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THEDIALOGUE

FEATURED Q&A

Was Mexico's First Round One Tender a Major Flop?

Mexico this month held the first of five public tenders in its Round One oil auction, part of the historic opening of the nation's energy sector. // Image: Mexican Government.

Q Mexico on July 15 held the first of five public tenders as part of its Round One oil auction. Only two of 14 areas available were auctioned off, falling short of the 30 percent rate the government had said would make the auction a success and putting a damper on enthusiasm about the opening of the nation's oil sector to foreign and private investors for the first time in decades. Was the first tender a flop, and why were so few blocks auctioned off? Will the other scheduled rounds attract more bids and investment? What needs to be done to ensure the other bid rounds go better?

A John Padilla, managing director of IPD Latin America: "Although officials have tried to put a good face on it, Mexico's first tender was clearly a huge disappointment. Many aver that low oil prices were to blame. That is not the case, though they may have prevented the more aggressive bids the government had hoped for—and has benefited from for decades in the energy sector space. It was not a lack of prospectivity either. Government officials appear to have concluded that it was size (one of the largest blocks, Block 7, received multiple bids—that block also benefited from 3D seismic) and the required guarantees. The government has now said that it will resize the blocks and lower required guarantees (which were indeed excessive). Though these changes may help, they still do not address all that ails Round One. The principal three variables that prevent significant round success continue to be: 1) Materiality (larger blocks will help to some extent, but size is not the only variable); 2) The contract is not a true production-sharing agreement, but rather a hybrid with a service

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TODAY'S NEWS

ECONOMIC

U.N. Commission Expecting Average Growth of 0.5% in Region This Year

Panama will lead the region in economic expansion this year, with 6 percent growth, said the Economic Commission for Latin America and the Caribbean.

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POLITICAL

Venezuela Arrests 212 Suspected Criminals

Authorities carried out a sweep at the Guillermo García Ponce development in Caracas.

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ECONOMIC

Brazilian Central Bank Hikes Key Rate Half Point

Brazil's central bank, led by Alexandre Tombini, on Wednesday increased its benchmark Selic interest rate 50 basis points to 14.25 percent. Policymakers are fighting above-target inflation while also facing stagnant economic growth.

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Tombini // File Photo: Brazilian Government.

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ECONOMIC NEWS

Brazil's Central Bank Boosts Key Interest Rate Half Point

Brazil's central bank on Wednesday hiked its benchmark Selic interest rate by a half percentage point to 14.25 percent as it fights inflation amid a stagnating economy, Agence France-Presse reported. The decision was a unanimous one by the bank's monetary policy committee, though board member Tony Volpon recused himself from the vote, The Wall Street Journal reported. Volpon abstained from voting after senators criticized him for saying last week that he intended to vote for rate hikes until the expected inflation rate returned to the central bank's target. The lawmakers said central bankers should not signal in advance how they plan to vote, and Volpon then recused himself, saying he wanted to avoid "possible damage to the image of the central bank." Wednesday's rate increase marked the 16th time the central bank has increased the Selic rate since April 2013. In a statement accompanying the decision the central bank indicated that the rate increase would be the last in its current tightening cycle. Policymakers said leaving the Selic unchanged "for a sufficiently prolonged period is necessary for inflation to converge with the target at the end of 2016." Brazil's annual inflation rate recently accelerated to 9.3 percent, and economists in a recent central bank survey expected it to end this year at 9.2 percent. On Tuesday, Standard & Poor's said the monetary authority's tightening is working to lower expectations for inflation. The ratings agency's top analyst for Brazil, Lisa Schineller, said during a conference call that the interest rate hikes are "important for credibility" of the central bank, The Wall Street Journal reported. Central bank chief Alexandre Tombini has said he will work to bring inflation down to 4.5 percent in 2016, Bloomberg News reported. Among Brazil's economic problems is a depreciating real, which makes imports more expensive. The Brazilian currency has fallen 20 percent in value against the U.S. dollar since the beginning of this year. [Editor's note: See **Q&A** on the Brazilian government's fiscal reforms in Monday's Advisor.]

The central bank indicated that Wednesday's increase would be the last in its current tightening cycle.

U.N. Expecting 0.5% Growth in Region

Economic growth this year in Latin America and the Caribbean will average 0.5 percent this year, according to a forecast released Wednesday by the United Nations Economic Commission for Latin America and the Caribbean, or ECLAC. The commission said Panama will see the region's strongest economic growth, at 6 percent, followed by Antigua and Barbuda at 5.4 percent and the Dominican Republic and Nicaragua, both with 4.8 percent growth. The region's largest economy, Brazil, will experience an economic contraction of 1.5 percent, while Venezuela will suffer a deeper decline of 5.5 percent, said ECLAC. The region's second-largest economy, Mexico, will see economic growth of 2.4 percent. The region needs a higher level of investment in order to increase growth and productivity, the commission said. "Revitalizing growth in the short and long term requires boosting public and private investment at a complex time," said ECLAC's executive secretary, Alicia Bárcena.

Bárcena // File Photo: United Nations.

NEWS BRIEFS

Venezuela Arrests 212 Suspected Criminals

The government of Venezuela earlier this week arrested 212 suspected criminals from the Guillermo García Ponce urban complex in Caracas' Montalbán III development as the country's security agencies carry out a nationwide security operation known as "Liberation of the People," UPI reported Wednesday. Six of those arrested were wanted for crimes including rape, murder and robbery, and three were wanted for drug trafficking. Officials are still trying to identify a number of the suspects, but recovered a pound of cocaine, more than a pound of marijuana and vehicles and motorcycles believed to be stolen.

Banco Bradesco Reports 18 Percent Rise in Profits

Brazil's Banco Bradesco on Wednesday reported an 18 percent increase in profits for the second quarter, beating analysts' estimates, Bloomberg News reported. Bradesco, the second-largest bank in Latin America by market value, said net income for the quarter, excluding one-time items, rose to 4.5 billion reais ($1.35 billion), as compared to 3.8 billion reais in the second quarter of last year.

Uber Drivers Attacked at Mexico City Airport

Smartphone-based transportation app Uber said Wednesday that an unruly crowd attacked Uber drivers and their vehicles outside the Mexico City airport, throwing eggs and flour inside the vehicles and kicking doors, Reuters reported. Leaders of the Organized Taxi Drivers of Mexico City union, which on Wednesday held a protest outside of the Colombian embassy in solidarity with cab drivers there, denied any involvement in the incident. Mexico City earlier this month became the first city in Latin America to issue regulations specific to smartphone-based ride services.

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contract foundation, which as a result is overly cumbersome, highly bureaucratic and leaves room for excessive government discretion (the opposite of the necessary contract certainty industry looks for); and 3) Perverse, less-than-globally attractive fiscal terms. The current contract does not incentivize maximizing production. In fact, if a winning bidder discovers more resources, its return on additional barrels produced goes down. Such a mechanism flies in the face of the dynamic that has made hydrocarbons activity so successful just north of the border. The extent to which the government addresses these three issues will determine the level of success that future Round One tenders achieve."

Jeremy M. Martin, director of the energy program at the Institute of the Americas: "July 15 will not go down as the most momentous day in Mexico's storied oil history. But there is more to the story than just the number of bids. Indeed, the government's emphasis on the success of the 'process' and the transparency of the bid round is praiseworthy. And the tender did produce some results. Nine international and Mexican firms participated, and two blocks were awarded to Mexico-based Sierra Oil & Gas in a consortium with Talos Energy from the United States and Premier Oil from the United Kingdom. Yet there should be no doubt that the overall uninspiring bid round only serves to increase the pressure on the Peña Nieto administration's energy and finance team. Specifically, the outcome ups the ante in two ways. First, it increases the burden on the government to improve competition and the fiscal and contractual attractiveness for future tenders. In particular, the highly-anticipated deepwater opportunities, which are considered the real prize of the new energy landscape in Mexico. Second, the pressure on the government and state oil company Pemex to further develop and deliver on the pending farm-out opportunities has now been greatly elevated. The proposed farm-outs will include large investment price tags across a wide range of oil and gas reserves onshore and in deepwater. The success of Mexico's historic energy reform measures will not be determined by the first tender of 14 blocks in shallow water. Though knocked back on their heels, the government still has time to regain momentum. To borrow from the recent cycling action in France, July 15 in Mexico City was not the final stretch down the Champs-Elysees in Paris. There are plenty of hills and legs still to race for Mexico. But they cannot hope to regain momentum merely by coasting."

Duncan Wood, director of the Mexico Institute at the Woodrow Wilson International Center for Scholars: "The disappointing reaction to Mexico's inaugural oil auction reflects two main factors. The first concerns the blocks that were put on offer. Their size and geology left many companies with serious doubts about the economic viability of exploration and production activities in those fields and led most to reject the fields as profitable investment opportunities. The second factor reflects the continuing doubts over the contract terms, legal environment and state of investor protections in Mexico. The contract terms were improved dramatically since their initial publication last December, but there were still issues regarding the company guarantee, regulatory involvement and fiscal terms (particularly

> **"There is reason to be optimistic about future bidding processes..."**
>
> **— Duncan Wood**

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BUSINESS NEWS

France's Casino Selling Latin America Supermarket Assets

French retailer Casino Guichard-Perrachon is selling its supermarket assets in Latin America to its Colombian unit, Éxito, for 1.7 billion euros ($1.9 billion) in an effort to simplify its regional operations, a deal which will make Éxito one of the region's largest grocers, Bloomberg News reported. The transaction will boost Éxito's profit by about 30 percent and lead to cost savings of about 145 million, most of which will be realized within a year and a half, Casino said. After the deal, Medellín-based Éxito will operate more than 2,500 stores and be the market leader in Brazil, Colombia and Uruguay, putting it in a good position to make more regional acquisitions, said Casino CEO Jean-Charles Naouri. The combined company would have earnings before interest, taxes, depreciation and amortization of 2 billion euros on sales of about 26.5 billion euros in 2014. While Naouri declined to comment on any potential acquisitions Éxito may be considering, he said the company may look at businesses in Central America due to its strong ties with Colombia. Casino will sell Argentina's Libertad and half of its stake in its Brazilian unit, GPA, to Éxito, in which it holds a 54.8 percent stake. The cost savings will help insulate Casino against recently weak profits in Latin America, where electronics sales have been down, Exane BNP Paribas analyst John Kershaw told Bloomberg.

Naouri // File Photo: Casino.

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regarding the minimum offer) that left a bad taste in the mouths of some companies. In the legal environment, the enduring disagreement between the government and oil companies over contractual and administrative rescission needs to be resolved, with executives demanding greater clarity from the government over the process and the larger question of whether existing investor protections apply to the hydrocarbons sector. The good news for both Mexico and the industry is that both of these problems can be resolved. In later tenders, more attractive blocks can be put on offer, and the government has shown itself willing and able to adjust contract terms. Its open attitude to dialogue with the industry is encouraging, and there is reason to be optimistic about future bidding processes."

Eduardo Canales, global energy transactions associate at Akin Gump Strauss Hauer & Feld in Houston: "With the opening and presentation of bid proposals of the first tender of Round One, Mexico officially reopened its energy industry to private oil companies after more than 70 years. Even though 14 contract areas were up for tender, only two were awarded to a consortium bidder formed by Sierra Oil & Gas (Mexico), Talos Energy (U.S.) and Premier Oil (U.K.). Government officials involved in the first tender and numerous analysts have been crystal clear about the results: the first tender was unable to attract the expected number of participants and bid offers. A 14 percent contract areas placement efficiency fell clearly short of the Mexican government's revised expectations (30 to 50 percent placement). Despite the results, Round One should not be considered a failure. It is of outmost importance to understand the underlying process that was required to reach this point. Historic constitutional, regulatory and administrative changes, necessary to accomplish the reopening of the Mexican energy sector and implemented at an unprecedented pace, cannot be overlooked. It is certain that Mexico has developed a strong legal foundation for the development of a competitive energy industry. However, government officials must reassess and realign their approach with the current market conditions in three different areas: contract area selection with attractive geological characteristics, competitive fiscal and financial terms, and contract and legal restructuring to incorporate industry best practices. Round One has two more tenders coming up soon, one for extraction in Gulf of Mexico shallow waters and another one for onshore exploration. Mexico must look within and make the necessary changes during these upcoming tenders to create a globally competitive bidding system in time for the crown jewel tender: Gulf of Mexico deepwater fields. Otherwise, Mexico will miss an unprecedented opportunity to evolve into a leading energy player."

> **"Government officials must reassess and realign their approach with the current market conditions..."**
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> **— Eduardo Canales**

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