CAPITAL ECONOMICS

LATIN AMERICA ECONOMICS UPDATE

Venezuela: raising oil output will be a long journey

- **The reported deal that is close to being reached to lift US sanctions on Venezuela's oil sector in return for competitive elections would help to raise the country's oil output from very depressed levels. But the sector requires enormous investment to return output to the levels seen only a decade ago. And this wouldn't materially affect the deficit in the global oil market in the near term. In the meantime, question marks hang over whether Venezuela's government sticks to its side of the deal.**

- According to a report in the *Washington Post* published today, sanctions on Venezuela's oil industry will be eased, which could include permitting state oil company PDVSA to do business in the US. In return, the Maduro government will allow competitive elections next year. The deal hinges on the Maduro government and the opposition reaching an agreement at meetings that start tomorrow in Barbados.

- If the deal is secured, there will be a lot of attention on whether the Maduro government honours its side of the deal. Past elections (such as the 2018 vote) were marred by irregularities and were widely disputed by the international community (and Venezuela's opposition). Reflecting scepticism, the deal would include a time limit on sanctions relief so the US can pull the plug if Venezuela backslides.

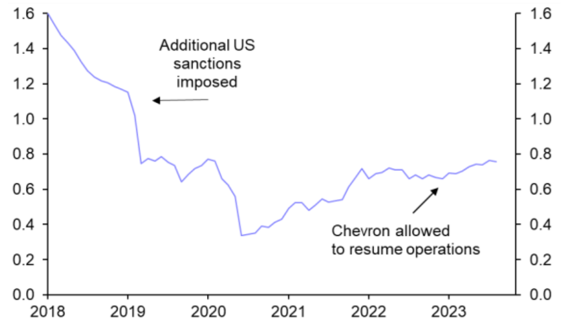
- **US sanctions have certainly played a role in the decline in Venezuela's oil production**. After the Trump administration ramped up sanctions in 2019, oil production fell from over 1mn bpd to a trough of less than 400k bpd in 2020. (See Chart 1.) As a result, there's probably scope for production, which has started to rise, to increase further if sanctions are lifted.

- **Venezuela's economy would certainly benefit from easing sanctions and greater hard currency inflows from the oil sector**. Although the economy has started to stabilise – GDP expanded in 2021 and 2022 after seven years of contraction – real GDP is still some 70% below is 2013 level. And while hyperinflation has now come to an end, inflation is still running at over 300%.

- **But sanctions only explain part of the demise of Venezuela's oil sector. Oil production has been in terminal decline since its most recent peak at 3.5mn bpd in 2005**. That reflects years of underinvestment and the loss of skilled labour (to emigration or repatriation) which have undermined production, and potential production. It will require enormous amounts of investment and take a lot of time to restore production back to anything like that level. Indeed, although US oil major Chevron was given permission to restart operations in late 2022, Venezuela's oil production was only up by 70,000 bpd in September (year on year, see Chart 1 again).

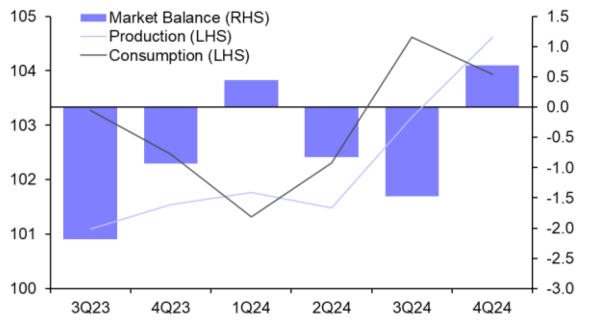
- **As a result, while the lifting of US sanctions would facilitate higher output from Venezuela in the medium term (if the US conditions are met), we are sceptical that it will make much difference to the global oil market in the near term**. After a deep deficit this year, we continue to expect the oil market to be finely balanced in 2024 (see Chart 2) even assuming some increase in Venezuela's oil output (Chevron plans an additional 65,000 bpd coming on stream next year).

Chart 1: Venezuela Oil Production (Mn. BpD)



Source: OPEC MOMR

Chart 2: Oil Market Balance (Mn. BpD)



Sources: IEA, Capital Economics

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