LATIN AMERICA ADVISOR

ENERGY ADVISOR

A WEEKLY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

August 11, 2017

FEATURED Q&A

Will China Still Need Latin American Energy?

Energy-exporting Latin American countries have long seen China as a top importer. Chinese President Xi Jinping and Venezuelan President Nicolás Maduro are pictured meeting in Caracas in 2014. // File Photo: Venezuelan Government.

Q New advances in drilling techniques have allowed China to increase its domestic production of shale gas. The sector is expected to fully cover the anticipated increase in domestic demand for fuel in the years and decades ahead, likely lessening China's reliance on Latin America as a source for fuel. How will advances in China's domestic energy sector affect Latin America's energy sector? How can Latin America establish safeguards so that its economy is not struggling in the wake of decreased Chinese demand?

A Margaret Myers, director of the Latin America and the World Program at the Inter-American Dialogue: "With the largest technically recoverable shale reserves in the world, China is well-positioned to increase domestic gas consumption in the coming years. New advances in drilling, along with skills acquired from overseas joint ventures with foreign firms, have substantially sped up the development of shale in China. Many new wells have been dug in China's Sichuan Basin and Guizhou regions. Successful development of the shale industry will no doubt lessen China's dependence on oil and coal, including from Latin America, which accounts for about 10 percent of China's oil imports and a smaller fraction of coal. However, Latin America and other regions should expect continued engagement from China in oil and gas and other energy industries in the near-term. China's shale production is still limited by complex geology, as well as insufficient infrastructure and water in areas with proven shale. In addition, because it is run in large part by the state, China's domestic shale industry is bridled by inefficiencies. China won't be able to maximize its shale output unless

Continued on page 3

TOP NEWS

OIL & GAS

Grupo México to Build New Terminals for Transporting Oil

Grupo México plans to build at least three terminals for transporting oil by railway in the country, including one exclusively for U.S. oil refiner Valero.

Page 2

RENEWABLES

Zuma Gets $600 Mn for Mexico Wind Farm

Mexican renewable energy group Zuma Energía received $600 million in project financing to build the country's largest wind farm. The wind farm will have enough capacity to generate energy for one million homes.

Page 3

OIL & GAS

YPF Sees Upturn in Oil, Gas Output

Argentina's YPF is expecting its production to increase next year after a contraction this year, the chairman of the state-run oil company, Miguel Gutiérrez, said Monday.

Page 2

Gutiérrez // File Photo: Argentine Government.

OIL & GAS SECTOR NEWS

YPF Expects Upturn in Oil, Gas Output

Argentina's YPF is expecting its production to increase next year after a contraction this year, the chairman of the state-run oil company said Monday, Reuters reported. The country's oil production has fallen since President Mauricio Macri took office in December 2015. Production of natural gas, however, has increased due to government price supports. "For me the adjustment process is over and looking at 2018 this situation will change, I think we have seen the floor of rigs," YPF Chairman Miguel Gutiérrez said in an interview with the wire service. Argentina had 49 active oil and gas drilling rigs as of April and 60 as of June, according to oil field service provider Baker Hughes. The totals are about half the number that were active two years ago, as companies have adjusted production due to lower global prices for oil. YPF's oil production accounts for between 35 percent and 45 percent of Argentina's monthly total. Gutiérrez, who previously held executive positions at JPMorgan Chase & Co. and Telefónica, forecast oil prices in the range of $50 to $60 per barrel for the next two to three years. "We don't see much change... companies have to see how they can modify costs so production is profitable," he said. YPF's production this year is expected to contract by 3 percent, said Gutiérrez, who added that adverse weather conditions will take a toll on output this year. Gutiérrez added that it will take about two years for new shale oil fields in Argentina's Vaca Muerta deposit to move into the development phase from their current pilot phases.

Grupo México to Build New Terminals for Transporting Oil

Mexican mining and infrastructure corporation Grupo México plans to build at least three terminals for transporting oil by railway in the country, including one exclusively for U.S. oil refiner Valero, the company's chief financial officer, Xavier García de Quevedo, said Tuesday, Reuters reported. The move to expand the company's oil-by-rail business comes as fuel imports from the United States to Mexico continue to grow. Grupo México has been in talks with importers of refined oil products into Mexico, and earlier in August, Valero announced it had signed a long-term agreement with the Mexican infrastructure company to transport fuels by rail from Veracruz to other inland terminals in Mexico. "Our interest is to build and operate the terminals, to offer rail services and [access to] the terminals," García de Quevedo said. Potential locations for the terminals include Torreón, Chihuahua, Mazatlán, Manzanillo and Guadalajara, he added. Grupo México operates rail lines in Texas and Florida, and its drilling unit, called Pemesa, is looking into participating in upcoming oil auctions in Mexico, particularly for shallow water blocks.

RENEWABLES NEWS

Ireland's Mainstream Confident in Future Chile Investments

Irish renewables company Mainstream Renewable Power is confident it will have a steady stream of power projects in Chile, the company's commercial manager for Chile, Daniel Canales, said Wednesday, Reuters reported. Aela Energía, a joint venture between Mainstream and British private equity firm Actis, on Wednesday announced it had acquired $410 million in financing to construct two wind farms in Chile with a combined total capacity of 299 megawatts. The financial close on the two wind farms, Sarco and Aurora, is one of the biggest wind power deals in the South American nation. The deal comes, however, as energy prices are falling amid transmission grid issues and low demand from Chile's mining sector, causing some investors to have doubts about the future of the country's energy sector. Mainstream remains optimistic about future

NEWS BRIEFS

Mexico's Pemex Seeks to Diversify Portfolio With Projects in U.S., Brazil

Mexican state oil company Pemex is looking to diversify its portfolio and possibly begin oil exploration projects in the United States, Brazil, Colombia and Argentina, a top executive at the company said Wednesday, Reuters reported. The company is in talks with Mexico's oil regulators to get a two-year extension on the deadline for the company to reach the minimum investment required to develop more than 100 domestic blocks the company was assigned in 2014 as part of the country's landmark energy reform.

France's Engie Eyes Renova's Wind Project in Brazil's Bahia State

The Brazil unit of French power company Engie is in talks to buy a wind power project located in Bahia State from local energy firm Renova Energia, according to a document filed with Brazilian power-sector watchdog Aneel, Reuters reported Tuesday. Engie's purchase of the 22 wind parks in the Umburanas project is dependent on Aneel's approval of proposed changes to the project. All parks should be operating by 2019, according to the existing license for the project. Renova and Engie did not respond to requests for comment.

Oil Extract from Brazil's Pre-Salt Costs $8 per Barrel: Petrobras CEO

Oil extraction at Brazil's pre-salt oil wells costs about $8 per barrel, the CEO of state oil company Petrobras, Pedro Parente, said Tuesday, Reuters reported. Output at the pre-salt wells, which were first discovered only 10 years ago, has surpassed the combined volumes of all other Brazilian oil fields for the first time last month.

investments in Chile, however, Canales said. He said the company is looking to build more wind farms in order to fulfill the 986 megawatts in contracts the Chilean government awarded Mainstream last year. He said the company has also seen “significant” interest from other firms to partner on future wind projects, including U.S. industrial conglomerate General Electric. Canales said Mainstream is also interested in participating in upcoming power auctions in Argentina, but that the country needed to improve regulations, invest in transmission and lower macroeconomic uncertainty in order to reach its full potential in the energy sector.

Zuma Gets $600 Mn in Financing for Mexico Wind Farm

Mexican renewable energy group Zuma Energía received $600 million in project financing to build the country’s largest wind farm, the Financial Times reported Tuesday. The wind farm will have enough capacity to generate energy for one million homes. “This is crucial for the country. It demonstrates that the reforms that have been enacted are bankable and that you can attract investment,” said Zuma Chief Executive Officer Adrián Katzew. Zuma received the project finance mostly from Mexican development banks, as well as from Santander, Danish export credit agency EKF and Zuma’s parent companies, United Kingdom-based private equity company Actis and Latin America-focused investor Mesoamerica Investments. Actis, which owns 80 percent of Zuma, said that according to consulting firm PricewaterhouseCoopers, Mexico’s renewable energy sector is expected to attract $70 billion in foreign investments between 2015 and 2029. Zuma originally won contracts to build the Reynosa wind farm and two solar projects during Mexico’s second renewable energy auction last year. Zuma is the first company to close on financing for a project won during that round of bidding, Katzew said. The Reynosa farm will be located in Tamaulipas State and will have a total capacity of 424 megawatts.

BNDES Approves Financing for Solar Power Plant

Canadian Solar and French renewables firm EDF Énergies Nouvelles announced the Brazilian Development Bank, or BNDES, has approved $163 million in project financing for the 191.5 megawatt Pirapora I solar power plant, PV-Tech reported Monday. The project, which is located in Minas Gerais state, will be the first photovoltaic project that BNDES has supported. The local subsidiary of EDF, EDF EN do Brasil, has acquired an 80 percent stake in the project from Canadian Solar. The project is fully contracted and has a 20-year inflation-linked power purchase agreement that the Brazilian government awarded in 2015. The project is expected to begin commercial operation in the third quarter of this year.

The solar project will be the first BNDES has supported.

FEATURED Q&A / Continued from page 1

these and other challenges are addressed. Even so, further progress will depend on international gas prices. What is more, China’s massive energy bureaucracy, though often engaged in heated debate on the matter, promotes diversifying the country’s energy supply. Toward this end, there is still broad support for international deal-making, and for the development of renewable and other sources of energy at home. Latin American nations such as Venezuela, Ecuador, Brazil and Argentina remain attractive destinations for China’s national oil companies and other energy firms. Oil-backed lending also remains a key feature of Chinese engagement with Latin America.”

A **Carlos Casanova, economist for the Asia-Pacific region at Coface:** “The increase in China’s domestic production of shale gas has been underscored by two main factors: the need to reduce the share of coal in primary energy consumption and Beijing’s desire to limit its dependency on fuel imports. The Chinese economy remains energy-intensive and coal-oriented, a state of affairs that will not change overnight. In order to reduce pressures—mainly on the environmental front—the State Council has recently issued targets to increase the share of natural gas from 6 percent to 10 percent by 2020 and 15 percent by 2030. Domestic shale gas production can play a key role in helping to meet these targets, while simultaneously reducing China’s dependency on fuel imports. Having said that, advances in drilling techniques will not be sufficient to service China’s growing demand for natural gas, and so it will not displace imports. Latin American commodity exporters are highly exposed to shifts in Chinese demand. This is true in the case of crude oil exports from Venezuela and Colombia, but not natural gas. The region has some large producers, for example Mexico, Bolivia, Trinidad and Tobago and Argentina, but these are not among the top exporters to China. Notwithstanding technical barriers to this type of trade, natural gas exports could help the region to re-balance trade relations with China. Latin American countries can implement policies that facilitate trade integration and boost production linkages to foster more

“Advances in drilling techniques will not be sufficient to service China’s growing demand for natural gas, and so it will not displace imports.”
— Carlos Casanova

Continued on page 6

POLITICAL NEWS

U.S. Sanctions Eight Venezuelans Linked to New Assembly

The U.S. Treasury on Wednesday slapped sanctions on eight Venezuelan officials linked to the creation of the Andean country's powerful new constituent assembly, The Wall Street Journal reported. The sanctioned officials reportedly supported the establishment of the new super-body. The Treasury imposed the penalties against the officials, who are mainly second-tier officials in President Nicolás Maduro's ruling party. They include Adán Chávez, the older brother of late Venezuelan President Hugo Chávez. "This regime's disregard for the will of the Venezuelan people is unacceptable," U.S. Treasury Secretary Steven Mnuchin said in a statement. The 545-member constituent assembly was seated last week after an election that opposition leaders and other critics of Maduro's government have called fraudulent. The assembly, which was selected from a list of candidates handpicked by Maduro's government, on Tuesday declared itself superior to all other branches of Venezuela's government, including the courts and the opposition-controlled legislature, the National Assembly. The sanctions freeze assets the targeted individuals have in the United States, and Americans will be barred from conducting business with them, the Financial Times reported. The United States previously sanctioned more than a dozen other current and former Venezuelan officials, including Maduro.

Adán Chávez // File Photo: Venezuelan Government.

ADVISOR Q&A

Should the Private Sector Help Manage Peru's Water?

Q The Peruvian government wants the private sector to play a larger role in water management as it enacts reforms that are aimed at giving more people across the country access to running water by 2021, Housing Minister Edmer Trujillo said July 25. He said reaching the goal of providing basic water services to millions of Peruvians who lack them will require some 50 billion soles, or approximately $15 billion, in investment in water infrastructure projects. How much involvement should the private sector have in water resource management in Peru? What are the pros and cons of giving the private sector a larger role in the management of water for Peruvians? What would be the likely dynamic between the two spheres as they work to achieve the goal of providing greater access to water across the country?

A Cesar Fonseca, acting regional head for Latin America and the Caribbean at 2030 Water Resources Group: "First, President Pedro Pablo Kuczynski has a particular knowledge and commitment to the management of water resources. He aims to provide water and sanitation to 100 percent of the population in urban areas and 84 percent in rural areas by the end of his term in 2021. He also has close links with the private sector and multilateral agencies, which facilitates development, financing and implementation. The expected funding that the state is able to provide is one-third of the $15 billion needed for total coverage in water and sanitation. The other two-thirds must come from the private sector and from international cooperation. The main problem is not financial resources, but rather how to properly manage water-related issues and how to develop water governance policies that include different sectors of society. Fortunately, the current scenario is allowing close cooperation between the state and the private sector. Second, the 'Niño Costero' weather phenomenon at the beginning of the year brought devastation and destruction, but at the same time, it put the issue of secured water supply on the public agenda. It offers a window of opportunity for the government to establish structural public policies and to involve the private sector and civil society in reconstruction efforts. Third, the private sector is increasingly aware of the risks associated with water and its role in its own day-to-day practices for the sustainability of its business. Fourth, social conflicts in the country have been reduced considerably since the beginning of this government. One of the most sensitive issues is access to water, especially in mining projects. Fortunately, the government is unlocking investments through inclusive dialogue policies, and the private sector is increasingly aware of the importance of involving civil society and communities in the decisions that affect their own wellness and environment. Finally, multiple Latin American governments and private organizations have recently been involved in corruption issues, which in principle weaken their credibility and institutional capacity. However, the positive side is that the transparency of information and management is now not only necessary, but essential."

EDITOR'S NOTE: More commentary on this topic appeared in the Q&A in Thursday's issue of the daily Latin America Advisor.

NEWS BRIEFS

U.S. Expels Two Cuban Diplomats After American Envoys Suffer Symptoms

The United States has expelled two diplomats from the Cuban Embassy in Washington after U.S. diplomats in Havana suffered mysterious symptoms of hearing loss, BBC News reported Thursday. State Department spokeswoman Heather Nauert said there were no "definitive answers about the source or cause" of the symptoms, but the U.S. diplomats' ailments reportedly may have been caused by some type of covert sonic device. Cuba's foreign ministry said it was investigating the matter and denied targeting the diplomats.

Chile Eyes Companies for Value-Added Lithium Projects

The Chilean government has identified seven companies that it wants to develop value-added lithium projects, state development agency CORFO said Tuesday, Reuters reported. Chile is part of South America's "lithium triangle," which contains more than half the known global reserves of the commodity. The short list is part of the government's plan to diversify its exports. Chile currently must send lithium abroad in order for it to be developed into consumer goods.

More Charges Could Be Filed Against Brazil's Temer: Chief Prosecutor

Brazil's chief prosecutor criticized the lower house of Congress on Monday for voting against trying President Michel Temer for bribery, and added that plea bargains that are being negotiated could lead to charges of racketeering and obstruction of justice against the president, the Associated Press reported. The chief prosecutor, Ricardo Janot, said the lower house's decision to not put Temer on trial does not help the country solve its political crisis.

ECONOMIC NEWS

Brazil's Meirelles Eyes Pension Reform Approval by Year End

Brazilian Finance Minister Henrique Meirelles said he expects a controversial pension reform to be passed by the end of this year, despite the political turmoil and corruption scandals surrounding the government, the Financial Times reported Thursday. "We expect that group of reforms, particularly the social security reform, to be concluded by this year-end," Meirelles said. "Which means [not only] social security, the most important one, but also tax reform, which is beginning to now be formulated." A reform to the country's pension system, which allows Brazilians to retire in their mid-50s, is a key component of President Michel Temer's plan to boost the struggling economy and narrow the budget deficit. Temer was on track to pass the reform until an audio recording was released in May in which Temer is allegedly heard discussing bribes with businessman Joesley Batista, igniting a corruption scandal and causing some to call for Temer to stand trial for the allegations. Last week, the president successfully avoided standing trial after securing enough votes in the lower house of Congress to keep him out of court. "After the vote for the rejection of the accusation from [Chief Prosecutor Rodrigo] Janot, the number was very good from the government's perspective in terms of being able to build a foundation from there again," said Brasília-based political consultant Thiago de Aragão. Meirelles said he now expects the government to resume efforts to pass the pension reform, and congressional leaders have indicated they may put the reform up for a vote next month.

Meirelles // File Photo: Brazilian Government.

Colombian Bourse Seeking New Listings to Spur Trading

Colombia's stock market hopes to attract billions of additional dollars by listing new assets in order to spur trading, which is currently limited to a few dozen companies, Colombian Securities Exchange President Juan Pablo Córdoba said, Reuters reported Monday. Córdoba said there are currently 69 companies trading on the exchange, but that the number should be doubled in order to attract the level of trading the government is seeking. In an interview on Aug. 3, he also called for modifying tax regulations in order to make the bourse more competitive. Colombia's local stock market trades an average of $50 million a day in sales, a relatively low number when compared to the $1.2 billion daily volume in domestic public fixed income instruments and the $1 billion in the foreign exchange market. Colombia's plan to list new assets like real estate investment funds aims to raise money in the market for the construction of shopping centers, office buildings and other structures, Córdoba said. "We're working toward being able to list those assets in the market, so there will be a new class of equity assets, not company shares, but a fund that's registered in the equity market and traded as a stock," Córdoba said. "In terms of market issuance, we could be talking about up to 5 trillion pesos, about $2 billion, in the next two or three years."

> **"In terms of market issuance, we could be talking about up to 5 trillion pesos, about $2 billion, in the next two or three years."**
> — Juan Pablo Córdoba

FEATURED Q&A / Continued from page 3

inclusive trade by lowering costs and entry barriers. This would, in turn, help to ensure that their economies remain competitive globally, and don't struggle in the wake of slowing Chinese demand."

A **Pablo Ferrara, of counsel at Estudio O'Farrell in Argentina and at Wöss & Partners in Mexico, and consultant to the Frente Renovador Party in Argentina:** "Despite the new scenario regarding the self-provision of fuel sources in China, the importance of Latin American energy development can be understood as safeguarded due to several reasons. In the first place, only Venezuela, Brazil and Colombia are substantial exporters of hydrocarbons to China, while the remaining participation around Latin America by Chinese companies has mainly been through minor percentages of shares in corporations and ad hoc joint operation agreements. The above mentioned modus operandi provided China with bargaining tools in relation to other relevant natural resources such as lithium, foreign direct investment negotiations, trade balance and (up to a certain point, and in certain cases such as Venezuela, which used to provide 21 percent of U.S. oil) to indirectly manage oil and gas provisions to geopolitically significant states. In addition, China passed the Paris COP21. That was not a public opinion action, but it opened the opportunity for a general energy technological jump in China in order not only to provide for security of supply, but also to enlarge heavy and capital-intensive industries, positively affecting economic growth. To sum up, Chinese shale development can be an opportunity for Latin America to develop its own extraction capacity and to obtain cheap renewables assets, evaluating each particular trade balance."

> **"Chinese shale development can be an opportunity for Latin America to develop its own extraction capacity."**
> — Pablo Ferrara

A **Agustín Crivelli, economist at the Scalabrini Ortiz Center for Economic and Social Studies in Buenos Aires:** "Trade relations between China and Latin America in recent years have increasingly responded to the classic north-south theme of commerce. Latin American exports are concentrated in a few primary goods, such as hydrocarbons and agriculture products, while imports from China to Latin America include a broad range of diverse consumer goods, with high technological content, durable goods and industrial products. This unequal trading framework has come to sustain China's demand for natural resources, and energy in particular, that are necessary in order to enable China's accelerated growth. In this sense, the change of scenery brought about by the growth in the levels of production of gas in China, and consequently the lowered demand for Latin American energy from China, could mean good news in the medium and long term. This is so, as long as the region has the will and decides to push for policies that will facilitate the development of their industrial sectors and domestic markets, which would reorient the energy that the countries would have previously exported to China to the growing energy demands in Latin America that come along with industrial development. Ultimately, a successfully path for the development of Latin American countries will depend on the opportunities to access energy sources at the affordable and competitive prices they have, in a way that can promote and strengthen the countries."

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

LATIN AMERICA ENERGY ADVISOR
is published weekly by the Inter-American Dialogue
Copyright © 2017

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Nicole Wasson
Reporter, Assistant Editor
nwasson@thedialogue.org

Latin America Energy Advisor is published weekly, with the exception of some major U.S. holidays, by the Inter-American Dialogue
1155 15th Street NW, Suite 800
Washington, DC 20005 **Phone:** 202-822-9002

www.thedialogue.org

ISSN 2163-7962

Subscription Inquiries are welcomed at
freetrial@thedialogue.org