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FEATURED Q&A

Do Brazil's Shaky Politics Jeopardize the Oil Sector?



President Michel Temer is unlikely to weather the current political upheaval surrounding his presidency and other Brazilian politicians, which would make it difficult to pass and maintain his proposed reforms, Isabella Alcañiz says below. // File Photo: Brazilian Government.

Q Brazilian President Michel Temer in recent months has initiated a reopening of the oil sector to private investment as part of a series of economic reforms aimed at bringing the nation's economy out of a profound recession. However, political dynamics in Brazil have deteriorated dramatically following recent allegations of corruption against Temer during the course of the ongoing "Lava Jato" investigations, with thousands of protesters taking to the streets, and some turning violent and destructive. Analysts now increasingly suggest that Temer will be forced from office before next year's scheduled presidential election. What are the consequences of Brazil's heightened political drama for the country's energy sector reforms? To what extent have international investors scaled back on plans to invest in Brazilian energy companies and projects?

A Isabella Alcañiz, assistant professor in the Department of Government and Politics at the University of Maryland: "The prospects for any significant energy reform in the near future in Brazil are slim. The political crisis is taking precedence over the country's economic recession. Temer's promise of a wave of economic reforms in energy, finance and labor were already on shaky ground, as it seemed at least questionable than an unelected president could pass a number of difficult reforms through Congress, albeit a sympathetic one. Brazil's Bovespa stocks recovered slightly from the plunge they took immediately after a recording of Temer allegedly approving hush money to Eduardo Cunha—the other architect of President Dilma Rousseff's impeachment—was made public. The new corruption allegation feels like

Continued on page 3

TODAY'S NEWS

POLITICAL

Venezuelan Agents Seize Opposition Leaders in Raids

In overnight raids, Venezuelan intelligence agents seized opposition leaders Leopoldo López and Antonio Ledezma, who had been under house arrest. The raids followed Sunday's controversial "constituent assembly" vote in Venezuela.

Page 2

BUSINESS

Veolia Posts 24% Gain in Latin America Revenue

The France-based utility attributed significant price increases and good volumes in the region for the increase.

Page 2

ECONOMIC

Mexico Names Smith as Top NAFTA Negotiator

Kenneth Smith, the current director of the Trade and North American Free Trade Agreement Office at the Mexican embassy in Washington, will lead Mexico's negotiating team.

Page 3



Smith // File Photo: University of Kansas.

POLITICAL NEWS

Venezuelan Agents Seize Opposition Leaders From Homes

Venezuelan security agents arrested two prominent opposition leaders in overnight raids, seizing them from their homes less than a day after President Nicolás Maduro threatened to jail opponents who accused him of electoral fraud following Sunday's widely denounced vote to select a "constituent assembly" to rewrite the country's Constitution. "Some will end up in a jail cell," Maduro said of such



In a video posted to Twitter, security agents are seen putting opposition leader Leopoldo López into a patrol car and driving away. // Image: @liliantintori.

opponents on Monday morning. In the raids, agents seized the two opposition leaders, who had been on house arrest—Leopoldo López, who less than a month ago was released from prison, where he was behind bars for more than three years, and Antonio Ledezma, the elected mayor of Caracas. "12:27 in the morning: the moment when the dictatorship kidnaps Leopoldo at my house," López's wife, Lilian Tintori wrote in a posting on Twitter, Reuters reported. Tintori also posted a video that appeared to show her husband being led into a vehicle bearing the word "Sebin," the name of Venezuela's intelligence agency. Ledezma's daughter, Vanessa, posted a video of intelligence agents taking away her father, who was dressed in pajamas. "The Sebin just took him," she wrote. Both opposition leaders had called for protests following Sunday's vote in Venezuela to elect the constituent assembly, which may be seated as early as Thursday. The powerful body will have the authority not only to rewrite the Constitution, which Maduro says is needed to end

Venezuela's political and economic crises, but also to overrule other government institutions, including the courts and the elected, opposition-controlled National Assembly. Maduro's critics see the move as a thinly veiled attempt to increase his own power and say the country is becoming a dictatorship. On Monday, the U.S. government imposed sanctions against Maduro, saying his government has trampled human rights and staged an illegitimate vote. The sanctions freeze any assets Maduro may have in the United States and bars U.S. entities from doing business with him. The sanctions also ban Maduro from traveling to the United States.

Brazilian Lawmakers to Vote on Whether to Put Temer on Trial

Brazil's lower house of Congress is scheduled Wednesday to vote on whether to put President Michel Temer on trial for alleged graft, The Wall Street Journal reported today. If two-thirds of the chamber approves the charges and the Supreme Court agrees, Temer will be suspended from the presidency for 180 days and will be put on trial, The Guardian reported. However, if more than one-third of the lower house votes against the charges, which political insiders are saying is becoming increasingly likely as Temer works to secure lawmakers' support, then he may successfully complete his term. Many of the lawmakers set to vote on whether to put Temer on trial are themselves under investigation as part of the "Operation Car Wash" corruption probe, The Wall Street Journal reported. "The real truth is that Car Wash doesn't have the strength to defend itself against attacks from the most powerful institution of Brazil, which is Congress," said lead Operation Car Wash prosecutor Deltan Dallagnol. While Temer has been very unpopular among voters, with an approval rating in the single digits, he has been more successful as a negotiator. In recent weeks, he has brought \$1.3 billion in financing for projects in lawmakers' home states, according to Open Accounts, a public-accounts watchdog, with the goal of securing their support.

NEWS BRIEFS

U.N. Begins Removing FARC Weapons From Demobilization Zones

The United Nations on Monday began removing more than 7,000 weapons from demobilization zones where Revolutionary Armed Forces of Colombia, or FARC, rebels relinquished them, the Associated Press reported. Rebels finished handing over their weapons at the end of June, seven months after the FARC and the government signed peace accords to end their half-century conflict.

Veolia Posts 24 Percent Improvement in Latin America Revenue

France-based utility Veolia announced Monday that its Latin America revenue grew 23.7 percent in the second quarter due to significant price increases and good volumes in the region. Tariff increases in Argentina were especially positive for results, the company said, and as well as the consolidation of the Pedreira landfill in Brazil and the start-up of the Santa Marta water contract in Colombia. In May, Veolia signed a deal with Mexico City worth \$1 billion for a waste incinerator whose heat will be used to power the city's subway, Reuters reported.

Brazil's Pre-Salt Oil Production Surpasses Rest of Combined Output

Oil output at Brazil's pre-salt offshore oil wells surpassed the combined output from all other fields in Brazil for the first time in June, raising the country's oil output by 0.8 percent from the month before to an average of 2.7 million barrels per day, Reuters reported Monday. Production at pre-salt oil wells increased to 1.353 million bpd in June, up 6.4 percent from the month before, according to Brazilian oil watchdog ANP.

ECONOMIC NEWS

Mexico's Economic Growth Slows Less Than Expected

Mexican economic growth slowed less than had been expected in the second quarter, due to strong output in the services sector as industrial production flagged, The Wall Street Journal reported Monday. GDP in the second quarter grew by 0.6 percent as compared to the first quarter and was up 1.8 percent year-over-year, according to the National Statistics Institute. The second quarter was Mexico's 16th consecutive quarter of growth, beating analysts' expectations that growth would slow significantly amid concerns that the election of U.S. President Donald Trump in November would lead to worsening trade and investment relations between the two countries. "Today's data should further allay the fears of a collapse in the Mexican economy that emerged in the aftermath of the U.S. election. In particular, the strength of the domestically focused services sectors suggests consumer spending remains resilient," Capital Economics' Latin America economist Adam Collins said following the publication of the preliminary reading from the National Statistics Institute. He added that while higher local interest rates and inflation could still slow down economic growth, the upcoming talks to renegotiate the North American Free Trade Agreement are unlikely to affect business and consumer confidence.

Mexico Names Smith as Top NAFTA Negotiator

Mexico has named veteran trade policy expert Kenneth Smith as the country's chief negotiator for the North American Free Trade Agreement, or NAFTA, renegotiation talks scheduled to begin this month, Economy Minister Ildefonso Guajardo said Monday, Reuters reported. Smith is the current director of the Trade and North

FEATURED Q&A / Continued from page 1

a chronicle of a scandal foretold, as Temer has been under investigation for quite some time. To maintain a legislative majority for his reforms and avoid being removed from office on corruption charges, Temer must hold together an electoral coalition between his own PMDB party and the PSDB. For now, the coalition is holding, but there is little expectation among political analysts and market actors that Temer will survive this. Temer himself does not seem too confident in his political future, as he unceremoniously just replaced the minister of justice without offering any explanation."

A Cleveland M. Jones, researcher at the National Institute of Oil and Gas, member of the geosciences advisory board at NXT Energy Solutions and professor of geology at the State University of Rio de Janeiro: "There are relatively few major plays available for investors worldwide that are easily accessible, in relatively safe countries and which can be economically produced with current technology. Despite the momentary political upheaval in Brazil, most analysts recognize that there is likely to be no major impact to oil regulations and operating conditions in Brazil. In fact, there are ongoing initiatives that can even improve the operating environment in Brazil. Brazil's announced upcoming rounds, 10 in all, finally offer a measure of predictability, and allow longer-term planning. Thus, both the concession rounds for post-salt areas, and the production-sharing rounds for pre-salt areas, represent exceptional opportunities for major world oil and gas players to partici-

pate in large-potential plays in a country that offers a favorable operating environment. Many of these plays have demonstrated

“Most analysts recognize that there is likely to be no major impact to oil regulations and operating conditions in Brazil.”

— Cleveland M. Jones

the exceptional quality of the discoveries possible, especially in the pre-salt areas. Our research has indicated potentially recoverable resources in the pre-salt alone, of between 176 billion and 273 billion barrels of good-quality oil, and even under a 'lower for longer' scenario, these estimates are only slightly reduced. Obviously, there is much oil to be discovered. The exceptional productivity of pre-salt fields is also an attractive factor for potential investors, since many fields have individual well production of 30,000 to 40,000 barrels of oil per day and more, thus reducing up-front costs for installing floating production storage and offloading vessels (FPSOs) and production facilities. There are FPSOs operating with merely five wells, when up to 18 wells would otherwise be required. Companies will not ignore these realities when deciding where to allocate their budgets for new exploratory plays. Even Mexico's Gulf of Mexico areas do not match such attractiveness, despite important modernization efforts there."

Continued on page 4

American Free Trade Agreement Office at the Mexican embassy in Washington. He also worked on Mexico's original NAFTA negotiating team in the early 1990s. In addition, Smith coordinated the implementation of the agreement at Mexico's economy ministry from 2002 to 2007, The Wall Street Journal reported. "He is a very talented man who has spent a

great part of his life dealing with NAFTA," a senior Mexican government official said. The administration of U.S. President Donald Trump has said that reducing U.S. trade deficits with Mexico and Canada has been its top trade priority. [Editor's note: See [Q&A](#) on the upcoming NAFTA negotiations in the July 28 issue of the Advisor.]

FEATURED Q&A / Continued from page 3

A John Albuquerque Forman, director of J Forman Consultoria and former ANP director: "On your questions, starting from the end, on the extension of international investors scaling back possible investments: it varies, depending on the investor. As conditions deteriorate, prices for assets decrease, and that is considered a favorable condition by some seasoned investors who recognize that Brazil will overcome its problems in the future, as has happened before. Others, more conservative, prefer to wait and see what will happen in the future. The main issues that are being considered are the economic reforms being voted upon in Congress, if the process goes on, as it seems it will by the current developments, and are approved, then the conditions for a turnaround are given. As for the energy sector, although the regulatory agencies were created from 1998 on, namely ANP, ANEEL, ANA, etc., with the role of regulating their sectors, they eventually became subordinated to the ministries, starting with the first PT government in 2006. The Lula government changed the laws to create profit-sharing contracts, to be applied to the pre-salt areas. Also, Petrobras was given the rights to at least a 30 percent stake in any block and to be the operator of the pre-salt areas. The Dilma government put more emphasis on the ministries and the CNPE, which became the

decision-making agency for energy matters, further reducing the regulatory agencies' role. The Temer government first proposed and Congress later approved changes that now allow Petrobras to decide if it will participate on pre-salt blocks and no longer is required to be the operator. The roles of

“The uncertainties and risk will remain, and investors will have to bear with them.”

— John Albuquerque Forman

CNPE and the ministries were enforced and made clear, and the agencies became even more restricted to studies and fiscalization. Any new government, if Temer leaves office or if elections to take place in 2018, will probably bring its own views and will try to impose them, something that is impossible to foresee now. The uncertainties and risk will remain, and investors will have to bear with them. Again, decisions will depend on the investors' experience and willingness to face risks.”

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org.

LATIN AMERICA ADVISOR

is published every business day by the Inter-American Dialogue, Copyright © 2017

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Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at 1155 15th Street NW, Suite 800 Washington, DC 20005

www.thedialogue.org

ISSN 2163-7962

Subscription inquiries are welcomed at freetrial@thedialogue.org

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