What’s Next for Venezuela?

Description

Tensions in the Latin American nation of Venezuela have ratcheted up to levels not seen since Chavez’s leftist Bolivarian revolution swept him into power in 1999. Recognition of Juan Guaido, the President of the opposition, dominated the National Assembly internationally because Venezuela’s legitimate interim ruler has thrown the nation into turmoil causing the social, economic and political crisis to deepen. It has also brought the spotlight back on Venezuela’s deeply-troubled oil industry, the only economic resource that can generate desperately needed hard-income that the country possesses at this time. This was predicted to be a boon for Canadian oil sands operators like **Cenovus Energy Inc.** (TSX:CVE)(NYSE:CVE) because it would trigger a shortfall of heavy crude imports from Venezuela, which Canadian oil sands were expected to fill.

Is a military option viable?

While Trump has stated that all options, including a military response, are on the table the deployment of U.S. armed forces to topple Maduro appears unlikely. Not only are many of Venezuela’s neighbours, including U.S. arch ally Colombia, opposed to such a move, it would reignite regional tensions relating to the long history of U.S Imperialism in Latin America.

Russia has also doubled its efforts to support Maduro, while China has offered support and the rationale for this is simple; it helps to protect the billions in loans that both nations have provided to prop up his regime. It also provides Putin with an opportunity to extend Russian national influence into a region long considered as exclusively a U.S. zone of influence.

Even though the toppling of Maduro appears a long way off now that Moscow is providing greater support, the situation has caused a shortage of heavy crude for U.S. refiners.

Venezuela’s oil output is declining

According to the U.S. Energy Information Administration (EIA) there has been a sharp decline in the volume of Venezuelan oil imports, which for December 2018 at 201,700 barrels were 7% lower than a year earlier. That figure is expected to plunge even lower during 2019 because of the impact of the latest round of U.S. sanctions against Venezuela imposed in January 2019 and deteriorating production in the oil rich Latin American nation.

According to Reuters, this has forced U.S. refiners to source heavier crude from the Gulf of Mexico to replace that lost because of the crisis in Venezuela.

It was also anticipated that it would be a boon for Canada's energy patch, with many U.S. mid-west refineries solely configured to process heavy crude which is produced by Canada's oil sands. There's a catch, however. Despite easing in recent weeks, Edmonton's mandatory oil cuts has caused the price differential between heavy oil benchmark Western Canadian Select (WCS) and West Texas Intermediate (WTI) to narrow substantially.

Since hitting a record low in November 2018, WCS prices have recovered to be almost US$50 a barrel, which is around four times higher. This sees the discount to WTI being a mere US$9 a barrel, which is challenging the economics of crude by rail. Already, integrated energy major Imperial Oil has wound down rail shipments.

When this is combined with narrower margins for U.S. refiners because of the far shallower discount applied to WCS against WTI and the difficulty of cost effectively shipping Canadian crude to U.S. refining markets due to a lack of pipeline exit capacity, the appeal of buying Canadian crude has waned. Many refiners including Valero Energy, therefore elected to source their feedstock from the Gulf of Mexico rather than Canada. While the production cuts have succeeded in bolstering prices for bitumen and other forms of heavy oil they haven't allowed Canadian producers to expand market share as anticipated.

What does it mean for the oil sands?

There are very real concerns that the issues impacting Canadian heavy crude could see U.S. refiners source heavier forms of oil domestically, as they have already to replace the feedstock lost because of the crisis in Venezuela. This along with the failure to address the fundamental issue of a lack of pipeline capacity, means that WCS prices could drop sharply once Edmonton removes the cuts.

That would be a bad outcome for those oil sands producers like Cenovus, which can only refine a small proportion of the heavy crude they produce. According to its 2018 results, Cenovus can only refine around half the heavy oil that it produces, making it dependent upon U.S. refining markets and the price of WCS for its operations to be profitable. For the aforementioned reasons, there is every likelihood that its earnings will be under pressure once Edmonton ends the production cuts.

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