elections invalid, calling for Juan Guaidó, the president of the National Assembly, to be implemented as interim president. Maduro refused to step aside and while Guaidó had his supporters both domestically and internationally, this effort was not sufficient to give him power. However, major economies such as the US and UK do recognise Guaidó as Interim President, meaning that Venezuelan assets in these countries are under the control of Guaidó²⁴, a major source of conflict between himself and Maduro.

In January 2019 the Permanent Council of the Organization of American States (OAS) approved a resolution "to not recognize the legitimacy of Nicolás Maduro's new term as of the 10th of January of 2019". This only served to increase political and economic instability and as a consequence consumer prices in Venezuela grew at a rate of more than 65,000% year over year in 2019, according to the International Monetary Fund (IMF).

Today, we are starting to see dollarisation in Venezuela as well as acceptance of other currencies such as the Euro, Yuan and domestic cryptocurrency Petro. The state of the bolivar had become so weak that in 2021, the maximum amount you could withdraw from an ATM was equivalent to \$0.20, and general consumer items like food were costing a high proportion of the population's income, which led to major food shortages. For context, it would take 40 bills of 50,000 bolivars to buy one kilogram of rice. A UN report estimated in March 2019 that 94% of Venezuelans lived in poverty, other sources²⁵ suggest poverty rates as high as 96.4%.



Source: IMF²⁶

PDVSA

In January 1976, under the presidency of Carlos Andrés Pérez, Venezuela officially nationalized its oil industry and created the state-owned oil company Petróleos de Venezuela, S.A. (PDVSA). Within 25 years of nationalisation, PDVSA had become the largest company in Latin America and the 10th most profitable company globally. In the same period, exploration efforts saw proven oil reserves rise from 18 billion barrels to over 80 billion barrels, with a similar increase in production capacity.

²⁴ <https://www.theguardian.com/law/2021/dec/20/guaido-closer-to-13bn-in-venezuelan-gold-after-uk-court-ruling>

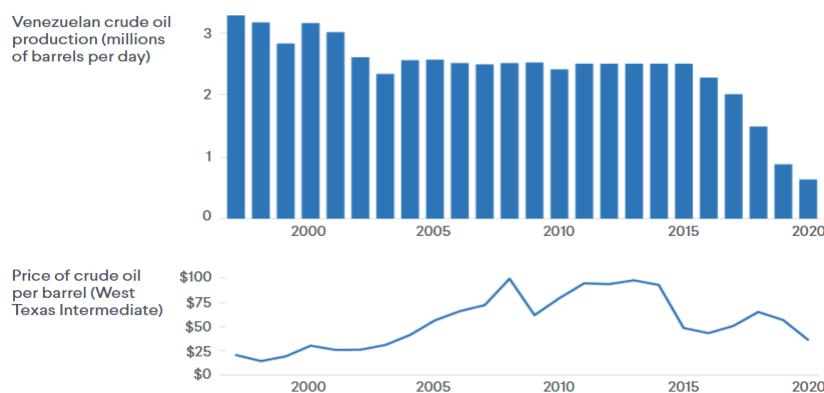
²⁵ <https://www.statista.com/statistics/1235189/household-poverty-rate-venezuela/>

²⁶ <https://www.statista.com/statistics/371895/inflation-rate-in-venezuela/>

Prior to the election of Chavez in 1998, PDVSA ran independently without the need for government intervention. However, during Chavez's presidency, he initiated control of PDVSA and effectively turned it into a direct government arm whose profits would be injected into social spending. This essentially meant that all revenues generated by PDVSA ran through the country's sovereign fund accounts in the Venezuela Central Bank.

Following the death of Chavez and with the country experiencing unprecedented hyperinflation, pay checks for PDVSA employees became essentially worthless, resulting in the mass resignation of the company's workforce. PDVSA's productivity fell to historic lows, and although we are seeing early indications of a potential turnaround, it is still nowhere near the peak production of 3.1 million barrels per day at the end of the 1990s and early 2000s.

Venezuela: From Oil Boom to Bust



Note: Data from 2020 represents the average over the first six months of the year.

Sources: Federal Reserve Bank of St. Louis; U.S. Energy Information Administration.

COUNCIL ON
FOREIGN
RELATIONS

Source: EIA²⁷

US SANCTIONS

Once the world's largest importer of Venezuelan oil, the United States has imposed sanctions on Venezuela for over 15 years²⁸. The first of these sanctions was under the Bush administration, imposed against three government officials for their involvement with narco-terrorism. While these had no economic effect it initiated the longstanding tensions between the two countries.

In 2015, Barack Obama placed sanctions on seven government officials accusing them of "perpetrating human rights violations and public corruption"²⁹. This was the first example of sanctions imposed against Venezuela that would materially affect its relationship with its biggest trade partner. These restrictions were not out of the blue however, tensions had been brewing prior this when Maduro had announced³⁰ his own sanctions which limited the number of US diplomats entering the country as well as mandatory visas.

The real economic impact came in 2017 under Donald Trump's administration, which imposed sanctions against Venezuela's state-owned oil company PDVSA as well as Venezuelan officials. The sanctions blocked US companies doing business with PDVSA while freezing the company's US assets. They also required payments to be made into accounts that PDVSA could not access.

²⁷ <https://www.cfr.org/backgrounder/venezuela-crisis>

²⁸ <https://www.ft.com/content/ade67fa7-0d56-4c21-9f58-a78ba4387cc5>

²⁹ <https://www.theguardian.com/world/2015/mar/09/obama-venezuela-security-threat-sanctions>

³⁰ <https://www.theguardian.com/world/2015/feb/28/venezuela-president-nicolas-maduro-diplomatic-sanctions-us>

Other sanctions included restrictions in US investors purchasing Venezuelan debt notes:

- August 2017: ban on US persons participating in the issuance of new non-short-term debt by Venezuela.
- August 2017: ban on secondary market purchases of the assets by US persons, or within the United States.
- August 2017: US authorities issue a licence that exempts trading in most Venezuelan Eurobonds (other than bonds held by the Republic itself).
- January 2019: US remove the exemption on the bonds issued by the state-owned oil company PDVSA, and thus subjected them to the trading ban, but retained the exemption on certain other bonds issued by the Republic.

Source: FT³¹

These sanctions had major repercussions, and by 2020 had contributed to a 38% reduction in the country's oil exports.

EASING OF CONTROLS

"As we've long said, sanctions aren't permanent. If we see change, sanctions can be lifted." – Antony Blinken, US Secretary of State, June 2022

The focus of the Biden Administration has been centred around one primary factor, dialogue. This dialogue has been evident between the US government and the Maduro Regime, but also Guiado's opposition have been strongly encouraged by the US to engage in dialogue with the Maduro government. Indeed, the Biden Administration have made particular efforts to further engage the wider international community on this dialogue strategy.

In July 2021, the US Treasury Department announced³² that it would remove sanctions on Venezuela importing liquified petroleum gas from the United States and other sources. This seems to demonstrate early signs that the Biden administration is willing to address the ongoing issues in Venezuela.

However, this loosening of restrictions should not be confused with direct support of the Maduro government. It likely stems from a desire to support the economic situation from a humanitarian viewpoint, indicating that they are conscious that the Venezuelan people have suffered enough at the hands of their own government.

Perhaps the most impactful news, so far, of 2022 was reports in March of US officials travelling to Caracas for meetings with President Maduro's government. This news cannot be understated, communication between the US and Maduro has been rare, physical meetings even more so. Experts have said that US officials see "an opportunity to ease longstanding sanctions on Venezuelan oil and coax Maduro away from Moscow's embrace at a time when global oil concerns are peaking."

Sources familiar with the matter stated that the US delegation focused not only on the fate of detained Americans but on the possibility of easing US oil sanctions on Venezuela to fill the supply gap created by Russian sanctions. In addition, officials sought to determine whether Caracas is prepared to distance itself from its close ally, Russia, following its invasion of Ukraine.³³

³¹ <https://www.ft.com/content/ade67fa7-0d56-4c21-9f58-a78ba4387cc5>

³² <https://www.reuters.com/business/energy/us-treasury-dept-authorizes-liquefied-petroleum-gas-exports-venezuela-2021-07-12/>

³³ <https://www.reuters.com/world/americas/us-officials-travel-venezuela-russian-ally-talks-source-2022-03-06/>

Further indication of cooperation between the two parties saw two men freed from Venezuelan jails as a result of the talks, in an apparent goodwill gesture toward the Biden administration following the visit.³⁴ On June 28th 2022, it was reported that US officials had returned to Caracas in a bid to rebuild ties. The main topic of discussion on this trip was bringing home detained Americans.

In mid-June of this year, Carlos Erik Malpica Flores, a former Venezuelan official and nephew of Venezuelan First Lady, was removed from the US sanctioned list.³⁵

Will the Biden administration accept humanitarian motivation as enough to further lift sanctions? Or could rising oil prices and energy security put sufficient pressure on the US economy to resume trading? The situation in Venezuela has been described as “the biggest political and humanitarian crisis in the Americas”. Considering this, and the fact that nearly 600,000 Venezuelans have fled to the US, President Biden will, no doubt, be facing pressure to find a fast solution.

CHEVRON

In May 2022, with its maintenance license nearly expired, senior administration officials said that the Biden administration has authorised a “narrow license” for US oil company Chevron to negotiate the terms of potential future activities in Venezuela, temporarily lifting a ban on such discussions. Chevron, whose legacy in Venezuela dates back to the Boscan Field discovery in the 1920s, requested permission to have greater involvement in its JVs with state-run oil company PDVSA. The US oil giant also received an OFAC licence to engage in negotiations to expand new business – a small yet important detail not widely publicised.

In November 2022, the US Treasury granted Chevron a six-month expanded license which allows exports to the US but still precludes proceeds from reaching Venezuela’s coffers.³⁶ This has led to further reimplementation of US operations on Venezuelan soil, particularly relevant as Venezuela desperately needs US technology, infrastructure and general expertise to rejuvenate its oil industry. Of particular focus is improving the performance at Orinoco, a territory in the southern strip of the Orinoco River Basin and overlies the world’s largest petroleum deposits.³⁷

In December 2022, Venezuelan energy officials met with Chevron executives for the first major meeting in years to address the ongoing strategy for their joint ventures, with a particular focus on the workforce. Following this, Maduro spoke at PDVSA headquarters saying that Chevron “will soon be producing and the oil reaching markets worldwide”

The Chevron story in particular has opened the door to further sanctions being lifted. It is also a widely held view that granting Chevron these licenses and opportunities in Venezuela will further motivate other US companies to pressure the Biden Administration to grant similar privileges to them.

These steps signify increased willingness to resolve the aging tension between these two nations, nations that ultimately could benefit greatly from one another as was the case prior to initial conflicts at the beginning of George Bush’s first administration.

³⁴ <https://www.reuters.com/markets/rates-bonds/venezuela-frees-least-two-americans-after-talks-with-us-sources-2022-03-09/>

³⁵ <https://www.bloomberg.com/news/articles/2022-06-17/us-removes-former-venezuelan-official-from-sanctions-list>

³⁶ <https://www.reuters.com/business/energy/venezuelas-pdvs-chevron-address-joint-venture-workers-after-license-2022-12-06/>

³⁷ https://en.wikipedia.org/wiki/Orinoco_Belt

DOLLARISATION

In September 2021, Venezuela implemented a ‘currency revamp’ which effectively knocked six zeros off the bolívar in order to make transactions and accounting simpler and encourage the use of the home currency. While there is no difference in intrinsic value, this step is evidently in response to the intense hyperinflationary environment in Venezuela today.

United States Dollar to Sovereign Bolívar



Source: Google Finance ³⁸

However, this move might be too little too late, as we are starting to see the dollarisation of the Venezuelan economy. The USD is increasingly becoming part of the fabric of Venezuelan life with the general population understanding that it is a more stable and reliable currency. A recent study by Ecoanalítica found that over half of all financial transactions in Venezuela are paid for in foreign currency — primarily USD. This shift has widened inequality between public and private sector workers, as those paid in foreign currency (private) enjoy greater purchasing power than public sector workers remunerated in the domestic bolívar.³⁹

At some point it seems increasingly likely that a decision will have to be made where Venezuela either formally accept the USD as their national currency or whether they stick with the heavily inflated bolívar. Given Maduro’s notorious abhorrence of the US, this total adoption seems unlikely. However, Maduro does see partial/temporary dollarisation acceptance as an important part of the economy: “Dollarisation can be useful for the recovery and for unleashing the country's productive forces and for the functioning of the economy...It is an escape valve. Thank god it exists.”

³⁸ https://www.google.com/finance/quote/USD-VES?sa=X&ved=2ahUKEwizp_Kj_n7AhVVolvKHdIpB6sQmY0JegQIBhAc&window=1Y

³⁹ <https://www.reuters.com/world/americas/venezuela-inflation-dollarization-deepen-schism-between-private-state-employees-2022-05-09/>

The exchange rate of the US dollar to the Venezuelan bolívar (USD/VEF) as of December 8th, 2022, is 1 USD = 12.65 VEF

POLITICAL OUTLOOK

The Maduro government has been under pressure both domestically and internationally for years. Domestically there has been movements on trying to resolve the country's leadership and negotiations in Mexico in August 2021 (overseen by Norway), aimed to find democratic solutions to electoral processes going forward. The negotiations began late, in terms of the electoral timeline, due to delays from the Maduro government caused by trying to prevent the extradition of its financial collaborator, Alex Saab. This meant that there could be no impact on the elections that shortly followed. However, for the first time in three years, more recent regional elections were held with opposition involvement, where previously there had been boycotts against their participation.

The results of these elections saw Maduro's socialist party take 20 of the country's 23 governorships, including mayorship of Caracas. The opposition claimed that it was neither their expectation nor intention to win these elections, but simply to reactivate their political presence. For the first time in 15 years, the EU sent a delegation to observe the elections⁴⁰, who noted that while improvements had been made compared with previous processes, there were still several "structural deficiencies".⁴¹ U.S. Secretary of State Antony Blinken noted that "Opposition harassment, media censorship and other undemocratic tactics ensured Venezuela's Nov 21 elections were neither free nor fair. We applaud the courageous opposition who participated despite unfair conditions & urge the Maduro regime to respect democratic principles."⁴²

In May 2022, opposition leaders announced that they have begun "formal talks" with the Venezuelan government to resume negotiations, with the two sides expected to set a date soon,⁴³ and in late November 2022, it was announced by Venezuelan negotiators that the dialogue process in Mexico City would restart between both parties. Again, the focus remains on engaging the two parties in good faith toward a comprehensive agreement leading to free and fair elections in 2024.⁴⁴

Internationally, those who oppose Maduro are calling for one thing, fair and democratic elections. The world awaits the 2024 Presidential elections and view this as the next major event capable of effectuating change. There are increasing concerns, however, that Maduro will suspend these elections if US sanctions are not lifted, a perfect example of the cycle of political stubbornness that has crippled the Venezuelan economy for years.

Recognised Interim President Guaidó has also faced recent challenges with questions continuing to be raised about his leadership and efficacy in sparking any political or social transformation. With no demonstrable changes, support for Guaidó has waned and this intensified in December 2021 when former foreign affairs minister Julio Borges stepped down, citing that real change under the interim government has not come to fruition and 'radical change'⁴⁵ is needed. Irrespective of these internal pressures, the opposition-majority congress ratified Guaidó's continuation as their leader through 2022. Guaidó's term as the President of the National Assembly expires in January 2023, and it remains unclear whether he will remain in this position going forward.

⁴⁰ <https://www.local10.com/news/2021/11/22/mega-elections-in-venezuela-wrap-up-with-maduros-party-taking-majority-of-positions/>

⁴¹ https://eeas.europa.eu/election-observation-missions/eom-venezuela-2021/107745/venezuela-statement-high-representative-josep-borrell-regional-and-local-elections_en

⁴² <https://twitter.com/SecBlinken/status/1462881148749725696?s=20>

⁴³ <https://www.washingtonpost.com/world/2022/05/17/venezuela-oil-sanctions-chevron/>

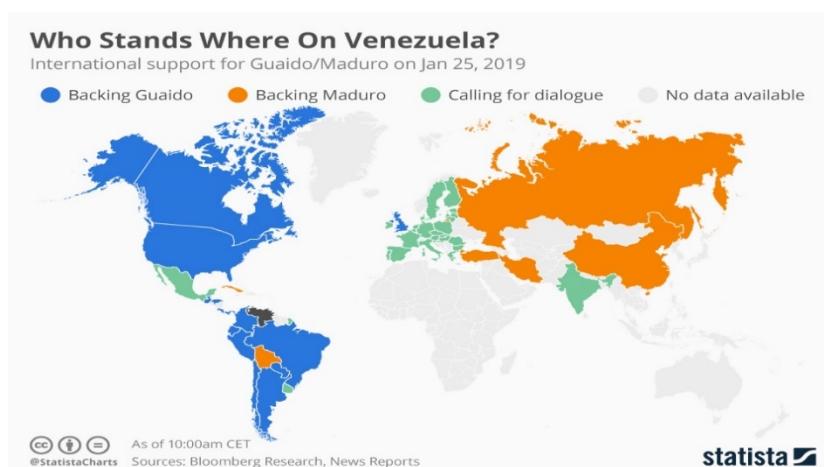
⁴⁴ <https://www.gov.uk/government/news/joint-statement-on-venezuela-negotiations-26-november>

⁴⁵ <https://www.ft.com/content/a02e5d23-4db2-456e-b3f7-5eee1171ace6>

Not only is Guaidó's position in jeopardy, but the very existence of the "Interim government" itself. Important figures within the opposition have called⁴⁶ for it to return to a socialist movement, forego the recognised structure and instead focus on determining an effective forward-looking strategy. International supporters would likely not change their recognition, something noted by Assistant Secretary of State for Western Hemisphere Affairs Brian Nichols who said the Biden administration would not change their policy regardless of a "change of heart from the opposition."

The opposition, whose late decision to run candidates in local elections, shows a further lack of unification in the party, resulting in them winning in only three out of 23 states. However, a key indicator was the opposition win in Barinas, the home region of former President Hugo Chavez. This marks the first time in 23 years that the opposition had won in this state. Guaidó called for unification of the opposition, as fighting and egotism continued among the leadership of his party. Other opposition groups and leaders returned from exile during the November 2021 elections. This included the G4, a coalition of the most important opposition parties who had not participated in elections for three years due to undemocratic conditions.⁴⁷ They cited ongoing negotiations in Mexico between Maduro and Guaidó as the reason for their return to participating in elections.

Internationally, recognition of Guaidó far outweighs that of Maduro, with 60 countries globally acknowledging the interim government. These countries are also being forced to face the fact that Guaidó is not receiving backing from the people of Venezuela. Some countries, however, are simply calling for dialogue between the two parties to come to a reasonable agreement that benefits, above all, the people of Venezuela. Major economies such as the US, EU and Canada have shown a commitment⁴⁸ to reconsider sanctions against Venezuela but note that these will be heavily dependent on political shifts. Guaidó has control of billions in foreign assets, mainly thanks to Washington's backing of the interim government. However, with the backing of the Venezuelan military, Maduro remains firmly in power of major decision making and policy changes, and this does not look likely to change in the near-term.



Source: Statista⁴⁹

⁴⁶ <https://www.csis.org/analysis/venezuela-time-opposition-reflection-and-renovation>

⁴⁷ https://en.wikipedia.org/wiki/2021_Venezuelan_regressional_elections

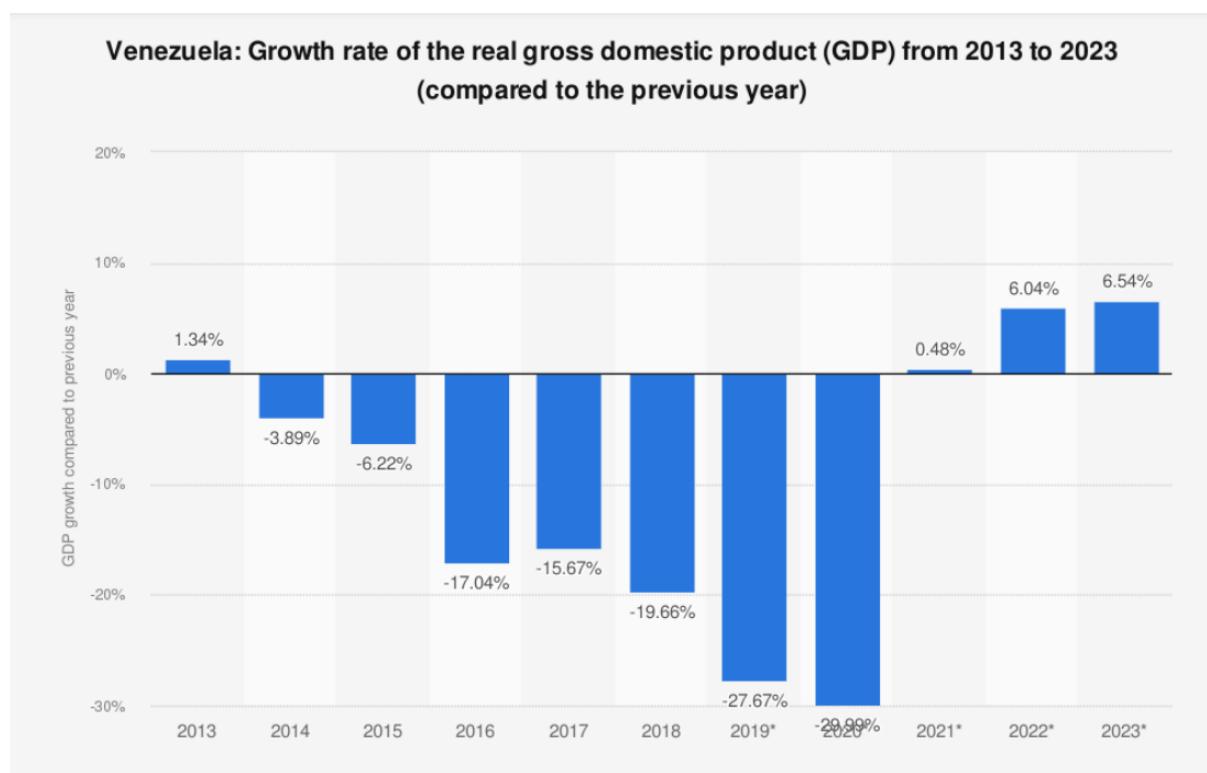
⁴⁸ <https://www.reuters.com/article/venezuela-politics-sanctions/u-s-eu-canada-willing-to-review-venezuela-sanctions-based-on-negotiations-idUSL2N2O736D>

⁴⁹ <https://www.statista.com/chart/16789/international-support-for-guaido-and-maduro/>

ECONOMIC OUTLOOK

After years of economic decline, analysts are tentatively predicting a recovery in the Venezuelan economy, noting, however, that the recovery will take a major strategic restructuring in both the country's political and economic situations. While a recovery might normally imply positive GDP forecasts, with the economy falling so sharply over recent years, in this case, analysts are initially predicting substantially smaller GDP declines than previous years. A recent poll by Focus Economics,⁵⁰ with a sample, of 21 banks found GDP forecasts are -3.1% for 2022 and 2.7% for 2023, the IMF predicts a similar contraction as you can see below.

In June 2022, Credit Suisse maintained a base-case expectation that Venezuela's real GDP will expand by 20% this year. This is based on oil output increasing 40% YoY in the first four months of the year, tax revenues have increased ~125% YoY, wages in the commercial centre of Caracas increased ~22% YoY, exports rose in the first quarter ~180% YoY, while imports grew 84% YoY.⁵¹ Given what is a low-base comparison, the economy should grow at a stronger pace in 2022.



Source: IMF, Statista⁵²

Additionally, Venezuela has longstanding relationships with both Russia and China, although failure by Maduro to repay its debt to both countries has created some friction. However, both remain the two largest creditors to Venezuela, exchanging billions in credit for oil (loan-for-oil transaction). While these relationships have not come without their issues, they are generally amicable and will be key to a positive turnaround in Venezuela.

⁵⁰ <https://www.focus-economics.com/countries/venezuela>

⁵¹ <https://plus2.credit-suisse.com/shorturlpdf.html?v=55A2-Vxmc-V>

⁵² <https://www.statista.com/statistics/370918/gross-domestic-product-gdp-growth-rate-in-venezuela/>

We see oil being used more like a currency than a commodity. Evidently, Venezuela's economic outlook is going to be heavily dependent on returning production to historic levels, but long-term recovery and sustained growth will require a significant diversification strategy. Maduro aims to double oil production in 2022 to two million barrels per day, but in the first half of the year has been unable to do so.⁵³ A potential increase in productivity coupled with a positive outlook on the price of oil considering global energy crises and uncertainty over Russian involvement in oil markets, has the potential to further contribute to the country's economic turnaround.

In January 2022, Maduro claimed that the Venezuelan economy had grown by 7.6% in the third quarter of 2021, and more than 4% on the year.⁵⁴ This would be the first time in eight years that the country had seen positive GDP growth. He also added that exports grew by 33%. Economists regard hyperinflation to be 50%+, and with the central bank reporting monthly inflation for December to be 7.6%, this marked Venezuela's 12th consecutive month below this benchmark.⁵⁵

FOREIGN INVESTMENT

In May 2022, Venezuela's government announced plans to open several state-owned companies in vital sectors for private investment, as it sought to address capital requirements for severely underinvested businesses. This likely signals that the government can no longer control the economy, and that they are to some extent setting it free.

The government intends to sell between 5% and 10% of shares in various companies, where the sales would be geared "fundamentally" toward local investors, but foreign money could also flow into the companies. Among the companies Maduro mentioned are CANTV and its subsidiary Movilnet, petrochemical producer Petroquimica de Venezuela (Pequiven) and a conglomerate focused in the mining sector. Attracting more capital to these rundown and poorly maintained institutions should have a knock-on effect on Venezuela's diminishing GDP.⁵⁶

In June 2022, Reuters reported that Spain's Repsol SA is to begin shipping Venezuelan oil to Europe as soon as July to make up for Russian crude⁵⁷. Additionally, on June 17th, it was reported that a 650,000-barrel-cargo of Venezuela's oil chartered by Italy's Eni was to set sail, carrying the first export of crude from Venezuela to Europe in two years.⁵⁸

This came to fruition in June and July with Eni receiving a total of 3.6 million barrels of Venezuelan diluted crude.⁵⁹ After a four-month pause, it was reported in November that Eni has resumed taking Venezuelan oil and that it had been assigned two one-million barrel cargoes of Venezuelan crude for November loading.

Furthermore, at this year's World Economic Forum in Davos, Venezuelan investors met to discuss potential opportunities in the oil sector, something that has never happened before.

SOVEREIGN DEBT RESTRUCTURING

For Venezuela, its sovereign debt restructuring (SDR) is likely to present significant challenges. There are a variety of options in terms of execution, but given the centrality of oil to the economy, it will likely revolve

⁵³ <https://economictimes.indiatimes.com/news/international/business/venezuela-the-decline-of-an-oil-giant-in-crisis/articleshow/88988730.cms>

⁵⁴ <https://www.bloomberg.com/news/articles/2022-01-16/venezuela-grew-4-in-2021-and-on-road-to-recovery-says-maduro>

⁵⁵ <https://www.ft.com/content/03e918f5-e316-483e-871a-bf47da919340>

⁵⁶ <https://www.independent.co.uk/news/ap-hugo-chavez-nicolas-maduro-caracas-internet-b2079069.html>

⁵⁷ <https://www.reuters.com/business/energy/exclusive-us-let-eni-repsol-ship-venezuela-oil-europe-debt-sources-2022-06-05/>

⁵⁸ <https://www.reuters.com/article/venezuela-eni-cargo-idAFL1N2Y420P>

⁵⁹ <https://www.reuters.com/business/energy/italys-eni-resume-taking-venezuelan-oil-after-4-month-pause-2022-11-07/>

around a rebirth of its oil industry. One thing is for sure, a successful Venezuelan restructuring, regardless of who is at the helm of government, will require easing of current US sanctions.

The Maduro government is viewed as unlikely to execute a SDR and Maduro, himself, is adamant that Venezuela will be able to recover on its own. However, if circumstances force his hand, then it is unlikely that he would be able to attract the significant international support required to perform an SDR. Therefore, such an occurrence would in all probability have to be under a new government.

Usually in the case of an SDR, the government would be the stand-alone obligor. In the case of Venezuela, both the Republic of Venezuela and PDVSA are likely to be liable in repaying the country's estimated \$150bn of debt.

There is a wide range of creditor interests involved⁶⁰ including "bondholders, bilateral creditors, suppliers/trade creditors, arbitration award holders, holders of claims for blocked funds (e.g., airlines, etc.), and promissory noteholders, among others". This variety of interests will likely create further tensions in the case of a restructuring, as creditors, many of whom have been forced holders due to sanctions, look to exit their positions.

Traditional SDR methods such as adjusting interest or coupon rates, or rescheduling debt deadline dates could be employed to make service payments more manageable.

As mentioned, Venezuela has good relationships with both Russia and China who both extend billions of dollars of credit in exchange for oil shipments. It is probable that both parties would look to capitalise in the case of an SDR.

OIL WARRANTS

Historically, warrants can be used to recover value from an indebted economy. Examples of this include GDP warrants in Argentina in 2002 and 2005, as well as Greece in 2012. Venezuela, however, could look to implement oil warrants⁶¹, whereby creditors receive an additional pay out on their debt above and beyond the required debt service payments if, and when, the price of oil exceeds a certain projection.

DEBT-FOR-EQUITY SWAPS

Another potential approach might be debt-for-equity swaps whereby credit is extended in exchange for shares in Venezuelan enterprises. Unlike corporate swaps, a government does not have shares to give away, thus, it would need to identify private domestic companies – usually companies that were previously government owned and then privatised – if this form of repayment is to occur. This strategy was used in previous restructurings by Venezuela in the mid-1980s to mid-1990s. This process involves foreign investors purchasing Venezuelan debt on the secondary market, converting the debt into the domestic tender and then use this cash to purchase shares of private companies from a pre-determined list by the government. If they use this route, they will likely skip the domestic currency swap stage, as the value of the bolivar has become so weak.

We have already seen this strategy implemented again as recently as August 2021, whereby Maduro assessed Venezuelan foreign assets to try and relieve some of their debt. Under the deal, the government gave investors its 49% stake in a Dominican oil refinery, settling \$361m of both government and PDVSA bonds, pricing them around 24 cents on the dollar.

⁶⁰ [http://www.kargmanassociates.com/AIRA_Journal_S.Kargman_Article_on_Venezuela_\(Final-May_2021\).pdf](http://www.kargmanassociates.com/AIRA_Journal_S.Kargman_Article_on_Venezuela_(Final-May_2021).pdf)

⁶¹ <https://www.law.ox.ac.uk/business-law-blog/blog/2021/10/venezuela-prospects-restructuring-sovereign-debt-and-rebuilding%20>

This is the first sign from the Maduro government that they are willing to begin the process of repaying their significant foreign debt. It is estimated that Venezuela have ~\$6bn in foreign assets, including close to \$2bn of gold reserves in the Bank of England.

OIL DEVELOPMENT RIGHTS

Similarly, Venezuela might look to exchange development rights in oil reserves for lines of credit. In practice, creditors to Venezuela who are involved in the oil industry in some capacity would look to receive oil development rights on an agreed plot in order to forgive some of the debt owed to them. Venezuela would likely be able to forego a significant portion of its debt, although the prices they receive for these development rights will be dependent on the price of oil at the time. A fair price must be agreed for the development rights, primarily so they can accelerate their debt repayments but also, so the government are not seen to be giving away the country's most valued resource at unfavourable prices.

SUMMARY

Global concerns around climate change are likely to play a role in any restructuring negotiations as the world looks to decarbonise and reduce reliance on oil. In any case, Venezuela will need to diversify its economy as a hedge against increasingly volatile oil prices. Regardless of the chosen strategy, Venezuela must ensure an appropriate and fair price for whatever is being offered to foreign investors who might be looking to capitalise on an economy on its knees. The wide range of creditor interests combined with the sheer size of government and PDVSA debt, and an essentially worthless domestic currency, makes successful execution of this restructuring incredibly complex.

BONDS OVERVIEW

There are two obligors in the case of Venezuela, namely, The Republic of Venezuela and the state-owned oil company PDVSA. Deeply distressed bond prices have come as a result years of pessimistic investor sentiment towards the possibility of a debt restructuring and economic recovery in Venezuela. As of June 2022, Venezuelan sovereign paper was the best performing EM strategy year-to-date.

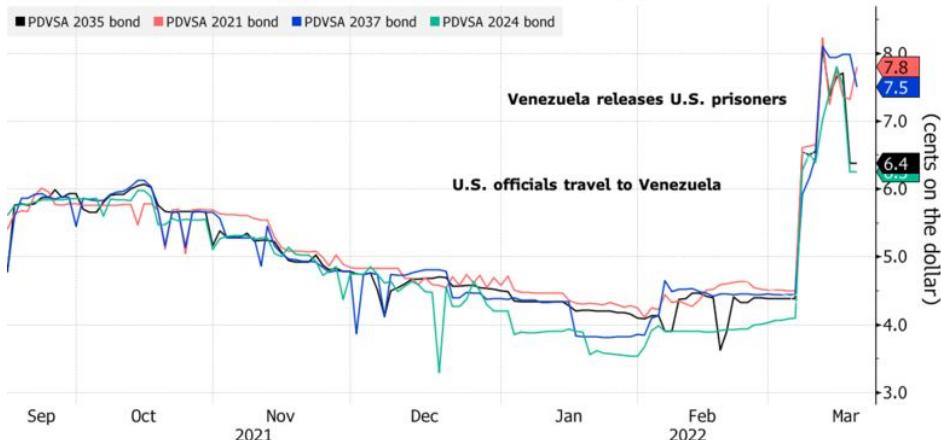
Venezuela Rally PDVSA and govt bonds have rallied amid negotiations and a debt swap



Source: Bloomberg⁶²

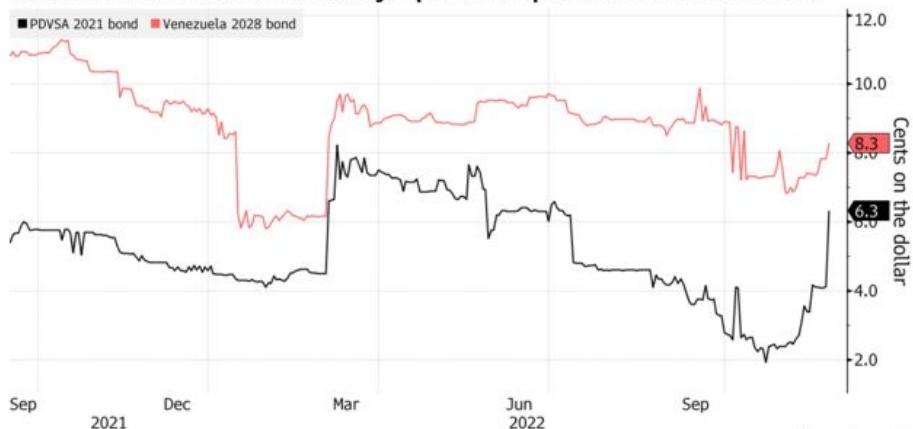
⁶² <https://www.bloomberg.com/news/articles/2022-03-18/defaulted-venezuela-bonds-are-luring-buyers-betting-on-u-s-deal>

Edging Higher Petroleos de Venezuela bonds jump on signs of U.S. engagement



Source: Bloomberg⁶³

Small Rebound Venezuela and PDVSA bonds have jumped amid optimism over sanction relief



Source: Bloomberg⁶⁴

However, we are starting to see a recovery in the market for Venezuela's defaulted bonds, with trading volumes reaching their highest levels since before US sanctions were imposed. Trump's sanctions against US investors purchasing Venezuelan debt notes does not limit them from purchasing securities, although most of the purchasing power remains in European funds with a big risk-appetite. The aforementioned debt-for-equity swap in August 2021 acted as a meaningful catalyst for a rise in both trading volumes of Venezuelan bonds as well as price.

In addition, the US visit to Caracas in early March gave investors better transparency on the potential impact that easing relations between the US and Venezuela would have on the price of PDVSA bonds. We see bond prices reacting favourably to news signalling a potential rapprochement between the two countries

⁶³ <https://www.bloomberg.com/news/articles/2021-09-22/venezuela-debt-swap-breathes-life-into-all-but-dead-bond-market>

⁶⁴ <https://www.bloomberg.com/news/articles/2022-11-28/venezuela-breakthrough-gives-defaulted-bonds-a-rare-bounce>

In January 2022, a call with US and European bondholders led by top economic aid Patricio Rivera, discussed Venezuela's plans to reopen deals in the country's oil and tourism industries to encourage international investor interest.

GOLDMAN SACHS PDVSA BOND PURCHASE

In 2017, Goldman Sachs purchased⁶⁵ £2.8bn PDVSA bonds, paying \$865 million for them, less than a third of their face value. The transaction was executed through a London-based brokerage instead of 'direct purchase' from the Venezuelan government. Goldman faced scrutiny over this for funding a corrupt government which was 'starving its people' and faced backlash for the investment at the time which saw protests⁶⁶ outside their New York headquarters.

Even when Venezuela had stopped paying off their foreign debt at the start of 2018, Goldman received a \$90m interest payment. Many at the time said the operation would fuel hunger in Venezuela by depriving the government of foreign exchange to import food - leading the securities to be dubbed "hunger bonds".⁶⁷

CONCLUSION

Any meaningful Venezuelan recovery is contingent on US sanctions being lifted, the possibility of which has increased given the current economic and geopolitical environment. With the US being so sensitive to rising prices of oil; the subsequent financial pressure may force them to drop sanctions. There have been positive economic signs with oil output and tax revenues increasing, growing adoption of the dollar, 'credit for oil' deals being done with foreign state entities, as well as some political shifts with the two parties expected to resume negotiations soon.

Furthermore, we are seeing regular positive news flow regarding US acknowledgement that the situation in Venezuela needs addressing. Meetings between US and Venezuelan officials, extended licenses for US corporations operating on Venezuelan soil, and easing of sanctions all point at the possibility of further rapprochement between the two nations.

However, investment in any Venezuelan debt will continue to have high associated risk. There continues to be a huge degree of uncertainty and instability – both politically and economically.

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⁶⁵ <https://www.nytimes.com/2017/05/30/business/dealbook/goldman-buys-2-8-billion-worth-of-venezuelan-bonds-and-an-uproar-begins.html>

⁶⁶ <https://www.ft.com/content/c2f0fc3c-466b-11e7-8519-9f94ee97d996>

⁶⁷ <https://www.reuters.com/article/us-venezuela-goldman-idUSKBN1HH36H>

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