



## Why Venezuela's Crisis Won't Save Canada's Oil Patch

### Description

Analysts have been speculating that Venezuela's sharply deteriorating oil production will be enough to bolster oil prices and the demand for Canadian heavy crude. While the Latin American nation's once great oil industry is on the brink of collapse with production poised to slide under one million barrels daily, it won't be enough to boost oil prices. Nor will it help to noticeably reduce the deep discount applied to Canadian heavy crude, which, by the end of October 2018, had reached a multi-year high of 61%.

### Now what?

This is poor news for Canada's energy patch. The increasingly bearish sentiment surrounding crude and ever-wider spread between Western Canadian Select (WCS) and West Texas Intermediate (WTI) have already been weighing heavily on oil sands stocks. While WTI is down by almost 5% since the start of 2018, Canada's three largest oil sands companies, **Canadian Natural Resources** ([TSX:CNQ](#))([NYSE:CNQ](#)), **Suncor Energy** ([TSX:SU](#))([NYSE:SU](#)), and **Cenovus Energy** ([TSX:CVE](#))([NYSE:CVE](#)) have lost 21%, 8%, and 12%, respectively.

Because of Venezuela's copious oil reserves, which are ranked as the largest in the world, and burgeoning oil industry, it was once the wealthiest nation in Latin America. Decades of economic mismanagement since the ascension of Hugo Chavez's socialist government in 1999 and the rise of Maduro as the embattled nation's latest president, coupled with oil's [prolonged slump](#) since late 2014, have all but crippled the economy.

Hyperinflation, the mass exodus of international oil companies, a lack of foreign investment, and a flight of capital as well as skilled labour have all brought the economy, including the nation's all-important oil industry, to the brink of collapse. A substantial lack of funds means that crucial maintenance on existing infrastructure, as well as essential exploration and development drilling, has virtually ceased, causing Venezuela's oil production to deteriorate noticeably. By September 2018, Venezuela's oil output had fallen to 1.2 million barrels daily compared to an average of 2.2 million barrels daily during 2016.

This is significantly aggravating the situation, because oil is responsible for 95% of all export earnings and anywhere up to three-quarters of all government revenue. It will probably precipitate a catastrophic collapse of Venezuela's economy and oil industry, causing oil output to sink to all-time lows. That has sparked considerable industry speculation that it will trigger a substantial increase in demand for Canadian heavy crude.

Over the last 20 years, U.S. refineries spent billions configuring their machinery to process heavy sour crude, because of the shortage of costlier lighter sweet crude blends, making them dependent on heavy oil imports from Venezuela. While it has caused demand for Canadian heavy crude to rise, it has done little to buoy either the price for oil or WCS.

The reasons for this are quite simple.

Firstly, Venezuela's rapidly collapsing oil production had already been factored in by global energy markets.

Furthermore, the rapid expansion of U.S. oil production, driven largely by rapidly growing oil output from the shale oil industry, has proceeded unexpectedly rapidly. U.S. August 2018 oil output expanded by 400,000 barrels daily compared to a month earlier to reach a record high of 11.3 million barrels, confirming the U.S. as the leading global producer. This illustrates that U.S. production growth is more than capable of making up for the shortfall in supply created by Venezuela's rapidly diminishing oil output. That — along with a notable increase in U.S. oil inventories, which, for the week ending November 2, 2018, climbed by 5.8 million barrels compared to the week prior to almost 432 million barrels — is weighing heavily on global oil prices.

Finally, Venezuela's sharply lower production, while sparking greater demand for Canadian heavy crude, has failed to narrow the spread between WCS and WTI. In fact, it has widened sharply in [recent months](#), reaching a multi-year high of 61% at the end of October. This is because of extensive transportation bottlenecks in Western Canada, which have caused local oil inventories to reach record levels, creating an enormous oil glut. Even record oil by rail shipments during August failed to reduce Western Canadian oil inventories, and it is difficult to see the glut clearing soon.

## So what?

This means the deep discount applied to WCS will continue for the foreseeable future. This will impact the earnings of Canadian Natural Resources, Suncor, and Cenovus, because 49%, 88% and 76% of their production, respectively, comes from oil sands, making them unattractive investments compared to light oil producers.

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