US sanctions debilitate Venezuelan oil output

President Nicolas Maduro is standing firm, despite oil production falling to levels not seen since the infamous oil lockout of 16 years ago

Venezuela’s oil sector continues its precipitous collapse, stricken by US sanctions and mismanagement, which have reduced crude production to its lowest level since 2003 — when several months of nationwide protests at Pdvsa, the state-owned oil company, wiped out almost a third of production.

US sanctions on Venezuela’s energy sector are having a crippling effect. The US Energy Administration (EIA) has reported losses in overall Venezuelan production of around 400,000bl/d since the year began. In April, output averaged just 830,000bl/d according to the EIA, while Opec’s *Monthly Oil Report* put the estimated production figure even lower at 768,000bl/d.

Output has recovered slightly from March, when power outages across the country devastated the sector. Information provider S&P Global Platts calculated roughly 40,000bl/d returning to production in April, but many facilities remain damaged and further losses are expected. Power failures paralysed exports at Venezuela's main oil terminal Jose, while the Puerto la Cruz refinery in Anzoategui, already barely operating, was put out of commission.

Until now, most of the production losses have been from Maracaibo and the Maturin sub-basin. But the power issues are now also starting to hit the Orinoco Belt oil fields. At the beginning of 2019, Orinoco constituted 40pc of total national output, according to the Center for Strategic and International Studies (CSIS) thinktank.

Three Orinoco upgraders were taken offline and are now in "recirculation" to prevent damage, but not outputting heavy crude. The Petropriar upgrader (jointly owned between Pdvsa and Chevron), Petromonagas upgrader (Russia's Rosneft/Pdvsa) and Petrocedeno upgrader (Total/Norway's Equinor/Pdvsa) were all affected and are still out of action due to lack of storage space. The Petrolera Sinovensa upgrader (China's CNPC/Pdvsa) is partly running but only at 105,000bl/d. Combined, the four upgraders have a normal synthetic crude capacity of 600,000bl/d.

The Orinoco Belt is also struggling to cope with shortages of diluent, previously imported from the US, and available tankers. Last year, Venezuela imported almost 90,000bl/d of naphtha, mostly from the US, to help blend its heavy crude. Issues with sourcing alternative supply, as well as the scarcity of funds, is having a significant impact in the Orinoco. Platts reported combined production had dropped 77pc by mid-May to just 169,800bl/d, from 764,100bl/d at the beginning of April.

"Venezuela was able to obtain diluents from Russia and India after the OFAC [Office of Foreign Assets Control] action, but not in the volume needed for the Orinoco to run smoothly," says Patrick O'Connell, fixed income analyst at Alliance Bernstein, a global asset management firm. "Partially due to the lower availability of diluent, Venezuela is converting its large Orinoco upgraders into simple blending facilities, which will yield a less valuable type of crude oil but save on imported intermediate products."

Clinging on

Damage to the country's oil industry may be a pyrrhic victory for the opposition-led National Assembly, increasing the pressure on incumbent president Nicolas Maduro, but so far there has been little sign of regime change.

On 30 April, head of the Venezuelan National Assembly and self-declared president Juan Guaido, alongside the recently freed opposition politician Leopoldo Lopez, called for national protests to unseat Maduro from power. He claimed Maduro no longer had the backing of the military; but the Venezuelan president, surrounded by key military personnel, quickly denounced the appeal as an attempted coup.

Pressure on the current regime will only mount, though, as crude production continues its prolific collapse. Carlos de Sousa, lead economist at Oxford Economics, a global economics forecaster, expects "oil production to fall to 500,00bl/d by year-end – China and India will remain the main buyers".

But the CSIS predicts that, if Maduro remains at the helm, then output will likely fall below 500,000bl/d as early as October. If he is still in power by November the institution expects production to be hovering around 400,000bl/d. Even if the opposition takes control it will be difficult to return national output to 1.3mn bl/d any time soon. Damage to oil assets, attracting foreign investment and changes in global oil markets in recent years all point to a tough recovery even if the opposition gain control.

Cutting its losses

Meanwhile, Venezuela’s financial position could soon deteriorate even further. In May, the National Assembly voted to pay the $71mn interest on the Pdvsa bond 2020, the only bond the country has yet to default on, to avoid creditors seizing its US-based refining subsidiary Citgo. Bond holders control 50.1pc of shares in the company, while the remaining 49.9pc serves as collateral for a $1.5bn loan issued by Rosneft, who could equally enforce its security should Venezuela default on the payment.

“We believe the country will do what it can to keep current on these payments, as a default on this bond would lead to creditors attempting to seize control of Citgo – a valuable overseas asset which would likely prove crucial in an eventual debt restructuring,” says Thomas Nicol, product manager at Alliance Bernstein. “The National Assembly successfully paid the $71mn coupon within the 30-day grace period in May 2019, but making a payment of more than $900mn in October will prove more challenging, particularly in the absence of regime change against a backdrop of US sanctions and plummeting domestic oil production.”

Daniel Pilarski, a partner at law firm Watson Farley & Williams, a global law firm, doubts the legality of a forced sale. “Even if Venezuela wished to sell (which they do not), it would violate existing sanctions for any parties (US or non-US) to purchase Citgo and pay the proceeds to Pdvsa. Also, given Pdvsa’s dire financial position, the transfer would be potentially subject to fraudulent conveyance and similar conditions, so it would be very hard for the purchaser to get clean title,” says Pilarski.

Citgo has so far escaped sanctions but has until 27 July to end all crude imports from Venezuela. Similarly, US oil services companies Baker Hughes, Chevron, Halliburton, Schlumberger and Weatherford International all have a three-month window to exit the country.