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What next for Venezuela?

By [Elsa Buchanan](#) | Tue, 12th March 2013 - 18:33



A week after Hugo Chavez's death, the atmosphere in Caracas is still loaded with grief, as thousands of supporters, all wearing red, are seen queuing in the streets to offer their last farewell to their adored president.

Slogans such as "Viva Chávez y viva la revolución" (Long live Chávez and long live the revolution) were repeated by the crowds sporting the now-famous T-shirts adorned with "Yo soy Chávez" (I am Chávez).

Besides the nation's tears and chants, Chavez's death has also been the centre of global debates concerning the country's most important asset: oil.

"His death is unlikely to have a significant impact on global oil markets in the short term, although this impact could yet be in either direction," says Tom Pugh, commodities economist at [Capital Economics](#).

"There is a possibility that the leadership transition will be less than smooth and that Venezuelan oil production will be disrupted, if only [briefly]," he adds, pointing out that a strike at Petroleos de Venezuela SA (PdVSA), the country's national oil company, almost brought output to a halt in 2002.

However, he notes: "Venezuelan oil and gas is in any event less important to the rest of the world than it used to be, especially given the boom in North American supply."

Over the long term, Pugh explains, changes in policy towards the energy sector might eventually allow Venezuela's oil production to return to the much higher levels seen in the 1990s. Oil production was running at between three and 3.5 million barrels per day (bpd) in 1999, before falling to between 2.4 million and 2.8 million in 2012, according to Pugh.

"And while changes in policy in the country should eventually contribute to increased global oil supply and add to the downward pressure on prices," he explains, "these impacts may only be marginal for some time to come."

Meanwhile, PdVSA says all its production is operating as normal.

Hostage of oil prices

There is a general consensus that Venezuela's oil industry has been severely hampered by the nationalisation of production and exploration, poor management and persistent under-investment in favour of social spending.

In fact, Thiago de Aragão, a Latin American Senior Research Associate at the Foreign Policy Centre, says Chávez was a "hostage of the international oil prices".

When the prices were soaring high, he explains, Chávez enjoyed a period of wealth that was "not fully translated" in social and economic development for the country.

But when the prices declined, the government had "difficulties in adjusting the high spending everyday with contention in the public expenditure".

He explains it is difficult to say if Venezuela's "oil money" has been distributed or not. "What we can say, though, is that the money from oil exports - which was a lot - does not correspond to the situation of the country or the lower classes today."

Kim March, economist and strategist at Société Générale Private Banking, explains: "We are talking about a country which has frequent blackouts, shortages of basic goods, and yet needs very intense funding for its social programmes, which are already under-funded."

Robert Bottome, a Caracas-based consultant and publisher of business journal *VenEconomia*, also points out the country's sky-high inflation rates, continuously devaluated currency and widening debt hole. In fact, he believes the government's actions of "throwing money at people" in a bid to boost the economy have had the opposite effect.

Illusion of prosperity

"People like to think they were better off because of the handouts, but even if they had more cash in their hands, the living conditions have not improved," he says. "The right hand boosted demand when the left hand was throwing up obstacles to new investment and increased production.

"It was all an illusion of prosperity," adds Bottome.

Aragão shares the train of thought: "It is true Chávez helped people out of poverty, and even recognised as true by opposition leaders in the country," he says. "Nevertheless, the question to be made is not if this is true or not, but whether it is sustainable or not."

He asks: "Was it a pure result of 'clientelism' that cannot walk on its own legs? Or was it something structured that created self-sustainable individuals able to keep themselves out of poverty by their own means?"

The country's economy, which relies approximately 90% on the extraction of oil, has seen inflation reach 22.18% over the last year, ranking Venezuela seventh-worst inflation rate out of more than 180 countries in January 2013.

And for the fifth time in over nine years, the bolivar, the Venezuelan currency, was devalued 32% on 13 February.

Analysts say the devaluation probably helped the government narrow the budget deficit by injecting bolivars received from oil exports in dollars, but it also has the potential to accelerate annual inflation.

Venezuela is now an importing economy, which now spends \$60 million (£40 million) in imports.

Despite the mismanagement, the country still gained an additional 84.5 billion bolivars (£9 billion) in revenue in 2012, when the currency was devalued against the dollar.

Looking ahead, Pugh says, "A severe shortage of hard currency may force the new government to focus more resources on increasing oil revenues, which account for over 90% of foreign income.

"But if oil prices fall below \$100 per barrel for a sustained period over the coming years, as we think it is likely," he expands, "then there is a high chance of a balance of

payments crisis and even a possible debt default."

Analysts at Capital Economics agree: "Venezuela could enter recession this year, and a period of lower oil prices trigger an even more abrupt adjustment over the coming years."

Mismanagement, corruption and waste

To understand how underperformance happened, Bottome says investors have to look at the base of all problems, mismanagement, corruption and waste.

He gives the example of the biggest Venezuelan steel corporation, Siderúrgica del Orinoco, also known as "Sidor". The company was privatised in 1997 under President Rafael Caldera, but in 2008, "Chavista" workers went on strike and "cleared the way for the government to take over".

Bottome explains that before being nationalised, the company was producing record-high results, with 4.3 million tonnes of liquid steel in 2007. In 2012, it fell to 1.7 million.

"Sidor underperforms because it is being mismanaged... the new managers [the government] are mostly perk-conscious and ignorant of the basics of good management."

Bonds benefit?

But it is not all doom and gloom, as March notes the Venezuelan sovereign bond market was "the greatest performer of 2012".

Indeed, she says, despite economic inefficiencies, the country has been supported by "double-digit high yields".

"And we are not getting that in any other economy," she adds, but summarises: "I think people are making a bet on Venezuela, especially those [investors] looking for those high yields, but I think that everyone is very aware of the fact that for those talking about structural investments, long-term fixed investments, it is a different story."

Emerging markets economist at Capital Economics, David Rees, suspects that the bond market "is being too sanguine on Venezuela".

"Yields on the government's bonds tumbled by about 500 basis points to around 9% over the past six months on speculation that Mr. Chavez's reign would end, and they barely budged in recent weeks as news of his deteriorating health intensified," Rees explains.

"Yields will probably remain around 9% in the near term," he adds, "But as a bleak economic outlook becomes apparent, we expect bond yields to rise back into double digits later this year."

More optimistically Luis Alfredo Araque Benzo, Caracas-based founding partner and lawyer at Araquereyna (Araque Reyna Sosa Viso y Asociados), believes if the country was to align with other open-market economies, the rule of law respected, and new national and international investments "not only just in oil" were handed, investors could flock in.

President of the poor

But that all depends on the country's new leader.

"Chavez's death was expected by the markets but has now left a vacuum in terms of leadership," comments March. "His absence draws the question: who can fill his shoes?"

Under the country's constitution, the head of the National Assembly, Diosdado Cabello, should have been the man assuming presidential powers until a new president is elected and sworn in.

A former soldier, Cabello has strong ties with the military, both in Venezuela and its ally Cuba, explains March.

Instead, Chavez chose former bus driver, vice president and foreign minister Nicolas Maduro as his successor: it was he who tearfully announced the death of the leader.

About his successor, Chavez publicly said: "He is a complete revolutionary, a man of great experience despite his youth, with great dedication and capacity for work, for leading, for handling the most difficult situations."

Under the constitution, Venezuela is required to elect a new leader within 30 days.

But Bottome hints that the elections will be delayed. He explains: "Per the constitution it should be no later than 4 April, maybe even 7 April. But no dates have been put down." He goes on: "The point is the timing will be set so as to 'help' Maduro's candidacy."

Bottome is not too keen on Maduro, whose name means "mature", saying: "He will try to follow Chavez's plan and will only change the path if Venezuela gets worse off than Cuba, or if he is forced to turn things around."

Until then, he is advising investors to "stay away" from Venezuela.

Opposition leader Henrique Capriles is seen as the greater contender by analysts, despite what March calls a "pretty fractured opposition party."

Views on Capriles are divided. While Bottome says he is a "good administrator" yet uncharismatic, Araque says the leader has not been clear about his ideas on economic issues, and for electoral reasons has "only said that the populist distribution of oil revenues has been a reason for Chavez's success, and that he would continue".

"But his chances are not good," Bottome adds.

In fact, most analysts concur Maduro is set to win the coming elections.

"He is the grand favourite," says Aragão. "He was chosen personally by Chavez and endorsed live on television: the commotion around the president's death will translate into massive voting for what Chavez represented. If nothing extraordinary happens Maduro should emerge as a winner."

March agrees: "There is a real popular support for Maduro based on the sympathy for Chavez."

She believes favourite Maduro will carry on Chavez's political and economical positioning, arguing there is no reason why investors can expect "any change whatsoever in terms of opening the country up to greater foreign investments at this stage."

Araque shares March's view: "Even though Venezuela is a ruined country with very rich oil reserves, it is committed to please all political fans of Chavez's anti-Western endeavours."

Investors should expect a fully "Chavista" electoral council and a tighter control on opponents, Araque adds. And this makes sense - for the millions of underprivileged in the country who make up to 80% of the population, Chavez was a demi-god.

Loyalists, or Chavistas, had nicknamed him the "president of the poor", in a cult of personality that had been moulded by 14 years of a populism, socialism and authoritarianism, explains Bottome.

"Even [at his death], every spokesman managed to include some kind of anti-opposition or anti-yankee sentence in their eulogy of Chávez."

A former paratrooper, the "Commandante", had erupted onto the political scene in 1992 after a failed military coup, and led a left-wing rebirth across Latin America with his own Bolivarianism ideology.

Aragão continues: "Domestic politics, foreign affairs, economy, social issues, all was under his full control. The decision-making process was his with as little intervention from others as possible."

"For a week now, the poor [have been] mourning," said Bottome.

Leader of the United Socialist Party of Venezuela until his death, Chávez was admired for the handouts he donated to the poor and funding of massive health and welfare programs.

"The only way to save the world is through socialism within a democracy," Chávez once said in a public announcement in 2010.

In December 2011, he was acclaimed by the general public when he pushed for "Amor Mayor" (love of the older generation), which provides aid to low-income senior citizens who do not receive any state pension, and "Hijos de Venezuela" (children of Venezuela), a programme that provides social benefits to low-income, single-parent families with younger children or disabled dependents.

839,818 Venezuelans have been benefiting from the programmes since their launch, according to government figures.

And social care numbers speak for themselves: in 1998 (and before Chávez's investiture) there were only 387,000 people on the state pension rolls - which were afflicted by delays and missed payments leading to protests.

By the end of 2012, the number of pensioners had reached nearly 2.5 million, representing an increase of over 600% in total pensions paid by the state.

Despite doubts in the effectiveness of certain policies, the leader was "successful in bringing social development to the agenda in Venezuela", explains Aragón.

"The country was selfishly ruled by the elites [before Chavez's], and [they] had no attention whatsoever towards the lower classes," says Aragón. "Even the opposition leader Henrique Capriles recognises that social development is a key, or the key issue to the country to reunite again.

"Chávez has to receive the praise for that."

Indeed, the control of the economy was under Chávez's complete guidance, Aragón says.

Chávez was responsible in placing Venezuela in the global news, using his charisma and strong political links. He also brought the country "to the team of big boys" of the Organization of the Petroleum Exporting Countries (OPEC), which "is no small victory," says Aragón.

What next?

March believes the new leader will continue spending and maintain popular support, which could require "another devaluation of the bolivar going forward, which would be fuel for further inflation."

"A lot has to be seen and proven in the upcoming months after the elections before investors feel that they can trust Venezuela again," concludes Aragón. "Again, structural changes do not come in one day, and it is precisely those structural changes that investors need to invest heavily in Venezuela again."

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