LATIN AMERICA ADVISOR

ENERGY ADVISOR

A WEEKLY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

November 30, 2018

FEATURED Q&A

Is Latin America Prepared for More Oil Price Volatility?

Global oil prices plummeted earlier this month, but didn't reach record lows. Gasoline pumping into a car in the United States is pictured above. // Image: Office of U.S. Rep. Tim Walberg.

Q **Global oil prices dropped sharply in early November, falling for a record 12 consecutive days. Venezuela has been desperate for a rise in prices as it struggles to keep oil production above one million barrels per day for the first time in decades. Meanwhile, interest in Brazil's oil resources has spiked, with international oil companies betting on strong investment conditions with a new government coming into office. In Mexico, the sweeping electoral victory of leftist Andrés Manuel López Obrador this year has given most energy sector investors pause, according to reports. What are the forces driving global oil prices, and how are they affecting stakeholders in Latin America and the Caribbean? What is the outlook for oil prices next year, and how are countries and companies in the region planning for 2019 amid fresh political and economic uncertainty?**

A **Edward L. Morse, managing director and global head of commodity research at Citigroup:** "Oil producing companies and governments are rapidly adjusting to an era of price volatility, as both expectations and investment decisions are becoming increasingly inured to price swings of $20 a barrel or more. These occur not just annually, but over short periods of time. In fact, the price of Brent was $80 in July, $71 in August, $86 in September and less than $65 in mid-November. Three factors loom large in these swings. First is that the ability of OPEC alone to defend a price floor has deteriorated dramatically—OPEC had 35 million of barrels per day (bpd) of capacity in 1980 when the world produced 65 million bpd; but it also has the same level of capacity in 2018 when the world is producing more than 100 million

Continued on page 3

TOP NEWS

OIL & GAS

Argentina to Begin LNG Exports with Belgium's Exmar

The South American country is expected to begin exports of liquefied natural gas, or LNG, in the second quarter of next year. It will use a vessel owned by Antwerp-based shipping company Exmar.

Page 3

OIL & GAS

Ecopetrol to Invest as Much as $4 Billion in 2019

The Colombian state oil company said it will invest between $3.5 billion and $4 billion next year as it aims to increase reserves and production.

Page 2

OIL & GAS

Mexico to Suspend All Oil and Gas Rounds Until 2021

Incoming Energy Minister Rocío Nahle said last week that López Obrador's administration, which takes office on Saturday, will suspend all oil and gas auctions until 2021. This includes the rounds originally scheduled for February.

Page 2

Nahle // File Photo: Mexican Government.

OIL AND GAS NEWS

Colombia's Ecopetrol to Invest as Much as $4 Billion Next Year

Colombian state oil company Ecopetrol plans to invest between $3.5 billion and $4 billion next year in an effort to boost production and bolster reserves, the company said Tuesday in a statement. The planned investments represent an increase of as much as 33 percent over its investment for this year. "Investments have been prioritized with a view to maintaining capital discipline and a focus on ensuring the company's future sustainability by increasing reserves and hydrocarbon production," the company said. More than 80 percent of the new investments are to be concentrated on upstream operations, with 90 percent of those investments allocated to Colombia. Exploration capital expenditures are set to increase from $250 million this year to more than $460 million next year, the company said. Ecopetrol added that it "expects to continue pursuing opportunities to develop gas discoveries in the Colombian Caribbean offshore and participate in a pilot testing of non-conventional hydrocarbon reservoirs in the Middle Magdalena basin."

López Obrador to Suspend Oil and Gas Auctions Until 2021

The government of Mexican President-elect Andrés Manuel López Obrador will suspend all oil and gas auction rounds until 2021, when its review of the 107 contracts awarded during current President Enrique Peña Nieto's administration is expected to end, incoming Energy Minister Rocío Nahle told El Sol de México last week. This includes the round originally scheduled for February. "We won't be handing out contracts in February," Nahle, who is also a senator with López Obrador's Morena party, told the local newspaper. Nahle added that the incoming administration, which takes office on Saturday, will respect existing contracts, as other officials had previously announced. She also said the administration will push ahead with its plans to build a new refinery in Dos Bocas, in Tabasco State, with a "restricted invitation" to companies to tender for the project, without providing any further details. Last weekend, López Obrador organized a public consultation for Mexicans to vote on the future of several of his proposed projects, including the Tabasco refinery. The construction project won the approval of 91.6 percent of voters, but less than one percent of Mexico's electorate participated, BBC News reported. López Obrador's earlier referendum on the continuation of the one-third completed new airport in Mexico City, which led to its cancellation, sparked uncertainty and spooked investors in Mexico, which in turn hit the country's oil sector. State-owned oil giant Pemex saw its 30-year debt plummet to around 82 cents on the dollar in three weeks, Bloomberg News reported. The company's debt now stands at more than $106 billion. "Pemex is the most vulnerable credit in Mexico right now," Shamaila Khan, director of emerging-market debt at AllianceBernstein in New York, told Bloomberg News. "Pemex has a very large capital structure, it has one rating that's on the fringe of below investment grade and [López Obrador's] policies are very uncertain with respect to energy reform." The incoming president has promised to reverse a nearly 14-year decline in the company's oil output. [Editor's note: See related **Q&A** in the Aug. 17 issue of the Energy Advisor.]

Bolsonaro Eyes Changes to Pre-Salt Oil Contract Model

Brazilian President-elect Jair Bolsonaro is reportedly planning to change the production-sharing model of pre-salt oil auctions to a concession model, Valor Econômico reported last week. To reduce state interference, Bolsonaro's administration will seek to adopt a concession model, an unnamed senior transition official told Reuters, without providing any further details. "That's a clear preference

NEWS BRIEFS

Italy's Enel to Invest $684 Million in Peru in Next Three Years

Italian energy producer Enel said last week it would invest 600 million euros ($684 million) in Peru between 2019 and 2021, El Comercio reported. Of that amount, more than 280 million euros is slated for Peru's power distribution sector, with 200 million euros in renewable energy and 100 million euros concentrated in thermal energy. Enel will invest a total of 8.4 billion euros in South America between 2019 and 2021, according to the report.

PDVSA Reopens Dock at Main Oil Terminal Closed Since August: Source

Venezuelan state-run oil company PDVSA has reopened a dock at the José oil terminal that had been closed for nearly three months, Reuters reported last week, citing a source at PDVSA. Dozens of shippers were rerouted to other PDVSA terminals since José port's South dock closed in August due to a tanker collision. The shutdown caused delivery delays and partly led crude exports to fall to 1.06 million barrels per day (bpd) in October, compared to 1.39 million bpd in July, the wire service reported.

Auction of Eletrobras Unit Delayed Until Dec. 10

Brazilian state-controlled power company Eletrobras will no longer hold the auction of its Amazonas Distribuidora unit this week, according to a securities filing released last week, Reuters reported. Brazilian state development bank BNDES, which handles the auction process, postponed it until Dec. 10, according to the report, but it did not specify reasons for the rescheduling. The sale of the distribution unit, located in the northern state of Amazonas, is a key part of the privatization of Eletrobras, which has faced several delays in recent months.

of ours, we will change to concessions instead of production-sharing," the source said. The incoming head of state oil company Petrobras, Roberto Castello Branco, later said there was not yet a final decision on the types of contracts the next government will offer. The production-sharing auction model has been successful under Workers' Party governments and currently under President Michel Temer, attracting major international oil companies including ExxonMobil, Chevron, Royal Dutch Shell and BP. In an event in Rio de Janeiro on Nov. 22, Energy Minister Márcio Félix expressed concerns over how the change in models would take place, saying lengthy congressional talks could pause or hurt the current round of tenders and the investment it would bring to the country, Reuters reported. He also suggested waiting until after 2020 to make any modifications. "If we get into that discussion in Congress, for example, we run the risk of paralyzing auctions and that's not what we want. The risks need to be well measured," said José Mauro Coelho, director at the Energy Research company, the wire service reported. Bolsonaro's transition team said last week that the sale of Brazil's deep-sea fields of oil could bring some $30 billion to help cope with the country's fiscal deficits, Bloomberg News reported. However, a key bill authorizing the pre-salt oil auction for international companies has been put on hold in the Senate. Currently, only Petrobras has the rights to operate in the so-called transfer-of-rights area.

Venezuela Reaches Deal to Retain Control of Citgo

Venezuela has reached a $1.4 billion settlement deal with Crystallex International to prevent it from seizing U.S. assets of Venezuelan state-owned company PDVSA, The Wall Street Journal reported Sunday. The Venezuelan government has agreed to pay the defunct Canadian mining company to resolve legal actions that will keep its U.S. refining subsidiary, Citgo, under its control. The case dates back to the beginning of late President Hugo Chávez's nationalization process a decade ago. The Venezuelan government expropriated a Crystallex project, leading the company to claim $1.2 billion in compensation, a sum that has grown to more than $1.4 billion with interest, Reuters reported. Crystallex CEO Robert Fung said Venezuela had already paid $500 million in cash and liquid securities, adding that it must post collateral by Jan. 10 or the company may restart legal proceedings, The Wall Street Journal reported. Venezuela has agreed to pay the rest of the arbitration settlement by 2021. Under the new settlement, Crystallex agreed to suspend an auction of shares in Citgo's parent company. The cash-strapped South American country has been able to protect Citgo amid a hyperinflation crisis and U.S. sanctions. In October, the government made payments of nearly $1 billion to creditors with collateral rights over Citgo, the only bonds it has stayed current on during the economic crisis, the newspaper reported. [Editor's note: See related Q&A in the Aug. 24 issue of the Energy Advisor.]

Argentina to Export LNG With Belgium's Exmar Next Year

Argentina will begin exporting liquefied natural gas, or LNG, from its Vaca Muerta shale gas resource next year using a floating LNG liquefaction vessel owned by Antwerp-based Exmar, the Belgian shipping company said Nov. 21, Reuters reported. The exports, set to start in the second quarter of next year, will make Argentina one of the around 20 countries that sell LNG. Exmar has a 10-year contract with Argentine state-owned oil company YPF to deploy its floating LNG liquefaction unit currently known as Caribbean FLNG to produce and export liquefied natural gas in the South American country. The vessel will be renamed TANGO FLNG and will be stationed in Bahía Blanca, approximately 400 miles south of

FEATURED Q&A / Continued from page 1

bpd. Even in cooperating with Russia on its 11.4 million bpd of production provides less clout given the dramatic rise in domestic production in oil producing countries. Second, the shale revolution has proven capable of adding more supply than demand once prices reach a level that is sharply lower than what is required to service. The harder OPEC+ tries to rein in inventories, the higher the price and the more incentive to produce oil from shale and other unconventional oils. Third, OPEC has run out of spare capacity, which means that while demand hits the limits of supply, prices jump and rebound sharply from new peaks. Latin America has new opportunities but also new problems as a result. Given that cost structures have fallen, the attraction of lower cost supplies in Argentina, Brazil, Mexico and elsewhere should continue to attract more capital to increase supply even at lower and more volatile prices. In true petro-states, such as Venezuela, production will decline until governments find a way to induce more capital spending. The oil price outline for 2019 should remain weak even if OPEC+ acts to cut output—demand is weakening with decelerating economic growth and supply looks abundant. Even so, governments are trying to attract global investment and companies are positioning themselves for greater growth everywhere they can."

A **John Price, managing director of Americas Market Index:** "Latin America's greatest economic threat comes from fracking and other technologies that have turned America's nimble oil patch into the global swing producer. Without cartel-like coordination, these hungry producers expand capacity every time pricing climbs above $65/barrel, sending it back down to the $45-55 range. Outside of Venezuela, most new Latin American oil capacity requires a steady floor price of $70 to attract investment. Until leaders in Brazil, Mexico, Colombia and Argentina can make their economies more competitive by bringing down taxes, improving infrastructure and

Continued on page 6

Buenos Aires, Exmar said in statement. It is expected to produce 500,000 tons of LNG per year and ship up to eight cargoes each year. “Thanks to the commercial relationship with Exmar, we are now able to add value to the resources extracted from Vaca Muerta, and take full advantage of the seasonal opportunity with Asian markets and our unique location to serve demand centers,” YPF President Miguel Gutiérrez said in a statement, the wire service reported.

ECONOMIC NEWS

Argentina, China Eye Deal for Nuclear Plant’s Construction

Argentina and China hope to reach a deal over the weekend for the construction of a Chinese-financed, multi-billion-dollar nuclear power plant in the South American country, a key regional ally of the United States, Reuters reported. The Argentine government anticipates an announcement of the agreement for the Atucha III project during Chinese President Xi Jinping’s official visit on Sunday after the Group of 20 summit, Juan Pablo Tripodi, the head of Argentina’s national investment agency, told the wire service. In addition to funding Argentina’s fourth nuclear power plant, which is reportedly worth as much as $8 billion, China is expected to double the amount of its credit line to Argentina to $18.7 billion, making the Asian country Argentina’s largest non-institutional lender, Clarín reported. The negotiations on the Atucha III project are concerning for the U.S. government, an unnamed senior Trump administration official told Reuters. “These are infrastructure projects where China is coming in and providing very low interest loans or they are just having Chinese companies do it,” the U.S. official said. “It’s creating an economic and political dependency on China that’s incredibly dangerous.” The Chinese foreign ministry said in a statement that China’s investment in Latin America is “in line with market rules” and “common international rules and practices,” Reuters reported.

SUBSCRIBER NOTICE

Jose Valera Joins the Board of Advisors

We are pleased to announce that Jose L. Valera has joined the Energy Advisor’s board of advisors.

Valera is a partner in the Houston office of Mayer Brown, an international law firm. He also co-heads the firm’s oil and gas practice.

Valera has more than 25 years of legal experience representing oil, gas and electric companies throughout Latin America and the Caribbean, the United States and elsewhere. He works with oil and gas companies on exploration and production contracts, investment agreements, upstream development projects, mergers and acquisitions and joint ventures.

His practice also represents electric companies in thermal and renewable energy projects and financing. Additionally, it has an LNG focus, including liquefaction services, regasification services, development of regasification terminals and the purchase and sale of liquefied natural gas.

Valera has served as an advisor for the governments of Argentina, Bolivia, Honduras, Peru and Iraq on energy policy reforms, the development of shared hydrocarbon resources and electric and oil and gas privatizations.

He is has contributed to the Energy Advisor since 2006, commenting on issues including Argentina’s oil and gas auctions, investment in Peru’s hydrocarbons sector, Ecuador’s oil industry’s competitiveness and the World Bank’s financing of exploration and extraction projects in Latin America, among numerous other topics.

Valera is a former member of the board of directors of the Association of International Petroleum Negotiators. He is fluent in English, Spanish and French.

Mexico’s Central Bank Cuts Economic Growth Forecast

Mexico’s central bank on Wednesday cut its economic growth forecast for next year to between 1.7 percent to 2.7 percent, from the previous 1.8-2.8 percent estimate, acknowledging investor uncertainty surrounding the incoming administration of President-elect Andrés Manuel López Obrador, who takes office on Saturday, El País reported. “It’s a revision of one-tenth, and it has to do with an update of available information. It’s a small adjustment. There are many uncertain factors that will soon be known, such as the budget for 2019,” central bank chief Alejandro Díaz de León said in presenting the bank’s quarterly report. Mexican stocks last week plummeted to their lowest level since 2015, as financial institutions reacted to news that López Obrador’s Morena party would continue to push for legislation that would cut banking fees, Bloomberg News reported. The bank said the reasons for

NEWS BRIEFS

Governor of Rio de Janeiro State Arrested in 'Car Wash' Case

The governor of Brazil's Rio de Janeiro State was arrested Thursday morning in connection with the sprawling "Car Wash" corruption case, the Associated Press reported. Federal police took Governor Luiz Fernando Pezão into custody at the governor's palace in an operation called "Wolf's Mouth," the wire service reported. Brazilian Attorney General Raquel Dodge told reporters that Pezão stands accused of criminal organization, corruption and money laundering. Neither Pezão's attorney nor the state government replied to a request for comment by the AP.

Venezuela's Central Bank Reports to IMF 860% Inflation for 2017

Venezuela's central bank has reportedly shared the country's official data with the International Monetary Fund to avoid sanctions by the multilateral lender for withholding statistics, Bloomberg News reported Wednesday, citing three unnamed sources with direct knowledge of the matter. For last year, the central bank reported inflation of 860 percent, below the IMF estimate of 2,818 percent, and an economic contraction of 15.7 percent last year, one source said.

Mexico May House Immigrants Applying for Asylum in U.S.: Official

Incoming Mexican Foreign Minister Marcelo Ebrard signaled Tuesday that the country is willing to house the more than 5,000 Central American migrants who are camped out at a sports complex in Tijuana while they apply for asylum in the United States, the Associated Press reported. Ebrard also said a key goal is to secure a U.S. commitment to development and job-creation projects in Central America. increased uncertainty included the cancellation of the airport project in Mexico City, expectations of changes at state oil company Pemex and the proposed banking bill.

POLITICAL NEWS

U.S. Sanctions Nicaraguan Vice President, Top Aide

The administration of U.S. President Donald Trump on Tuesday slapped sanctions on Nicaraguan Vice President and First Lady Rosario Murillo and the country's national security advisor, Néstor Moncada, freezing any assets or other property they may have in the United States, The Wall Street Journal reported. The sanctions, against a government that the United States has accused of deadly repression and widespread corruption, also bar the two officials from entering the United States and complicate other international travel, the newspaper reported. "This administration is committed to holding the Ortega regime accountable for the violent protests and widespread corruption that have led to the deaths of hundreds of innocent Nicaraguans and destroyed their economy," said U.S. Treasury Secretary Steven Mnuchin. The sanctions also bar U.S. financial institutions from doing business with Murillo and Moncada, The New York Times reported. The Treasury Department's sanctions were accompanied by an executive order from Trump who said the actions by Nicaraguan President Daniel Ortega's government amounted to "an unusual and extraordinary threat to the national security and foreign policy of the United States." Murillo did not respond to a request for comment emailed by The Wall Street Journal, but Nicaragua's ambassador to the United States late Tuesday forwarded a government statement rejecting the sanctions and called them and the accusations against the Nicaraguan officials "inconsequential, disrespectful, false and illegitimate." More than 300 people have been killed in Nicaragua in connection with months of anti-government protests that erupted in April. U.S. officials and human rights groups have blamed many of the deaths on armed groups that they say have links to Ortega's government. In addition to those killed, the Nicaraguan Center for Human Rights has said that more than 600 people have been imprisoned since the protests began, The New York Times reported. Earlier this month, the Trump administration imposed sanctions on four high-ranking officials in Nicaragua's government. At the time, U.S. National Security Advisor John Bolton said the United States would toughen its position toward not only the government of Nicaragua, but also those of Venezuela and Cuba, which he called Latin America's "troika of tyranny."

Brazil Backs Out of Hosting Climate Change Conference

Brazil is backing out of hosting next year's U.N. climate change conference, a move that comes two months after the country won the bid to organize it, Folha de S.Paulo reported Tuesday. The foreign ministry communicated its decision to Patrícia Espinosa, the executive secretary of the U.N. Convention on Climate Change, citing budgetary restrictions and the government transition process of President-elect Jair Bolsonaro, who takes office Jan. 1, as its reasons for the reversal. The announcement comes after Bolsonaro appointed diplomat Ernesto Araújo as the incoming foreign minister. Araújo has previously voiced his opposition to the Paris climate agreement and has called climate change a "Marxist dogma," Folha reported. On Monday, local newspaper Gazeta do Povo published an article by Araújo in which he promised to fight international ideologies, including "climate alarmism." The U.N. conference, which focuses on the implementation of the Paris accord, was scheduled to take place next November. Home to the largest rainforest in the world, the Amazon, Brazil is a key player in global international talks. Deforestation in the South American nation has increased by nearly 14 percent between August last year and July, resulting in an area of 7,900 square kilometers of forest cleared in one year, according to a report by Greenpeace.

FEATURED Q&A / Continued from page 3

simplifying regulations, their promising new oil reserves will stay in the ground. To add insult to injury, the rapid conversion of the United States from a natural gas importer to a massive exporter threatens the gas-driven economies of Trinidad and Tobago and Peru and further dampens enthusiasm for Venezuelan and Colombian oil, which is rich in gas. The specter of long-term weak energy pricing and aging oil fields may have a silver lining. It is only in times of economic hardship that the squabbling political class gets its act together and passes modernizing reforms. Such a scenario seems within grasp in Brasília for the first time in 20 years and may keep Argentina on a reform path in spite of next year's elections. Low oil prices may also keep López Obrador's penchant for bold project spending in check and convince governments across the region to invite more private investment in infrastructure. Cheap energy also provides welcome relief to Caribbean and Central American economies. There are many reasons to cheer on U.S. fracking."

A **David Shields, independent energy consultant based in Mexico City:** "Oil now contributes much less to the Latin American economy overall than it did a decade ago, especially due to the collapse in output in Venezuela and a lesser but significant drop in Mexico's production. At the same time, the shale boom means that the U.S. economy is no longer so reliant on major crude imports from these two countries. As López Obrador prepares to take office in Mexico, lower oil prices will put pressure on federal spending in 2019, when he hopes to start up new social welfare programs and would also like to invest in boosting oil output and in building a new refinery, a personal pet project whose economic logic is not clear to most observers. Markets will be looking for prudent spending forecasts that can prop up shaky investor confidence in the Mexican economy. Energy investors have been uneasy ever since López Obrador suggested he might review or cancel the E&P contracts awarded to global firms under recent energy reforms. He has, however, reluctantly backed down on this, and the contracts will move forward, but perhaps not with the same enthusiasm from investors. His incomprehensible prohibition of fracking has also sent a negative signal. An inward-looking energy policy is foreseen, emphasizing greater domestic refinery output as the key to achieving self-sufficiency in fuels, with Mexico no longer importing gasoline nor exporting crude a few years from now. But that looks more like a pipe dream than future reality. With interest rates expected to move up, the Mexican economy will face a more complicated panorama in the short to medium term."

> **"Markets will be looking for prudent spending forecasts that can prop up shaky investor confidence in the Mexican economy."**
> **— David Shields**

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

LATIN AMERICA ENERGY ADVISOR
is published weekly by the Inter-American Dialogue
Copyright © 2018

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter
achacon@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