



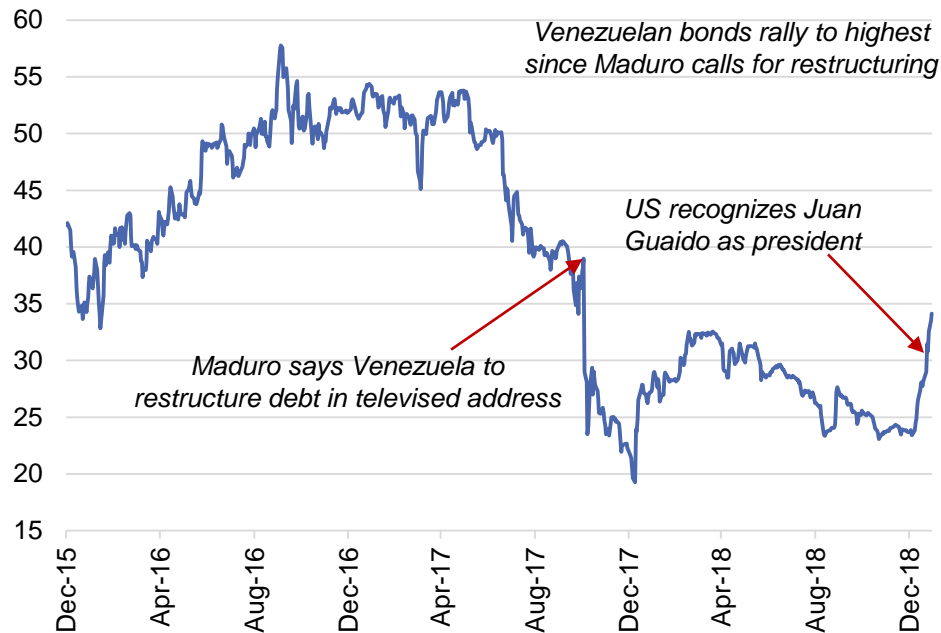
Key Developments in Venezuela & Implications on Global Markets

Overview of key development in Venezuela

- After taking office in 2013, opponents of President Nicolas Maduro complained of economic mismanagement, corruption and political oppression. Guaido, the president of the opposition-dominated National Assembly, announced on 23 January that he would assume Maduro's powers atop a caretaker government until new elections can be held. His move was swiftly recognized by the US, Brazil, Canada, Colombia, Peru and Chile. The Bank of England, under lobbying from US officials, denied a request this month by Maduro to pull USD1.2bln of Venezuelan gold out of its vaults. The Wall Street Journal reported that the US government, which has recognized Guaido's claim to the presidency, gave him access to Venezuelan accounts in the Federal Reserve Bank of New York and other US-insured banks.
- Guaido has argued that Maduro's May 2018 reelection was illegitimate. With that as the foundation, Guaido cites Article 233 of Venezuela's constitution, which invests temporary presidential power in the head of the National Assembly when the presidency is otherwise vacant. In a 15 January column for the Washington Post, Guaido also cited Article 350, which says Venezuelans "shall disown any regime, legislation or authority that violates democratic values, principles and guarantees or encroaches upon human rights."
- **Russia and Bolivia have stated their continued recognition of Maduro as Venezuela's rightful leader.** President Recep Tayyip Erdogan of Turkey, who survived an attempted coup in 2016, called Maduro to say, "Stand tall, we are with you." China's foreign ministry spokesman noted that the country recognized Maduro's reelection by sending representatives to last year's inauguration and said it "opposes foreign forces from interfering into Venezuela affairs." Russia has helped Maduro's government with loans and weapons exports. China has provided more than USD62bln, mostly in loans, to Venezuela since 2007 and it's paid back in crude.

Countries supporting Maduro and Guaido

Стоимость государственных международных облигаций Венесуэлы с погашением 15 сентября 2027 года



Venezuela's benchmark bonds due in 2027 have rallied to their highest since President Nicolas Maduro's debt restructuring speech in November 2017 amid optimism about a regime change.

Waning Support

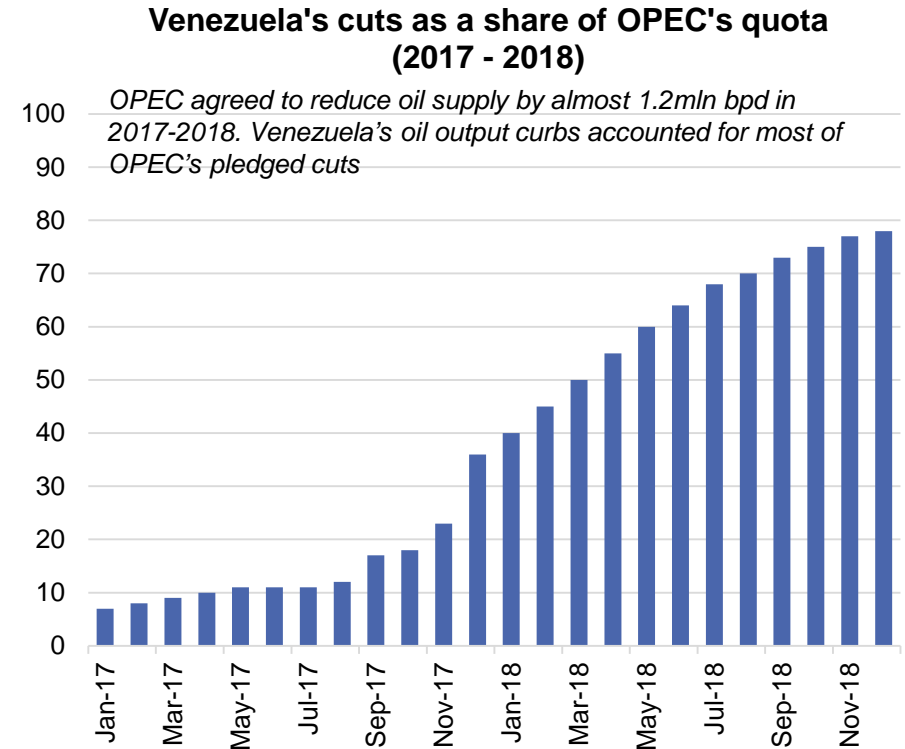
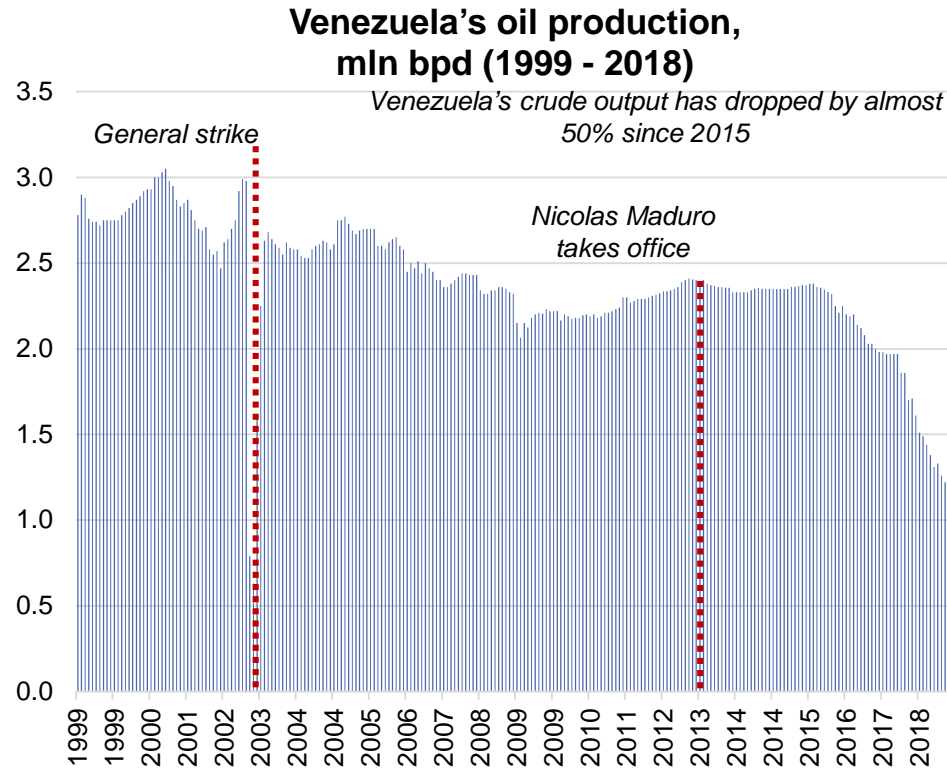
Global leaders back Venezuela's Guaido as Maduro clings to usual allies



Source: Bloomberg research

The US, Canada and most Latin American governments recognized National Assembly President Juan Guaido as the nation's leader.

In Venezuela, political crisis risks oil production outlook in 2019 after losses of ~50% of its production in the past two years.



The OPEC member has already seen its output drop 50% in five years as a spiraling economic crisis takes its toll on the oil industry. Even without new US sanctions, Venezuela's production -- currently ~1.2 mln bpd -- may lose a further 300,000 to 500,000 bpd, RBC estimates.

Venezuela - crippled first by an economic crisis and now a political one -- has shouldered the burden of OPEC's oil output curbs. The nation's crude production has involuntarily dropped by almost 10 times what its leaders pledged to cut in 2017, when the deal to reduce supply took effect.

The Latin American nation could see crude production drop by a third this year

- Venezuela's economy has contracted for five years straight. Inflation is forecast to reach 10 mln % in 2019. Venezuela defaulted on a portion of its debt in 2017, and creditors are demanding more than USD9bln in overdue bond payments. Maduro said he hoped to negotiate a debt restructuring, but US sanctions prevent American investors and banks from participating, complicating the process. That said, the US has steadily expanded economic sanctions and denunciations of Maduro since Trump took office, all but urging that Venezuelans overturn their government.
- The Organization of Petroleum Exporting Countries alone pledged to remove almost 1.2 mln bpd from the global market to end the glut. Venezuela's share of the curbs was to be 95,000 bpd, or ~8% of OPEC's total. However, as of last month, the country's crude output was 919,000 bpd lower than its starting point for the first round of supply curbs, according to Bloomberg calculations from OPEC secondary source data. Venezuela accounted for 78% of the group's nearly 1.2 mln bpd quota by the end of last year. That is helped enable some OPEC powerhouses -- such as Saudi Arabia, Iraq, Kuwait and the United Arab Emirates -- to avoid lowering their own production as agreed, while still allowing the cartel itself to be in compliance with the curbs. The troubled nation isn't part of the revised supply agreement, in place since the start of the year.
- Internal conflict could result in a much bigger and longer-lasting disruption. Even if Maduro's government is replaced, "the road back for Venezuela will be extremely arduous given the depths of the economic and humanitarian crisis," Tran and fellow RBC analyst Helima Croft wrote in a note.
- Venezuela's production decline plateaued in late-2018 at about 1.2 million barrels a day, though surging political risk, overwhelmingly weak economic conditions and underinvestment suggest this could further deteriorate to below 1 million barrels a day in the near term. Through 2018, Venezuelan volumes fell by more than 500,000 barrels of oil a day, and market players expect operations to weaken further amid PDVSA's liquidity shortage, bond defaults, and underinvestment, while the country's broader economy faces eye-watering inflation.

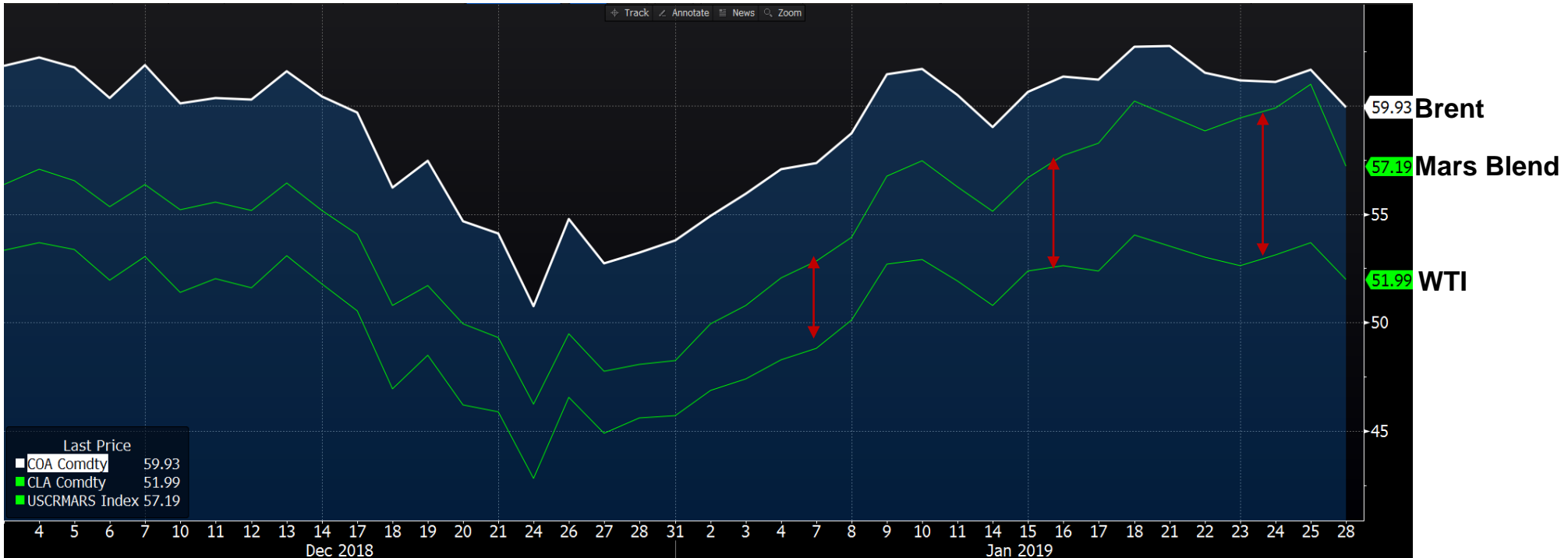
Implications on oil market players

- Repsol's global production portfolio is the most exposed among international upstream companies to the crisis in Venezuela. Repsol produced about 77,000 barrels of oil equivalent a day in Venezuela in 2017, more than 11% of its global total. This compares unfavorably with Chevron, Eni, Equinor, Shell and Total, for which production in Venezuela accounts for 3% or less. Repsol's Perla offshore natural-gas project is producing at about half of its 2020 target of 1.2 billion cubic feet a day due to waning investment from Eni and Repsol, given the financial capacity of partner PDVSA.
- Among Russian companies, state-run oil giant Rosneft is most exposed to the political turmoil in Venezuela as the Kremlin maintains tight ties with Maduro's government. Rosneft has paid several billion dollars in advance for oil supplies to Petroleos de Venezuela SA. At the end of September, PDVSA owed USD3.1bln in debt principal to Rosneft, according to the Russian company.
- Rosneft PJSC fell the most in seven weeks in Moscow trading as protests erupted in Venezuela, where the company has close ties with the state oil producer. Rosneft sank as much as 3.4% on 24 January, the biggest intraday decline since 6 December. The slump followed the US's decision to recognize Venezuelan opposition leader Juan Guaido.
- The prospect of missing out on debt payments has caused the selloff amid fears that dividends could be affected. Nevertheless, the financial exposure to PDVSA is declining and may have fallen to USD2.6bln by the end of 2018, less than 4% of Rosneft's capitalization, according to market players' estimates. In a worst-case scenario, a new Venezuelan government may not acknowledge the debts of previous authorities, but it's unlikely that PDVSA's debt would be written off as the agreement with Rosneft was a commercial deal.

US issued new sanctions on Venezuela

- On 27 January, the Trump administration dealt its toughest blow yet to the authoritarian Venezuelan leader Nicolas Maduro, issuing new sanctions on the nation's state-owned oil company PDVSA that effectively block his regime from exporting crude to the US. US officials had long been hesitant to apply sanctions on Venezuelan oil because they did not want to exacerbate the humanitarian crisis in the country.
- As of Monday, all PDVSA assets and property subject to U.S. jurisdiction are blocked, according to a Treasury statement, and U.S. citizens and companies are generally prohibited from doing business with the Venezuelan firm. The move is consistent with the Trump administration's efforts to starve Maduro of oil money, while still blunting the potential impact on U.S. refiners and U.S. motorists, said Jim Lucier, managing director of Washington, D.C.-based Capital Alpha Partners.
- National Security Adviser John Bolton told reporters at the White House that Trump's action would block USD7bln in Venezuelan assets and reduce the country's exports by USD11bln over the next year, though Maduro is sure to attempt to sell PDVSA's crude elsewhere.
- State-run PDVSA generates cash from its heavy oil exports to US refineries (about 50% of output), with the remaining compromised by its loan-for-oil deals with China, Russia and sales to the Caribbean. Mnuchin, the Treasury secretary, added that in the "short term" he expects "modest" impact on U.S. refineries. He noted the sanctions wouldn't affect oil already purchased that is being shipped, and said he didn't expect US gas prices to rise.
- PDVSA has been moving away from dollar-denominated transactions in the past couple of years, since the Trump administration announced financial sanctions in August 2017. The company sells oil to clients in the U.S., Europe and Asia and requires payment in euros, and buys gasoline and diesel for payment in euros as well. PDVSA also buys fuels via Citgo, owner of three refineries in the U.S. Most of those are barter deals, which means PDVSA gets the fuels and pays the suppliers -- including trading house Vitol SA and Reliance Industries Ltd from India -- in Venezuelan crude.

Implications on oil prices



- The premium for Mars Blend, a grade found in the Gulf of Mexico, surged to a fresh five-year high on Wednesday relative to West Texas Intermediate.
- Mainstream oil prices - WTI and Brent - have so far been little changed in response to the potential for upheaval in a country that holds the world's largest oil reserves. The two grades have in recent months become increasingly linked to the fortunes of wider asset markets as oil traders monitor things like the US-China trade dispute for clues on where demand will go.
- Oil has advanced 14% this year as the Organization of Petroleum Exporting Countries and allies curbed output to ease glut concerns. Nevertheless, price gains have been capped by record American output, expanding stockpiles and the US-China trade war. Talks between the world's two biggest economies later this week may provide the catalyst for crude to break out of its recent tight trading range.

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