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THEDIALOGUE

FEATURED Q&A

Are the Skeptics Wrong on Brazil's Next Oil Auction?

Brazilian Mines and Energy Minister Eduardo Braga has had to contend with a sharp fall in oil prices, which has put into question how attractive Brazil's oil deposits are to investors compared to Mexico and other areas of the world, experts say. // File Photo: Agência Brasil.

Q Brazilian officials expect oil companies to invest nearly $900 million to complete minimum exploration work at concessions Brazil plans to auction in October, Bloomberg News reported in July. Facing a beleaguered economy and low prices for oil and gas globally, Brazil will offer 266 blocks—182 onshore and 84 offshore—in what will be the country's 13th round. How strong is investor sentiment ahead of Brazil's next oil auction? Have giant deposits of oil discovered last decade in the so-called pre-salt region in deep waters proven to be as productive as Brazilians hoped? Does Brazil have the right regulations and business climate in place to maximize return on its natural resources?

A Alexis Arthur, energy policy associate at the Institute of the Americas: "Brazil is having a tough year. Corruption scandals have reached deep into the nation's energy sector, with casualties adding up. President Dilma Rousseff is facing calls for her impeachment, and the economy is heading into recession. The 13th bid round provides an opportunity for the country to focus on keeping the economy moving. Thirty-nine companies have registered their interest in the bid round, which is set to be adjudicated in October. This is an improvement on the pre-salt bid round in October 2013, in which 26 companies registered their interest and just one contract was awarded to a five-company consortium. There are also more big names on this year's list, which reportedly includes majors BP and Exxon Mobil, Russia's Rosneft, and China's CNOOC, among local companies. Still, a better marker for success would be a comparison with the 2013 general

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TODAY'S NEWS

ECONOMIC

S&P Cuts Brazil Credit Rating to Junk Territory

The ratings agency cited a struggling economy, political challenges and the Petrobras corruption scandal among the reasons for taking away Brazil's investment-grade rating.

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BUSINESS

Codelco Contract Workers Begin Strike

Workers at five mines of the state-owned company started a strike after labor talks broke down.

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POLITICAL

Santos, Maduro Trade Barbs Amid Border Crisis

Colombian President Juan Manuel Santos on Wednesday blasted Venezuela's government, saying its Bolivarian Revolution is "self-destructing." His Venezuelan counterpart, Nicolás Maduro, responded by saying Santos had made a "serious mistake." The barbs come amid a border crisis between the two nations.

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Santos // File Photo: Colombian Government.

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ECONOMIC NEWS

S&P Cuts Brazil's Credit Rating to Junk

Standard & Poor's on Wednesday cut its credit rating for Brazil to junk territory, lowering its sovereign debt rating for Latin America's largest economy one notch, to BB+, and also maintained its negative rating for the country's debt. "The political challenges Brazil faces have continued to mount, weighing on the government's ability and willingness to submit a 2016 budget to Congress consistent with the significant policy correction signaled during the first part of President Dilma Rousseff's second term," the ratings agency said in a statement. "The negative outlook reflects what we believe is a greater than one–in–three likelihood of a further downgrade due to a further deterioration of Brazil's fiscal position, potential key policy reversals given the fluid political dynamics, including a further lack of cohesion within the president's cabinet, or due to greater economic turmoil than we currently expect." The move by S&P places its credit rating for Brazil in junk territory for the first time since 2008, The Wall Street Journal reported. It comes as Brazil's economy is in recession and facing its worst downturn in 25 years. If another of the three major ratings agencies also downgrades Brazil's debt to junk status, a massive outflow of money from Brazilian financial markets could follow, as many large international pension funds may only invest in assets that are rated investment-grade by two of the three ratings firms. Last month, Moody's Investors Service downgraded Brazil to its lowest investment-grade rating, but placed on it a stable outlook. Fitch Ratings has a negative outlook for Brazil's debt, but has it two notches into investment-grade territory. In addition to Brazil's struggling economy, S&P cited the ongoing corruption scandal at state-owned oil company Petrobras as part of its rationale for the downgrade. "We find that the ongoing investigations of corruption allegations against high-profile individuals and companies—in both the private and public sectors and across political parties—have led to increased near-term political uncertainty," the ratings agency said in a statement. The downgrade is a major setback for the government of President Dilma Rousseff, who has pushed austerity measures in an effort to save the country's investment-grade rating, at the cost of her popularity ratings. "It's a major defeat for the government, a major stigma for the Rousseff administration that puts the government even more on the defensive," Thiago de Aragão, an analyst at the Arko Advice consulting firm, told The Wall Street Journal.

Puerto Rico Unveils Fiscal Reform Plan

Puerto Rico's government on Wednesday released a fiscal reform plan that calls for major spending cuts and debt restructuring in an effort to reduce much of the U.S. territory's $72 billion debt load, the Associated Press reported. Under the five year plan, the commonwealth would reduce subsidies to municipalities and the University of Puerto Rico. It also would merge some government agencies and offer early retirement. In a televised address to announce the plan, Governor Alejandro García Padilla acknowledged that Puerto Ricans already have been slapped with new taxes, higher utility rates and layoffs over the past decade. "Our island faces an unprecedented fiscal and economic crisis," he said. "We have asked our people for many sacrifices." The plan also calls for restructuring the island's public debt and would require bondholders to shoulder the expense. It is not clear how creditors will react to the plan. The reforms announced Wednesday address just $47 billion of the island's total debt and would require the approval of its legislature.

García // File Photo: Government of Puerto Rico.

NEWS BRIEFS

Rowley Takes Office as Trinidad & Tobago's Prime Minister

Keith Rowley was sworn in as Trinidad and Tobago's prime minister on Wednesday after he and his party won in the general elections on Monday, Reuters reported. Rowley is the leader of the People's National Movement, or PNM, and said that his first act as prime minister will be to get the 2015-2016 budget, which is heavily tied to oil, passed. The incumbent party, United National Congress/Congress of the People, won only 18 electoral seats, losing its majority after one term.

Morales' Allies Eyeing Constitutional Change to Allow Fourth Term

Bolivian President Evo Morales and his political allies are seeking to amend the Constitution so that he may run for a fourth term as president, the Associated Press reported. The amendment plan was finalized Tuesday, and Morales' political allies control two-thirds of congress, which would be enough to pass the new legislation. However, in order for the legislation to come into force, Bolivians would need to vote to pass it in a nationwide referendum.

Correa's Government Seeking to Dissolve Press Freedom Group

The government of Ecuadorean President Rafael Correa is seeking to shut down the country's last remaining press freedom group, the Associated Press reported Wednesday. The government accuses Fundamedios of political partisanship, saying it has published essays and postings on Twitter "of indisputably political intent." The group's director, Cesar Ricuarte, reacted by saying the government is seeking to dissolve the group because it has denounced government attacks on journalists.

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POLITICAL NEWS

Santos, Maduro Trade Barbs Amid Border Crisis

Colombian President Juan Manuel Santos on Wednesday delivered harsh criticism of Venezuela, saying "The Bolivarian Revolution is self-destructing," in reference to the country's socialist economic and political model, The Wall Street Journal reported. Santos' statement came three weeks after Venezuelan President Nicolás Maduro closed the border between Colombia and Venezuela, deported thousands of

> **"The Bolivarian Revolution is self-destructing."**
>
> **— Juan Manuel Santos**

Venezuelan residents of Colombian origin, and sent troops to the border. More than 20,000 people have crossed the border into Colombia, overwhelming immigration centers. Maduro's administration took out a full-page advertisement in The New York Times on Wednesday, explaining the rationale behind his actions. In it, he said his country needed to take steps to prevent smugglers from doing harm, but added he was still committed to supporting peace and human rights. At a National Assembly meeting after Santos' speech, Maduro said, "Do you know the numbers of Colombians who come over here and enjoy free housing and gasoline?" Maduro added that he was deeply offended by Santos' comments. "You've made a serious mistake, disrespecting the office of the president of Venezuela. But I'm obligated to talk with you nonetheless and work to resolve the urgent matter of the border," The New York Times reported. Santos called the assertion that Colombians go to Venezuela seeking better economic and social opportunities "ridiculous," adding that "On the contrary, today thousands of Venezuelans come to Colombia to look for work, to do business or to study."

BUSINESS NEWS

Codelco Workers Strike After Talks Break Down

Contract workers from Chile's state-owned copper mining company, Codelco, went on strike Wednesday at its Chuquicamata, Gabriela Mistral, Salvador, Andina and El Teniente mines, Reuters reported. The contract workers and Codelco employers had previously agreed to begin discussions, though those talks broke down last week. A six-year low in copper prices, as well as bad weather, previous labor disputes and engineering issues, make the strike and subsequent halt in production a particularly difficult situation for Codelco. Though Codelco would not comment as to how much of a loss the strikes would cause, a recent three-week strike at Salvador and Ministro Hales cost the company 17,000 metric tons of copper. Chief Executive Nelson Pizarro said on Sunday that the company would be laying off employees at the management level, according to local newspaper La Tercera.

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oil and gas auction, which drew bids from 39 companies totaling $1.4 billion. Brazil is not just facing domestic pressure. In a low oil price environment, energy companies have slashed exploration budgets, increasing competition particularly in more expensive or higher risk areas. Brazil also faces new competition from Mexico, and those interested in the deepwater may choose to wait for 2016 when Mexico will open areas on its side of the Gulf of Mexico for the first time. It is too soon to tell how successful Brazil's Round 13 will ultimately be, particularly as concerns ranging from local content requirements to political uncertainty add up. And with no pre-salt blocks on the menu, it remains to be seen whether the array of areas onshore and offshore, mature and frontier, will attract the kind of investment Brazil needs to reboot its oil and gas sector."

Paulo Valois Pires, partner at Schmidt, Valois, Miranda, Ferreira & Agel Advogados in Rio de Janeiro: "Oil companies seem not to be bullish about the 13th bidding round. A series of internal and external factors have been adversely affecting the oil companies' interest in the upcoming bid, such as decreasing oil prices, weak results in Mexico's tender, Petrobras' current financial status and the macroeconomic situation of Brazil, which may lose its investment-grade rating depending on the government's policy results. Besides, recent changes in the general terms and conditions of the concession contracts introduced by the National Agency of Petroleum (ANP) do not seem attractive to prospective bidders. On top of that, one may say that there are still important farm-in opportunities competing with Round 13, arising from Petrobras' divestiture program and from the assignment of exploration areas currently held by other concessionaires which intend to monetize their investments. In the medium run, pre-salt will be productive, but the level of productivity will depend on a new range of oil prices and on the assignment of the operatorship in the pre-salt areas to other oil companies. Local content policy proved to be unfeasible and disconnected from the oil and gas supply market. This needs to be urgently reviewed to improve attractiveness of the model."

> **"Local content policy proved to be unfeasible and disconnected from the oil and gas supply market."**
>
> **— Paulo Valois Pires**

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John M. Albuquerque Forman, president of J Forman Consultoria in Rio de Janeiro: "The Brazilian government has announced the 13th bid round, and since that first announcement has reduced the number of blocks and amount of bonuses to be repaid. This is in part a response to an industry that is voicing complaints via media and conferences and seminars. The industry has a number of complaints, like mandatory local content percentages, violations of which result in fines, and it has also asked for a change in the law to permit Petrobras to decide whether it participates on bids on the pre-salt area. (Currently, Petrobras is legally required to have at least 30 percent participation on any pre-salt bid, and it has to be the operator.) The industry also wants the rules for the unitization of blocks revised and clarified. The government has stated, however, that everything is fine and that no changes are necessary. There will be offers for blocks on the best known and promising basins, but not for all the blocks on offer. As far as is known up to now, production from pre-salt reservoirs has been good to excellent, although some problems are present. The production of gas, as it is associated gas, will be governed by the oil-production demand. Reinjection is the priority in order to enhance production. The presence of CO2 also has to be addressed."

Mark Langevin, director of BrazilWorks in Washington: "Brazil's concession-based auction does not include pre-salt blocks, but it does include a broad range of opportunities for both large and small companies. These factors contribute to heightened interest and more credentialed bidders, but the results of the auction will likely be modest. More importantly, and with the exception of 2013, Brazil's petroleum production continues to rise, boosted by the success of the pre-salt exploration. Today, pre-salt production has surpassed 500,000 barrels a day and composes approximately 22 percent of national production. In short, pre-salt production has been a success, albeit downplayed because of low prices and the Petrobras kickback scandal. Expect these national production figures to continue to rise during the second half of the decade to reach 3 million barrels per day by 2020. Brazil's economic and political crises have sparked new calls for reform of the production-sharing regime, but the positive pre-salt numbers do not necessarily indicate that a reform is necessary at this juncture. Petrobras is largely succeeding, and it remains the most important enterprise in Brazil. While the company needs corporate governance reforms to guarantee external credibility, its operational productivity continues to impress. However, if President Dilma falls and a new governing coalition emerges from Congress, the pre-salt production-sharing regime may be reformed, but this is unlikely in the short-term."

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> **— John M. Albuquerque Forman**

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