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FEATURED Q&A

How Are Plunging Oil Prices Changing Petrobras' Strategy?

Brazilian state oil company Petrobras has announced a series of measures in response to falling crude prices and demand. A terminal operated by Petrobras is pictured above. // File Photo: Petrobras.

Q Brazilian state oil company Petrobras on April 1 said it would cut production by a total of 200,000 barrels per day. The company is also slashing planned investments this year from $12 billion to $8.5 billion, cutting operating expenses by $2 billion and reducing personnel expenses by $133 million. What are the most significant ways in which the plunge in international oil prices and the coronavirus pandemic have altered Petrobras' plans for the period ahead? What do the company's production and investment cuts imply for its financial stability, and which areas will be most affected? What consequences does the global context—with both lower prices and falling demand—have on Petrobras' long-term strategies in and on Brazil's oil and gas sector in general?

A Vera De Brito de Gyarfas, partner at Mayer Brown: "In recent years, Petrobras has taken important measures to become stronger financially, which will allow it to resist and survive the current global crisis resulting from the Covid-19 pandemic and the abrupt decline in oil prices. Petrobras divested a number of assets and is now a stronger and leaner company and probably the national oil company in Latin America best positioned to navigate the current oil price crisis. Petrobras' decrease in investment will have a temporary detrimental impact on Brazil's oil and gas industry. It is expected that once demand for crude returns, prices will rise to at least $30 per barrel at the end of 2020. Petrobras' cost of lifting crude in the pre-salt is relatively low, approximately $5.03 per barrel, and the crude produced is light,

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TOP NEWS

RENEWABLES

Brazil Names New Biofuel Secretary, Cancels Auction

Brazil's government has named José Mauro Ferreira Coelho as the new secretary for petrol, natural gas and biofuel. It also announced it had suspended its biodiesel auction.

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OIL & GAS

Production at Guyana Project Unaffected: Exxon

The recent oil price shock has had no impact on production at Guyana's flagship Liza project, which ExxonMobil operates, the company said.

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OIL & GAS

Mexico Cuts Estimates for Energy Plans

Mexican President Andrés Manuel López Obrador's government has cut its estimate for the worth of its long-awaited energy plans with the private sector amid the lowest crude prices in years and the economic fallout of Covid-19.

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López Obrador // File Photo: Mexican Government.

OIL AND GAS NEWS

Mexico Slashes Estimate for Energy Plans, Pemex Taxes

Mexico's government has slashed its estimate for the value of its long-awaited energy investment plans amid the Covid-19 pandemic and the lowest crude prices in years, Mexican President Andrés Manuel López Obrador said Monday, Argus Media reported. The president said the government next week will unveil energy projects that include "collaboration with the private sector" worth some 339 billion pesos ($13.4 billion), adding that the value of the plan had declined since the government's initial estimate of $100 billion last year. López Obrador and other officials have provided very few details about the initiative. The plan showed the government's willingness to collaborate even as it has shut down many avenues for private-sector energy investment, which opened under a 2014 reform that López Obrador opposed, according to the report. The investment package has been highly anticipated since the beginning of the year, with analysts seeing it as essential in order to increase crude production and achieve the government's goals of pumping two million barrels per day (bpd) of oil by the end of the year, up from about 1.7 million bpd currently, S&P Global Platts reported. Meanwhile, the president announced that his government was granting state oil company Pemex a tax cut worth $2.6 billion to help it amid the economic fallout of the coronavirus pandemic and the collapse in oil prices, S&P Global Platts reported. The tax cut, which is equivalent to around 54 percent of Pemex's profits, down from 58 percent as originally planned for this year, is part of a broader set of measures to protect the economy that López Obrador announced on Sunday. López Obrador said Pemex remains a priority for his administration. Crude prices recovered this week in anticipation of a meeting between Russia and OPEC to discuss the possibility of cutting production, which at current levels has left the global market oversupplied as fuel demand has plunged by as much as 30 percent as the Covid-19 pandemic forces much of the world to stay at home. Benchmark Brent crude oil prices hit an 18-year low last month and are currently trading at around $34, half of their level at the end of last year, Reuters reported.

The tax cut is part of a broader set of measures to protect the economy.

Production at Guyana Project Unaffected by Price Shock: Exxon

The recent oil price shock has had no impact on production at Guyana's flagship Liza project, which ExxonMobil operates, according to a company spokeswoman, who added Exxon would make adjustments as necessary, Reuters reported April 2. An oil price war between Saudi Arabia and Russia in combination with rapidly dwindling crude demand amid the Covid-19 pandemic has left many Latin American producers struggling to cover production costs, which in turn increases the chances of output cuts. "We are managing production rates to ensure safe and responsible operations," Janelle Persaud, Exxon's public and government affairs advisor in Guyana, said in a statement. She added, "We continue to monitor the situation closely and will make adjustments as necessary." Output at the offshore Liza well, which Exxon manages alongside partners Hess Corp. and China's CNOOC, is expected to reach some 120,000 barrels per day (bpd) in its first phase. Production began in December. According to Guyana's finance ministry, the country will receive approximately $1.2 million in royalty payments from Exxon and its partners recently lifting some one million barrels of crude from the Liza well, Stabroek News reported. However, Exxon said on Tuesday that production at the Payara project, its third development in Guyana, could be pushed back due to delays

NEWS BRIEFS

Renewable Sources Make Up 71% of Guatemala's Electricity in March

Power from renewable sources accounted for 71.48 percent of Guatemala's electricity in March, increasing their share from 68 percent recorded the previous month, according to the latest figures published by the country's National Electric Energy Commission, Renewables Now reported Monday. Biomass-based power plants continue to be Guatemala's largest producers of electricity, including nonrenewable sources, it was an increase in hydropower, solar and geothermal systems that drove up renewables' share last month.

Storage Hubs Filling Up in Panama as Fuel Demand Drops Amid Covid-19

Storage hubs in Panama are filling up with refined products, as dwindling demand for fuels amid the Covid-19 pandemic has created a growing surplus with no destination, Argus Media reported Monday. Arrivals of gasoline and diesel in Panama as of Monday registered 21,000 barrels per day (bpd), compared to just 7,000 bpd in departures. Since April 1, approximately 460,000 bpd have loaded for Panama, more than double the amount for all of March, which had the largest loading volumes on record since 2017, according to oil analytics firm Vortexa.

Venezuelan Opposition Opens Probe of Russian Firm Rosneft's Exit

Venezuela's opposition-controlled National Assembly has opened a probe into Russian state oil company Rosneft's recent sale of its Venezuelan assets to an unspecified Russian state firm, Argus Media reported Tuesday. The move violated three articles of the Venezuelan constitution and an article of the hydrocarbons law, according to lawmaker Elías Matta.

in government approvals, Reuters reported. Payara was set to begin production "as early as 2023," according to Exxon's website.

RENEWABLES NEWS

Solar Energy Breaks Record in Brazil's Northeastern Region

Solar farms in Brazil's northeast region reached peak generation of 1,465 megawatts on March 28 at around 10 a.m. local time, registering a new regional record, the country's National Electric System Operator, or ONS, announced, Renewables Now reported Monday. It is the seventh time this year that the region has broken the peak generation record and the second time just in March, after previously registering 1,378 megawatts on March 6. The electricity generated with photovoltaic (PV) farms represented 17.4 percent of the region's load when the record was set, according to data from the ONS. The region also broke the record of average solar generation throughout one day, with 496 average megawatts produced, which accounts to 5.4 percent of the northeast region's load, according to the report. The last time a record had been set for daily average solar generation was on Feb. 11.

Brazil Names New Biofuel Secretary, Suspends Auction

Brazil's government has named José Mauro Ferreira Coelho, the director of Brazilian state-owned energy research firm EPE, as the new secretary for petrol, natural gas and biofuel within the Ministry of Mines and Energy, according to the country's official gazette on Monday, Renewables Now reported. Ferreira Coelho has led EPE's directorate of studies for petroleum, natural gas and biofuels since 2016. He will replace Renata Isfer, who has served

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which has a huge market in Asia. The pre-salt is an excellent investment for Petrobras and the other major international oil companies currently operating there. Petrobras' announcement of the 200,000-barrel-per-day production cut is expected to be mostly from onshore production, which is more expensive and has fewer outlets. The immediate impact on Petrobras will be a decrease in cash flow. Petrobras' long-term strategy will continue to focus on pre-salt, which has very competitive production costs. The capex involved is very high; therefore, the players involved are strong major oil and gas companies that will likely survive the downturn, as they have survived previous downturns. It is the smaller companies and oil and gas service providers that are more at risk."

A John Forman, director of J Forman Consultoria in Rio de Janeiro and former ANP director: "Petrobras is divesting many assets, not only due to the large debt it has to serve, but also in order to become an exploration and production company, to do what it knows best, in the words of its president, Roberto Castello Branco. It is a dangerous path. The company had been indicating that production costs for the pre-salt were between $7 and $8 per barrel. More recently, it said $21 per barrel is its breakeven price. Consumption is declining all over, as are prices due to the price war and the coronavirus. It is understandable that production from the more costly wells should be cut, an option that may be reinforced, depending on the evolution of market prices. The international price war scenario weighs much more than the coronavirus. Concentrating in exploration and production at a time of low prices affects the company more than when it had other sources of income. It becomes more fragile, and, in the years to come, this strategy may be questioned. The steep carbon reduction in economies, like in Europe, is a major threat to the use of crude for fuel production. Thus, concentrating on exploration and production, in an attempt to use the pre salt hydrocarbons as much and as soon as possible, and giving up assets that could contribute to the company's cash flow, leads to a reduced flexibility to meet debt needs and fewer resources to develop new production areas. At present, the exploration and production budget has not been greatly affected as the aim is to ensure production. However, the market is not showing signs of being ready to absorb larger volumes of oil and gas in the near future, endangering the company's only source of cash. The low prices affect the royalties and special participations as well as production sharing, enormously reducing the payments to all levels of government, at a time when they are in dire need of resources to meet budget demands amid deficits that are already huge."

> **"In the years to come, this strategy may be questioned."**
> **— John Forman**

A Cleveland Jones, professor and researcher at the National Institute of Oil and Gas at the State University of Rio de Janeiro: "Petrobras has become much more proactive than in the past, in relation to major industry and world events. In the past, we might have expected Petrobras to react to the current oil crisis of low prices, oversupply and extreme uncertainty, by displaying an inflexible corporate response. Nowadays, it is capable of quick adjustments. A 200,000-barrel-per-day cut in production will not hurt its bottom line much, especially since low oil prices reduce economic incentives, and 23,000 barrels per day of that reduction is shallow water production, among the least economically viable for Petrobras. The balance of cuts will come

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in the ministry for the past four years. Gioviani Machado will temporarily take over Ferreira Coelho's position at the research firm while maintaining his responsibilities as EPE's director of economic, energy and environmental studies. On Monday, Brazil's Petroleum, Natural Gas and Biofuels Agency, or ANP, also announced it had suspended the second phase of its 72nd biodiesel auction due to the economic fallout of the Covid-19 pandemic. The ANP said it would re-evaluate possible adjustments to the auction, adding that the new schedule will be made public soon. The announcement follows a similar one last week when the ministry said it was indefinitely delaying all energy and generation auctions planned for 2020.

POLITICAL NEWS

Former Ecuadorean President Correa Sentenced to 8 Years

Former Ecuadorean President Rafael Correa, who now lives in exile in Belgium, was sentenced Tuesday in absentia to eight years in prison after being convicted on corruption charges, El Comercio reported. The court also sentenced Correa's vice president, Jorge Glas, and more than a dozen others on related charges. Glas was imprisoned in 2017 and is serving a six-year term in a separate case for accepting a bribe from Brazilian construction conglomerate Odebrecht. Correa, who was Ecuador's president from 2007 to 2017, was convicted on charges that he accepted money from private businesses for his re-election campaign in 2013 in exchange for government contracts, Agence-France Presse reported. Correa was accused of accepting a $6,000 payment into his private account, which he said was a loan. Correa can appeal the conviction, but he will be subject to arrest in Ecuador if he returns, The New York Times reported. The court on Tuesday also banned Correa and the others convicted in the case from politics for 25 years. After the sentence was announced, Correa asserted his innocence in a posting

ADVISOR Q&A

Will Emergency Measures Amid the Pandemic Threaten Democracies?

Q In the face of the Covid-19 health crisis, some Latin American and Caribbean governments have implemented tough measures to keep citizens at home, including temporarily waiving constitutional rights such as freedom of movement. At the same time, some governments have invoked extraordinary powers to pass emergency economic packages without consulting the legislative branch. To what extent do such drastic measures pose risks for democracies in the region once the pandemic has passed? How can governments ensure their systems of checks and balances hold up, even during times of crisis? What lessons can be drawn from the current circumstances in terms of areas to be improved on in Latin American and Caribbean democracies, including the strengthening of state institutions and the rule of law?

A Kevin Casas-Zamora, secretary general of the International Institute for Democracy and Electoral Assistance (International IDEA: "This is a danger that transcends Latin America, as seen in Hungary over the past few days. It would be foolhardy to deny democratic governments the ability to restrict freedoms, bypass normal controls and deploy the military in times of emergency, as long as they do so temporarily and under strict oversight from legislatures and judges. The risk is that this becomes par for the course in democracies. Or moreover, that it becomes the norm, not simply because authoritarian leaders demand it, but because fearful citizens tolerate it. In times of great uncertainty, the longing for the 'paternal' embrace (and it's paternal, because it's always men) of authoritarian leaders can be a powerful impulse. This danger is most acute, of course, in those countries where the rule of law was weak well before the virus struck. That's most of Latin America. In those cases, it is possible, indeed likely, that emergency legislation and a more prominent role for the military will stick around after the public health crisis is over. Conversely, the likes of Costa Rica, Uruguay and Chile, with vigorous checks and balances, independent judiciaries and a vibrant free press, are in a much better position to resist any authoritarian temptation. Yet, we are still in the early days. The real test will come if the mammoth economic crisis that is already engulfing the region (and the world) leads to widespread social unrest. In such a situation, the inclination of many governments to invoke emergency powers and resort to authoritarian measures to try and restore public order may become irresistible. It is then that the role of judiciaries and, in particular, constitutional courts may prove decisive."

"The real test will come if the mammoth economic crisis that is already engulfing the region (and the world) leads to widespread social unrest."

— Kevin Casas-Zamora

EDITOR'S NOTE: More commentary on this topic appears in Monday's issue of the Latin America Advisor.

NEWS BRIEFS

Guatemala to Resume Receiving Deportation Flights From U.S.

Guatemala's government said on Wednesday that it would resume receiving deportation flights from the United States next week, after halting flights during Holy Week after three deported Guatemalans later tested positive for the novel coronavirus, the Associated Press reported. The Guatemalan foreign affairs ministry also said the government was preparing temporary reception centers for deported migrants from the United States in order to monitor their health.

Mexico Has Lost Nearly 350,000 Jobs Amid Efforts to Fight Virus: Official

Mexico has lost 346,748 jobs since the middle of March due to its efforts to fight the Covid-19 pandemic, Labor Minister Luisa María Alcalde said Wednesday, the Voice of America reported. Tourism-dependent Quintana Roo, the home of Cancún, has suffered the largest number of job losses among the country's states, with 64,000 job losses, said Alcalde. The labor minister called on businesses to help workers, though she stopped short of saying companies should provide workers financial relief.

S&P Downgrades Argentina's Credit Rating After Payment Delay

S&P Global Ratings on Tuesday downgraded Argentina, the third ratings agency to revise down its sovereign credit rating in less than a week as the coronavirus pandemic worsens the indebted country's economic outlook, Reuters reported. S&P downgraded Argentina's long-term foreign currency rating to SD from CCC- after the government's announcement on Sunday that it plans to delay payments on as much as $10 billion of dollar-denominated debt issued under local law.

on Twitter. "I know the process and what the judges say is a LIE. They've proved absolutely NOTHING. Pure false testimony without evidence," he said.

Brazil's Order of Ventilators From China Falls Through

Brazil's health minister said Wednesday that the government's purchase of ventilators from China has fallen through and that the South American country will now rely on domestic companies to produce the machines, Reuters reported. Brazil wants to buy 15,000 ventilators from Chinese suppliers, but competition is intense for medical equipment amid the coronavirus pandemic, said Health Minister Luiz Henrique Mandetta. "Practically all our purchases of equipment in China are not being approved," he told reporters. On Tuesday, Mandetta said the government was encountering "difficulties" in obtaining the equipment after saying last week that Brazil was being outbid. Brazil's government has contracted Magnamed, a local medical equipment manufacturer, to produce 6,000 ventilators in 90 days, said Mandetta. Additionally, pulp and paper companies Suzano and Klabin, aircraft manufacturer Embraer, information technology provider Positivo Tecnologia and automaker Fiat Chrysler have offered to make ventilators, Mandetta added. Also, pharmaceutical and hospital equipment company Nutriex, which is based in Goiania, said it had succeeded in purchasing 40 metric tons of test kits and masks from China and that the purchase would arrive in Brasília on Wednesday via cargo plane. The company bought six million masks and other equipment, which is worth 160 million reais ($30 million), Reuters reported. The company is planning to donate a portion of the order to medical facilities. Officials in Rio de Janeiro reported the first deaths from Covid-19 in the city's favelas, raising concern that infections could tear through the slums where residents have little access to health care and often do not have running water. Coronavirus has spread to 10 of the city's favelas, putting as many as two million people at risk, said the Rio de Janeiro mayor's office. Mandetta also reported the first case of the virus among the Yanomami indigenous community and said the government will build a field hospital to help tribes that are vulnerable. "We are extremely concerned about indigenous communities," the health minister said. Brazilian President Jair Bolsonaro, whom critics have said has not been taking the pandemic seriously enough, said in a national address that the anti-malaria drug hydroxychloroquine was saving Covid-19 patients' lives and should be used in the initial stages of treating the disease. However, Brazil's health officials have limited its use to patients who are seriously ill and hospitalized because of a lack of evidence on the drug's safety and effectiveness for patients with the disease. Several governors and even members of his own cabinet have rebelled against Bolsonaro, saying he is putting lives at risk amid the pandemic, the Los Angeles Times reported. Bolsonaro has dismissed Covid-19 as "a little flu" and has called media coverage of the pandemic "hysteria." He has also urged Brazilians to return to work to prevent damage to the economy. "Don't follow the president's directions," said São Paulo Governor João Doria. Brazil has more than 16,000 confirmed cases of Covid-19 and 823 related deaths.

ECONOMIC NEWS

Chile's Piñera Unveils $2 Bn Fund to Help Informal Workers

Chilean President Sebastián Piñera on Wednesday announced a second phase to his emergency measures designed to help soften the blow from the economic fallout of the Covid-19 pandemic, which includes a $2 billion fund to benefit informal workers, La Tercera reported. The Chilean government had previously announced a stimulus package of almost $12 billion, or 5 percent of GDP, aimed at saving jobs and protecting small businesses, Reuters reported. Finance Minister Ignacio Briones said the new measures would bring Chile's fiscal deficit to 8 percent of GDP.

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from other assets that are also relatively unattractive. Overall, the decision to cut low-margin production is consistent with its strategy of focusing its business on assets with high potential and divesting assets with less attractive production. As to projected capital expenditures for 2020, the decision to cut investment is consistent with the current oil price scenario, and it does not impair future potential, since those cuts could be reversed quickly. Reduced exploratory expenditures will not mean reduced production in the near future, since Petrobras has a vast array of exploratory assets and a full pipeline of assets that could be brought into production even if exploratory activities are delayed for some time. Given Petrobras' low breakeven for major projects, less than $40 per barrel and falling, large new projects will be economically viable again even if prices rebound only modestly. In the meantime, Petrobras can continue producing at some of the world's lowest lifting costs per barrel ($5.60 per barrel for the pre-salt fields)."

> **"Large new projects will be economically viable again even if prices rebound only modestly."**
>
> **— Cleveland Jones**

A Nathália Weber Neiva Masulino, researcher at the Research Centre for Gas Innovation (RCGI) at the University of São Paulo: "Petrobras' strategy to address the drop in demand and oil prices faced by the global oil and gas industry follows international trends of investment and production cuts. Given the new scenario, the company has reinforced its portfolio management focused on pre-salt and cut administrative and operational costs, mainly affecting exploration activities, interconnection of wells and construction of production and refining facilities. Petrobras had been conducting an aggressive divestment program and saw its production increase significantly since the former crisis, resulting in debt reduction and better profitability. These efforts might have made the company stronger to deal with the current low price scenario, as compared to the one in 2014. The current oversupply and fall in demand will have further impacts, especially on the pressure over Petrobras' financial leverage, since divestment policy efforts are at risk now. The present situation does not favor asset pricing and creates enormous uncertainties in the upstream sector, risking ongoing and planned divestment negotiations. Petrobras has been adopting a strategy of analyzing currency exchange and crude oil prices to decide oil products' prices. The problem now is that the impact of such a strategy will be significantly lower, due to the fall in demand for oil products. Petrobras' exposure to international market volatility—related to the company's focus on exploration and production and the Chinese market—will not be easily balanced by this strategy, since a large impact on demand for gasoline and diesel is expected in the coming months. Beyond concerns over the breakeven, the pressure on Petrobras' financial leverage brings many doubts about its stability. With debt tied to the dollar, the devaluation of the real against the U.S. currency deepens the company's indebtedness, and the unfavorable scenario for asset pricing undermines the divestment policy. The current scenario of uncertainties regarding the world economy and changes in Petrobras' plans dash hopes for resuming drilling activities from the latest auctions and put at risk ongoing and future divestment negotiations."

Editor's note: The commentaries above were submitted before OPEC+ met on Thursday to discuss oil production.

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

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