

NOVEMBER, 2020

UPDATE ON VENEZUELA

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EXECUTIVE SUMMARY

Venezuela has officially been in default since November 3, 2017 when President Nicholas Maduro announced the establishment of a **national commission to pursue the restructuring of all of Venezuela's external debt obligations**. These debt obligations included **all** the debt of the state run oil company **Petroleos De Venezuela S.A.** more popularly known as **PDVSA**.

HOW DID WE GET HERE

Venezuela's challenges began during the administration of now deceased President, Hugo Chavez, when the country began the nationalization of key industries including all segments of the oil and natural gas sector. The selling of oil at concessionary rates to key strategic allies and neighbours in Latin America also led to reduced revenue inflows. Nationalized entities often employed inefficient state employees who in some instances lacked the skills and expertise to continue to drive production. Consequently, output from the hydrocarbon sector, which represented as much as 95% of export earnings, declined consistently on an annual basis.

The nationalizations often came with limited compensation which led to legal action in international courts and at times further legal action to seize state owned international assets. Fast forward to 2008, when the Lehman driven global financial crisis led to a steep

decline in global commodity prices, Venezuela took a heavy hit on the revenue side. Increased fiscal deficits, high debt, widening current account deficits and balance of payments challenges ensued.

Nicholas Maduro was elected President in 2013 following Hugo Chavez's death. After a narrow election victory, Maduro ruled by decree for the majority of his presidency. In December 2015, a coalition of opposition parties won the parliamentary elections. Subsequently, the Assembly named 13 Justices sympathetic to the ruling party, to the Supreme Court. This allowed President Maduro to extend his rule by decree again, angering the Opposition who had, prior to for years, been calling for presidential elections. This led to further discontent in the domestic and international community and began accelerated action in the form of increased and more aggressive sanctions, against the ruling party by the US and the OECD.

THE CURRENT SITUATION

The Venezuela situation can be described as "murky at best" with no clear recovery in sight as continued US sanctions restrict the sale of oil. Oil and related hydrocarbon revenues represent approximately 95% of export earnings and about 25% of total Venezuelan GDP. Cash flow to the government is further restricted by the fact that about 75% of Venezuela's oil revenues, as at 2017, originated from the sale of high sulphur crude and its bi-products through PDVSA's US

subsidiary, CITGO. On the positive side, unsubstantiated amounts of USD inflows are thought to trickle in from hydrocarbon sales to Russia, China and India through alternatives to the SWIFT system of money transfer. Venezuela also has diplomatic support from Cuba, Bolivia, Uruguay, Iran and Mexico.

Venezuela has suffered from very weak institutions and erratic policy making which has led to hyperinflation, economic stagnation and social upheaval. There has been the mass migration of approximately 3 million persons between 2014 and 2018 with more people seeking new pastures every day according to reports. The legitimacy of the government has been questioned and the US sanctions that have come, seem to be based on liberating the people who, according to the US, are suffering at the hands of a dictator.

According to a US Congress report dated October 20, 2020, the Treasury and State Departments have imposed sanctions on approximately 159 Venezuelan connected individuals and has revoked the visas of 1,000 individuals and their families who are connected to Venezuela. Further restrictions have been imposed on PDVSA and the Central Bank. On the external side, two subsidiaries of the Russian state-owned Rosneft Oil Company, who facilitated Venezuelan oil exports, plus four other shipping companies have been sanctioned for transporting Venezuelan oil.

On the political side, the US has also refused to recognize Maduro's legitimacy as President and has instead given support to National Assembly President Juan Guaido. The US and about 57 other governments recognize Guaido as Interim President of Venezuela.

Despite the sanctions, non-recognition of Maduro as President, attempted coups and mass migration, economic stagnation and hyperinflation; Maduro remains President and still in control of Venezuela after two years of increased sanctions by President Donald Trump's Administration. Reports suggest that despite the challenges, there is still strong support for President Maduro among the 28.4 million people, especially the police and the military. Any attempt to take control of Venezuela must have the support of the armed forces. Otherwise, any such attempt would lead to loss of lives on both sides and would suggest that the "people" whom the US is allegedly seeking to liberate, are still in support of their President.

There have been attempts to seek a **diplomatic solution**; however, the government's unwillingness to compromise and the opposition's refusal to accept the reality of the situation has led to deadlock.

THE ECONOMICS

Official data coming out of Venezuela basically came to a halt in late 2018. However, the IMF has very reliable forecasts and estimates that should provide the best picture possible given the circumstances.

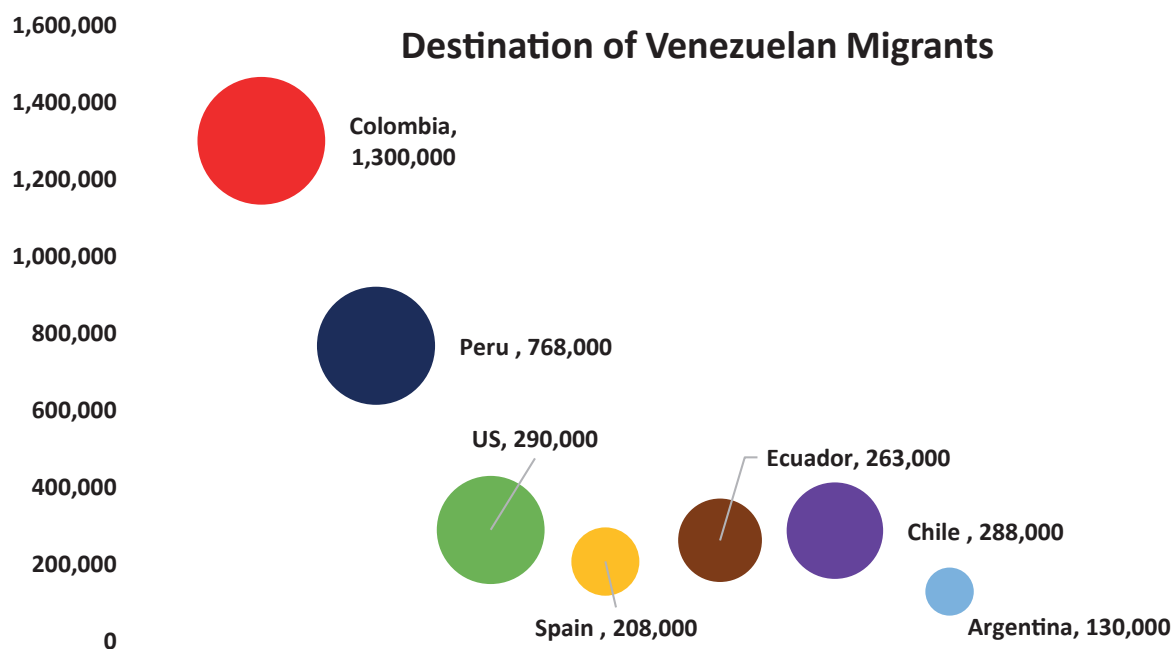
	Venezuela Economic Fundamentals					
	2015	2016	2017	2018 E	2019 F	2020 F
GDP (%-age Change)	-6.221	-17.04	-15.671	-19.621	-35	-25
GDP Per Capita (USD)	10,568.10	9,092.02	4,725.05	3,404.43	2,299.31	1,739.11
Total Investment (%-age of GDP)	30.868	0.102	-3.744	n/a	n/a	n/a
Inflation, op (%-age Change)	180.87	274.354	862.629	130,060.24	9,585.49	6,500.00
Vol. of Imp of Goods & Services	-23.102	-50.061	-34.651	-8.752	-32.644	-19.528
Vol. of Exp of Goods & Services	-0.863	-11.729	-0.044	-22.764	-28.869	-50.183
Unempl. Rate (%-age of Labour Force)	7.4	20.863	27.886	35.543	n/a	n/a
Population (Millions)	30.62	30.714	30.442	28.903	27.817	27.951
Gross Debt/GDP	11.045	5.054	26.004	180.789	232.786	n/a
C/A Balance (%-GDP)	-4.96	-1.386	6.053	8.753	8.368	-4.14

IMF-WE0 Database, Oct-2020 ; E-Estimates; F-Forecasts

Economic contraction, averaging about 14.6% since 2015 has been the norm with forecasts suggesting that the economy contracted by 35% in 2019. As noted earlier, the effects of US sanctions and the country's inability to sell oil globally, has had a debilitating effect. Inflation has skyrocketed to a high of 130,060 percent in 2018 (hyperinflation) as chronic shortages of basic goods has gripped the population.

The chronic situation described above should mean that it comes as no surprise that the population has contracted by approximately 2.897 million between 2016 and 2019. Mass migration for some, to Colombia, Peru, the US, Spain, Chile and Ecuador, has become the norm as asylum seekers seek new pastures due to political persecution, violence and economic stagnation.

The economic difficulties have also led to a ballooning of the debt/GDP to a forecasted 232.8% as at 2019. If and when the debt situation is addressed, there will likely have to be some reduction in principal and/or interest as the ratio of interest payments to government revenue should represent an unsustainable burden. That said, it is not clear if or when the impasse will come to an end.



UPCOMING ELECTIONS COULD BE THE KEY!!

There are two (2) upcoming elections which could prove the key to unlocking the Venezuelan impasse. **Presidential elections in the US and 2020 Parliamentary polls in Venezuela.** If there is a change in the US President and Joe Biden wins, this could signal a softening of the stance by the US towards Venezuela. A less aggressive US negotiating team could lead Maduro to a greater acceptance of dialogue.

Combining the possibility of a new US President with aid on condition of free and fair elections, monitored by international observers and an acceptance by both sides of the results...could completely change the circumstances. If Maduro's party also does poorly in the upcoming Parliamentary vote, this could speed up calls for Presidential elections. Once Presidential elections are deemed free and fair, with limited violence and voter intimidation, then

there is no reason for sanctions to continue. Venezuela could then slowly emerge from this quagmire. **The problem however is that a number of scenarios must fall in place for this to materialize and we do not have a “crystal ball”.**

On the negative side, if Joe Biden wins, he could reiterate Trump’s stance on Venezuela or if Trump wins, he could maintain his own stance. A poor showing by Maduro’s party in Parliamentary Elections could then lead Maduro to bunker down and hold on to power / leadership until elections are constitutionally due in 2024, thereby stretching out any possible solution or recovery. Maduro could also substantiate this potential stance by using the political ideology of “*Chavismo*” (Political ideology ideas, style and programs of former Venezuelan president Hugo Chavez) thereby rallying the people. **As we have noted, the waters / situation remains murky.**

OUTLOOK & RECOMMENDATION

A timeline for a possible resolution to the Venezuelan situation is simply not known. The economic crisis continues unabated as US sanctions have crippled the economy. Despite the sanctions however, President Maduro remains firmly in place. In our view, as long as he has the support of the armed forces, an invasion or any military solution is unlikely as it would lead to possible conflict and bloodshed.

A possible solution could come depending on the outcome of US elections as well as parliamentary elections in Venezuela. A Joe Biden win could see a change in personnel and negotiation tactics that might yield a solution. That said however, there are no guarantees and we cannot say with any level of certainty what will happen in local parliamentary elections. Maduro’s party could have a decent showing with citizens holding on to the “Chavismo” doctrine despite the difficulties of hyperinflation, a contraction in economic output and mass migrations.

The above indicates that a **SELL is the only plausible recommendation** that can come at this time.

Source: *Capitaliq.com, Moodys.com, Reuters, US-Department of Treasury, Bloomberg,*

APPENDIX

IMPORTANT DISCLOSURES

ABSTRACT— As a part of our new Portfolio Strategy we are recommending strict adherence to the following Portfolio Allocation DEFINITIONS/ RECOMMENDATIONS.

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REDUCE EXPOSURE IN YOUR PORTFOLIO TO ZERO.

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