

May 20, 2019

Venezuela: An Update, Part II

(N.B. Due to the Memorial Day holiday, the next issue will be published June 3.)

In Part I of this report, we provided readers with a short history of Venezuela to bring some context to the current situation. This week, Part II, will examine the attempts by the opposition to oust Maduro, the problems the opposition faces in removing the current leader and the interests of foreign players. As always, we will conclude with market ramifications.

Attempts to Remove Maduro

Maduro remains in control despite 50 nations declaring Guaido the legitimate leader of Venezuela. Guaido has made three attempts to seize power. Soon after his appointment in January, he called on the people and the military to rise up and oust Maduro. The security services remained loyal to Maduro. In late February, Guaido attempted to bring in convoys of humanitarian goods across the Colombian and Brazilian borders. His goal was to show impoverished Venezuelans that he could bring much needed food and medicine into the country. However, Maduro's forces prevented the goods from crossing the border.

The most serious attempt occurred on April 30. In the early morning hours, Leopoldo Lopez, an opposition leader and mentor to Guaido who had been under house arrest, emerged on social media, free and surrounded by his captors. The security forces assigned to him had set him free.

While under house arrest, Lopez had meetings with some of Maduro's inner circle, including Defense Minister Vladimir Padrino Lopez and the head of intelligence, Manuel Figuera. Both were prepared to turn on Maduro in return for similar positions in the new government. Guaido went on social media and told his followers to take to the streets to join the military to remove Maduro from power. As we note below, the Chief Justice of the Supreme Court was also involved in talks.

By the end of the day, it had all unraveled. Padrino Lopez had either changed his mind or been duplicitous all along. He was seen vowing support for Maduro and condemning the ouster. Maduro's spy chief fled to the U.S. and Lopez sought refuge in the Spanish Embassy. The U.S. claimed that Maduro had a plane ready to take him to Havana but was stopped on his way to the airport by Russian security forces.

Although the ouster clearly failed,¹ Maduro has not moved against Guaido personally. However, he has arrested at least 80 of Guaido's followers. It is likely that Maduro believes arresting Guaido would cross a "red line" for the U.S. and result in even harsher sanctions or a military intervention.

The Problem for the Opposition

The opposition faces the problem of trying to get the military to turn against the regime. It is quite possible the military may be willing to remove Maduro from power. He isn't all that popular and there is little

¹ We don't consider it a coup because, based on the constitution, Guaido is the legitimate leader of Venezuela.

evidence to suggest he is leading the country out of its morass. At the same time, one of the ways that Chavez and Maduro have kept the military loyal is by allowing its leaders to engage in nefarious but lucrative activities, including drug trafficking, smuggling and illegal mining. Simply put, the military is complicit in the deterioration of the economy and has an interest in maintaining the regime. Unfortunately, the status quo is awful for everyone else outside Maduro's inner circle. Even the poor, who had been the base of the "Bolivarian" support, are suffering. The poor have remained mostly loyal to the regime because they don't trust the opposition, which is mostly composed of the upper and middle classes that haven't left yet.

So, Guaido and the opposition can probably oust Maduro relatively peacefully only if they are willing to leave the corrupt military and other elements of the current government in place. For example, we note that the Chief Justice of the Supreme Court, Maikel Moreno, was interested in supporting the ouster of Maduro but only if he was appointed as interim leader of the country.²

Merely removing Maduro might not change much of anything, except offer some sanctions relief. However, it will likely take a more violent revolution to bring real change to the current situation. It is hard to see how the Venezuelan economy can improve without market reforms that the security forces will likely oppose. So far, what appears to be happening is a movement to remove Maduro, but not much more beyond that (except, perhaps, removing

²https://www.washingtonpost.com/world/the_american/inside-the-secret-plot-to-turn-senior-venezuelan-officials-against-maduro/2019/05/13/5ad022a8-737e-11e9-8be0-ca575670e91c_story.html?utm_term=.bcabc2cd2dff

Maduro's foreign enablers, a topic of the next section).

The Foreign Players

Venezuela has become a proxy conflict involving numerous nations. Here are the interests and concerns of several of them.

United States: The U.S. has had a longtime interest in South and Central America. Since 1823, when the Monroe Doctrine was introduced, the U.S. has strived to reduce any European and Asian influences from these areas. That doesn't mean the U.S. was always successful in these efforts. When initially proclaimed, the U.S. did not have the power to enforce it. But, it put a "marker" in world foreign policy of the U.S. intentions.

By the late 19th century, the U.S. was strong enough to enforce the doctrine if it chose to do so. The U.S. made it clear to the British during Grover Cleveland's administration that the U.S. could enforce the doctrine and the British acquiesced. In the Spanish-American War in 1898, the U.S. moved to protect its interests by ousting Spain from much of the region and, critically, gaining control of Cuba. A hostile power in Cuba could potentially affect shipping from the Port of New Orleans and bottle up the entire Mississippi River system. This river system allowed for the easy transfer of the agricultural and manufacturing wealth of the Midwest; controlling Cuba gave teeth to the Monroe Doctrine.

During the U.S. imperial period before WWII, the U.S. intervened periodically in Central and South America. For example, the U.S. wrested Panama from Colombia to build the Panama Canal. During the Cold War, the U.S. tended to pressure leftist governments that showed affinity to the Soviet Bloc. U.S. support for a coup to oust

Salvador Allende from Chile is an example of such activities. Losing Cuba to the Soviets was a sore point but the U.S. managed to isolate the island and reduce its ability to project power.

Until Chavez, the U.S. had generally friendly relations with Venezuela. Clearly, U.S. administrations have not been on great terms with Chavez's Bolivarian revolution, but it wasn't important enough to directly intervene. However, the U.S. noticed that Venezuela was supportive of leftist governments in the region; Venezuela's ties to Cuba were close and Chavez supported Nicaragua and Bolivia, too. Still, U.S. administrations tended to view Chavez as an irritant, but not a direct threat.

Since the Venezuelan economy has collapsed, creating a refugee crisis, the failed state has become a much more serious problem. Around four million Venezuelans have fled their country, with most going to Colombia but sizeable groups have also ended up in Peru and Brazil.³ It is not inconceivable that these refugees will make their way north to the U.S., exacerbating an already difficult immigrant situation.

The U.S. has three goals. First, it wants to maintain its traditional position as regional hegemon. Nations that oppose U.S. dominance will always be a threat to that status. Second, it wants to prevent further deterioration of the Venezuelan economy, which is creating a refugee crisis. And, third, it wants to remove a power that has not only supported regional governments opposed by the U.S. but has become friendly with global competitors to U.S. hegemony. Thus, the U.S. would like to see Maduro go; it may be able to work with a military strongman who is on more friendly terms.

³ See WGR, [The Venezuelan Migration Crisis: Part II](#) (9/24/18).

For now, we would not expect a military incursion by the U.S. It isn't clear who wants the responsibility for fixing the Venezuelan economy. But, if the U.S. uses military force to install a new government, it will likely be required to support the economy, too. President Trump appears reluctant to take on that burden.

Colombia: The Colombian government has two concerns. First, the failed state in Caracas has caused Colombia to be at the front line of a refugee crisis. Second, if a military incursion does occur, not only could the current crisis worsen but the conflict could also spill over the frontier. Colombia wants a peaceful transfer of power and an economic recovery in Venezuela. Sadly, it has little ability to affect that outcome.

Brazil: Brazil's interests are similar to Colombia's but on a smaller scale. It is facing a refugee problem and does not want to see an international conflict arise.

Cuba: The Castro government does not want to lose an ally or the cheap oil it has been receiving on a regular basis. It can probably live with Maduro leaving power, but it won't support a U.S.-friendly regime and it has people on the ground to support this outcome.

Russia: Russia views Venezuela as a means to project its image as a global superpower. Russia has investments and loans in Venezuela but these are secondary to the value Moscow receives by supporting an opposition government in America's sphere of influence. Russia has been upset with the expansion of NATO into the Eastern bloc and the interventions in the Middle East. By supporting Maduro, Putin is able to turn the tables on the U.S. At the same time, Russia's capability to support Maduro is limited. In a full-scale military incursion,

the U.S. Navy would easily block Russian supply lines and prevent power projection. Putin appears to be gambling that the U.S. won't become overly aggressive in ousting Maduro and thus is able to "score points" with little risk. And, if the U.S. is distracted with ousting Maduro, then America will have less bandwidth to interfere elsewhere, e.g., Ukraine, Syria.

China: China has a much larger investment in Venezuela. Currently, the Maduro government owes China around \$23 billion. So far, China's interests have mostly been financial. It has reportedly met with members of the opposition.⁴ For now, China will likely support any government that agrees to service its loans. However, if the U.S./China relationship turns hostile (as the recent trade tensions indicate), then China may decide a base of operations in Venezuela is useful. China's military has little experience with long-distance logistics but the U.S. does have to consider this as a risk if relations with China deteriorate.

Overall, the most likely outcome is that Maduro leaves but the new government is a military version of Chavez's. If this occurs, Caracas will remain friendly with Cuba and Russia but will likely try to repair relations with the U.S. to reduce or eliminate sanctions. Although this appears to be a narrow path to manage, in reality, most of the major players can live with this outcome; simply put, Venezuela isn't critical enough for any foreign power to expend significant resources to rebuild the country. Thus, supporting a new leader to begin the process of recovery is the most likely path.

⁴ <https://www.reuters.com/article/us-venezuela-politics-colombia/ambassadors-designated-by-venezuelas-guaido-meet-in-colombia-on-winning-over-china-and-russia-idUSKCN1S30FC>

Ramifications

There are two major market concerns with the situation in Venezuela. The first, and most obvious, is oil. Falling Venezuelan oil production has been a factor in boosting prices. If a war breaks out or conditions deteriorate further, it would be bullish for oil prices. However, given that production has already fallen precipitously, the oil price impact is probably discounted. On the other hand, the peaceful ouster of Maduro holds the promise of repairing Venezuela's oil industry. Over time, that outcome would be bearish, although the impact will be manageable.

Second, equity markets of surrounding nations would likely benefit from a peaceful resolution of tensions in Venezuela. Conversely, the opposite would be true if conditions deteriorate.

Overall, we believe odds favor a resolution that removes Maduro and replaces him with a current leader within the regime. Although Guaido will likely be part of that government, we would not expect a wholesale change in policy, e.g. an ouster of Cuban or Russian advisors or default on all non-U.S. foreign debt. The opposition is too divided to fully reform Caracas and the Bolivarians are entrenched. But, both sides would benefit from a relaxation of sanctions which will, by itself, improve the economy. This isn't to say that the crisis won't worsen but the fact that leaders within Maduro's circle are talking to the opposition suggests a deal is possible.

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May 20, 2019

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