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FEATURED Q&A

How Well Prepared Is Ecopetrol for New Market Realities?

Colombian state-owned oil firm Ecopetrol has cut its investment plan for the second time this year in response to the challenging international context. // File Photo: Colombian Government.

Q **In the wake of a 95 percent drop in net profits in the first quarter, Colombian state-owned oil company Ecopetrol cut its investment plans for the second time this year due to the oil price shock, which also means reduced production, CEO Felipe Bayón said May 12. The firm's capital expenditures for the year will now be between $2.5 billion and $3 billion, nearly half of the original target range of $4.5 billion to $5.5 billion. What implications does the dramatic drop in profits have both for Ecopetrol and for Colombia's economy? Does Ecopetrol have the right plans to face lower oil prices and demand? Which areas will be most affected by the investment cuts, and which ones should the company prioritize in the period ahead?**

A **Leopoldo Olavarria, international partner at Norton Rose Fulbright:** "A significant portion of Ecopetrol's Colombian revenues come from profitable transport activities. The company has steadily increased reserves and production and secured access to transportation, handling and storage facilities, so its focus on capital preservation and discipline, as well as its recent $2 billion capital increase, should ensure its long-term viability, despite the hard times and uncertainty that management expects. Colombia will see important decreases in royalty collections (mainly due to the price drop, as Colombian production has not yet dropped significantly). These decreases will adversely affect regions that rely on transfers of royalty revenues. To mitigate this, the government should ensure the swift implementation of the transitory industry support measures in ANH Accords 1 and 2 of 2020. Ecopetrol's breakeven price of oil is below $30/barrel,

Continued on page 3

TOP NEWS

POWER SECTOR

Enel Moves to Close Coal-Fired Plants in Chile

The power company is planning to file for a permit to close its last coal-fired units in Chile by 2022, an earlier exit than previously agreed with the Chilean government.

Page 2

POWER SECTOR

Mexico Regulator Approves New Power Rates

Mexican energy regulator CRE has approved new rates that electricity providers must pay the national power utility for transmission.

Page 3

OIL & GAS

Maduro Rolls Back Venezuela Fuel Subsidy

Venezuelan President Nicolás Maduro said he was rolling back a longstanding fuel subsidy and privatizing service stations in a historic shift in policy as the Andean nation grapples with a sharp gasoline shortage. A similar move decades ago pushed Venezuela into protests.

Page 2

Maduro // File Photo: Venezuelan Government.

OIL AND GAS NEWS

Venezuela's Maduro Announces Rollback of Gasoline Subsidy

Venezuelan President Nicolás Maduro announced the rollback of a longstanding fuel subsidy and the privatization of service stations in a historic shift in policy as the Andean nation struggles with a sharp gasoline shortage, The Wall Street Journal reported Sunday. Under the measures, which took effect on Monday, Venezuelans will be limited to 32 monthly gallons of fuel at a subsidized price of nearly 10 cents a gallon. However, they can purchase unlimited quantities of gasoline at a price of $1.90 per gallon, which will be sold at a network of 200 gas stations that the government has privatized to unspecified businessmen. The change in the pricing system brought confusion to many Venezuelans this week, prompting long lines at service stations. By 9 a.m. local time on Monday, stations in Caracas remained shuttered as staff and security forces responsible for overseeing the distribution awaited instructions from state-run oil company PDVSA, Reuters reported. "We do have gasoline, but it is unclear if we are selling at subsidized [prices] or dollarized [prices]," Jefferson Suárez, a military official managing pump lines at a station in the eastern part of the capital, told the wire service. "PDVSA workers have not shown up yet to explain, and I don't have any idea what is going on," he added. The situation was worse outside Caracas, with many stations in the western border state of Tachira remaining closed on Monday. In many places, including the western cities of Barquisimeto and Maracaibo, stations quickly ran out of the subsidized gasoline, Reuters reported. The government has said the measure will make fuel supply more efficient. However, the move is a gamble for Maduro in a country that has long provided gasoline virtually free of charge. A similar move decades ago pushed the nation into protests. "In Latin America, removing energy subsidies is a form of political suicide, and when they're done badly, they result in chaos," said Giorgio Cunto, a statistics professor and economist with consulting firm Ecoanalítica in Caracas, The Wall Street Journal reported. Maduro's announcement of the change in the pricing system came just hours after more fuel from Iran began to arrive in Venezuela on Saturday, Reuters reported. The fifth cargo of an Iranian flotilla was expected to reach Venezuelan waters on Sunday, in spite of U.S. warnings. U.S. officials said last week that the last two ships loaded with Iranian oil cargoes had halted their deliveries after the threat of sanctions. Iran has provided Maduro's government with as much as 1.53 million barrels of gasoline and components to help alleviate the gasoline shortage and boost the country's refining capacity. Maduro has described the deal as "two rebel revolutionary peoples" that won't "kneel before North American imperialism," referring to U.S. sanctions against both Venezuela and Iran. The Middle Eastern country said on Monday that it was prepared to continue supplying fuel to Venezuela, saying Iran is exercising "its rights to free trade," Reuters reported. Following a fresh round of sanctions on Tuesday against entities that own vessels that have transported crude to Venezuela this year, U.S. officials said targeting the private sector through financial sanctions helps the administration avoid military action, The Wall Street Journal reported. After the United States blacklisted Russian state oil company Rosneft earlier this year, Venezuela has been forced to turn to Iran, drug traffickers and other illicit networks to trade its oil and gold for fuel and cash, the unnamed U.S. officials added.

Colombia Oil Output Falls by 10 Percent in April: Government

Oil production in Colombia fell 10 percent year-on-year in April, as output was hit by the temporary closures of wells amid the plunge in international crude prices and the health crisis brought on by the coronavirus pandemic, the Mines and Energy Ministry said Monday, Reuters reported. Oil output in April reached 796,164 barrels per day (bpd), down from

NEWS BRIEFS

Enel Moves to Close Coal-Fired Plants in Chile Earlier Than Planned

Power company Enel Chile and its electricity generation subsidiary, Enel Generación Chile, are planning to file for a permit to close their last coal-fired units in Chile by 2022, an earlier exit than previously agreed with the Chilean government, Renewables Now reported May 28. The move would affect the 128-megawatt Bocamina I plant, as well as the 350-megawatt Bocamina II plant. The two units were originally scheduled to close in 2023 and 2040, respectively.

Bolivian Authorities Detain Three Executives at State Oil Company YPFB

Authorities in Bolivia have detained three executives at state oil company YPFB over alleged irregularities in the process of contracting an insurance policy with local company Credinform for $6.9 million, América Economía reported Wednesday. Sergio Bustillos, an official with the prosecutor's office in La Paz, told reporters that the three individuals being questioned are the contract manager, legal manager and the head of the legal unit of YPFB. Others under investigation will be called for questioning in the coming days, he added.

Grupo Bimbo Strikes Power Deal With Genneia

Mexican bakery products maker Grupo Bimbo has signed a deal for thermal and renewable energy company Genneia to supply it with electricity from its wind farms in Argentina, Genneia said in a press release May 26. The 15-year agreement was signed under the Argentine purchase mechanism called Mercado a Término de Energías Renvoables, or MATER, which allows large private power consumers to freely negotiate their contracts with clean electricity generators, the company said.

891,012 bpd in the same month last year. Oil production declined by 7.1 percent as compared to March, when 857,113 bpd were produced. "The decline was mainly due to the temporary closure of wells due to international crude prices, the health emergency of Covid-19 and some [other] factors," the ministry said in a statement, Reuters reported. So far this year, the Andean nation has produced 853,884 bpd, a 4.2 percent decrease as compared to the same period last year. The government has cut its forecast for oil production this year to 850,000 bpd, assuming a price per barrel of $35.

POWER SECTOR NEWS

Mexico's Energy Regulator OKs New Transmission Rates

Mexican energy regulator CRE has approved new rates that electricity providers must pay the national power utility for transmission, CRE said last week, Reuters reported. The announcement comes as a dispute between the government and the private sector over recent changes in the industry. CRE said the new rates will apply to companies that signed contracts with state utility CFE before the constitutional reform of the country's energy sector in 2013-14, without providing further details of the new changes. The new transmission rates were approved following a request by the CFE in March of last year, the CRE said. "The carriage charges did not reflect fair and proportional costs for providing the service," it added, saying that the result of was "inequitable" competitive conditions within the electricity market. However, Mexico's business coordinating council, known as CCE, has estimated that the new rates are between five and 10 times higher than current prices and that they will affect nearly 100 companies. "This is a new step on the road inhibiting competition and putting up arbitrary barriers and violating the rights of the private sector," CCE President Carlos Salazar said in a virtual press conference. The administration of

FEATURED Q&A / Continued from page 1

and it has shut down unprofitable wells. Its newest production goals are based on a cash-flow positive $30-40/barrel price range, so, if prices hold, the company should reach the forecast production range. If prices increase, the company will progressively reactivate producer wells. Felipe Bayón said Ecopetrol entered the current crisis with solid operational and financial positions. The company's first quarter report shows it is exercising strong capital discipline by correctly prioritizing the most profitable projects, preserving cash and using its leverage capabilities. Moreover, it also prioritizes the wellbeing of its work force during the pandemic, which is not only ethically correct but also ensures business continuity."

A **John Padilla, managing director of IPD Latin America:** "The profit drop in the first quarter was principally due to a noncash impairment charge related to unprofitable assets in the current environment. Ecopetrol expects 10 percent less production starting in the second quarter. Its EBITDA margin fell to 34.9 percent in the first quarter (it was 46.1 percent in the same period last year), due largely to higher operating and administrative costs, now being addressed by 2020 cost and expense reductions totaling more than $900 million. With a crude differential of roughly $10/barrel, it needs Brent prices of between $30-40/barrel. Ecopetrol's revenues are supported by healthy and captive midstream and downstream activities. However, if oil prices fall again, private sector operators (who produce roughly one-third of Colombia's total production) may increase pressure to reduce Ecopetrol-controlled transport costs. Roughly 25-30 percent of planned capital expenditure reductions will come from its Oxy joint venture in the United States. Other cuts will come from currently unprofitable projects or profitable assets that will not be materially impaired by reductions. Ecopetrol's well-regarded management team has proactively taken steps to ensure viability and profitability. It added $3 billion in debt in the first quarter to ensure liquidity, increasing total debt to $11.4 billion (it raised gross debt/EBITDA to 2.0x, up from 1.6x). Two other challenges remain: its percentage of heavy oil (around 66 percent), which is witnessing wider differentials due to global supply overhang; and the government's increasing dependence on Ecopetrol—it paid $111 million in first-quarter dividends but deferred nearly $1.43 billion until the second half of the year. Potential further sovereign credit rating downgrades would directly affect Ecopetrol."

> **"Ecopetrol's well-regarded management team has proactively taken steps to ensure viability and profitability."**
> **— John Padilla**

A **Marianna Boza, director of Brigard Urrutia in Bogotá:** "Ecopetrol has taken timely and proper steps to face the impact of the fall in oil prices and the effect in its activities due to the deceleration of the economy because of the coronavirus pandemic, which in Colombia has brought a mandatory preventive isolation since March 22. In addition, this crisis has found a company in a stronger operational and financial position and a diversified investment portfolio. As Ecopetrol mentioned, cuts will focus on projects that are not profitable under the new market conditions; thus, the reduction in costs and expenses and in the investment plan. In other words, it is keeping projects with significant profitability in terms of production. In this respect, it is important to bear in mind that Ecopetrol has sustained that the company's breakeven is still below $30, which will cover more than 90 percent of its production. Thus, Ecopetrol will keep

Continued on page 6

President Andrés Manuel López Obrador has been moving to bolster the role of the state in the energy sector. Local industry groups and energy companies have blasted the new rules, saying they favor the CFE. [Editor's note: See related **Q&A** in the May 29 issue of the Energy Advisor.]

POLITICAL NEWS

Brazil, Mexico Report Highest Daily Death Tolls From Covid-19

Brazil and Mexico, Latin America's two most populous nations, reported their highest daily death tolls so far from the novel coronavirus. On Wednesday night, Brazil reported 1,349 new deaths in the preceding 24 hours, pushing its total number of confirmed deaths from the virus to 32,548, Bloomberg News reported. The country's health ministry also recorded 28,633 new cases on Wednesday, putting the country's total number of confirmed cases at 584,016. Brazil has the second highest number of confirmed cases in the world, behind only the United States, which has more than 1.8 million. Following two months of quarantines that have been loosely enforced, some parts of the country are starting to reopen businesses, and health experts say the peak is yet to arrive. On Wednesday the state government in São Paulo said the state's number of cases could rise to 265,000 by the end of June, from the current level of approximately 118,000. President Jair Bolsonaro has frequently resisted social-distancing measures and has called on people to get back to work to mitigate the economic damage of the pandemic. On Wednesday, economic data showed that the country's industrial output saw its sharpest decline ever in April. The country has also seen historic declines in economic indicators relating to formal jobs as well as retail sales because of the pandemic. On Wednesday, Wilson Witzel, a political opponent of Bolsonaro and the governor of Rio de Janeiro state, said the state was taking over management of field hospitals that are under construction and intended to help the health system cope with a flood of patients with Covid-19. Local media in Brazil have reported on problems including delays and mismanagement in the initiative. Last week, authorities searched Witzel's official residence and seized computers and mobile phones belonging to

ADVISOR Q&A

Should Countries in Latin America Provide a Universal Basic Income?

Q **The U.N. Economic Commission for Latin America and the Caribbean, or ECLAC, in a report published in May proposed that governments in the region ensure immediate temporary cash transfers to the most vulnerable in response to the economic fallout of the Covid-19 pandemic, suggesting such transfers be made permanent in the long term as a step toward a universal basic income, or UBI. Will such a cash transfer policy successfully lift people out of poverty, and what unintended consequences might it have in the region? What would a UBI system look like in Latin America and the Caribbean? Is there political will among countries in the region to carry out such programs, and do governments have the ability to implement them effectively as they face the worst global recession in decades?**

A **Nora Lustig, professor of Latin American economics at Tulane University and nonresident fellow at the Center for Development and the Inter-American Dialogue:** "As a response to the pandemic, countries are expanding cash transfer programs to protect those hurt by the coronavirus' economic fallout. Whether to convert this into a permanent change is a different matter. A UBI can provide a broad-based safety net in the face of a reduction in income (such as during the current pandemic). However, if the main objective is poverty reduction, replacing existing targeted programs by a UBI would leave the poor worse off. If the aim is to both reduce poverty and create a social protection floor, a UBI should be high enough, at the minimum, for the poor to be no worse off than under current programs. Achieving this in a budget-neutral manner will require an increase in taxation, which may create work disincentives and political resistance from the middle classes. Thus, there is a tradeoff between efficiency and the size of the universal basic income floor. The higher the floor, the larger the potential losses in efficiency due to higher taxes. But, the lower the floor, the smaller the ability of a UBI to act as a genuine safety net. In the end, whether to introduce a UBI will depend on the country. What cannot wait is implementing a universal registry that includes informal workers and the self-employed. In the absence of such a registry, expanding the coverage of transfers quickly enough is difficult. A second matter that cannot wait is to keep track of spending on cash transfers. Accurate information is not available. ECLAC discontinued reporting this data some time ago."

"There is a tradeoff between efficiency and the size of the universal basic income floor."
— Nora Lustig

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

NEWS BRIEFS

U.S. House Democrats Oppose Plans to Expand Economic Ties With Brazil

Democrats on the powerful U.S. House Ways and Means Committee said Wednesday they opposed President Donald Trump's plans to expand economic ties with Brazil, Reuters reported. Committee Chairman Richard Neal (D-Mass.) told U.S. Trade Representative Robert Lighthizer in a letter that Brazilian President Jair Bolsonaro's government had shown a "complete disregard for basic human rights." U.S. and Brazilian officials agreed last month to accelerate talks aimed at concluding an agreement on trade rules and transparency this year.

Mexico's Mining Output to Fall 17% Due to Pandemic: Industry Chamber Official

Mexico's mining production is likely to decline by approximately 17 percent this year due to the coronavirus pandemic, the head of the country's mining chamber, Camimex, told Reuters in an interview Wednesday. The official, Fernando Alanís, added that the chamber expects Mexico's mining exports to decline by about 10 percent this year.

Colombia's Supreme Court to Investigate Uribe Over Spying Allegations

Colombia's Supreme Court announced on Tuesday that it is opening a probe into former President Álvaro Uribe in connection with illegal military spying on journalists and politicians, Agence France-Presse reported. It is investigating Uribe as "the possible recipient of information provided by illegal military intelligence surveillance in 2019," the Supreme Court said. "Another preliminary investigation by an anonymous coward who says that I am the beneficiary of the reports," Uribe said on Twitter. him in connection with an investigation into the misuse of public money related to the fight against the disease. On Wednesday, health officials in Mexico also reported their highest daily confirmed death toll from Covid-19. The country had 1,092 reported deaths in 24 hours, Reuters reported. Mexico has 101,238 confirmed cases and 11,729 reported deaths. Mexican President Andrés Manuel López Obrador has been under pressure from the United States to reopen major parts of the country's economy in order to reactivate supply chains.

Authorities Arrest Former Ecuadorean President Bucaram

Abdalá Bucaram, who was Ecuador's president for about six months in 1996 and 1997, was arrested Wednesday after authorities searched his home and found a reportedly unlicensed gun and medical supplies in connection with an investigation into corruption amid the Covid-19 pandemic, the Voice of America reported. The raid at Bucaram's house in Guayaquil, a city hit hard during the pandemic, was related to an investigation into suspected embezzlement at a public hospital, according to investigators. Agents reportedly found some 5,000 masks and 2,000 coronavirus test kits in the search of Bucaram's house, the Associated Press reported. "A lot of medical supplies were found," said chief prosecutor Diana Salazar. Bucaram, who was accused of corruption and nepotism during his brief time in office, has so far not been charged in connection with Wednesday's search of his property. As he was taken into custody, Bucaram shouted "Long live the homeland!" to local media. His family members defended him on Wednesday, calling the raid illegal and saying he needed the gun because he regularly faces threats. They also said he had legally purchased the masks and test kits. "This is ABUSE!!!" his son, Dalo Bucaram, said in a posting on Twitter. In all, prosecutors carried out 37 raids on Wednesday in Guayaquil and Quito and have detained 17 people on accusations of criminal organization, influence peddling and overcharging for medical supplies, the AP reported. Other people detained include five people with connections to Quito's public water company, the former director of the Teodoro Maldonado Carbo Hospital in Guayaquil and the prefect of Guayas province, which includes Guayaquil. Salazar said her office estimates that there was $12 million in overcharging related to the graft scheme.

ECONOMIC NEWS

Argentina Again Extends Deadline in Debt Negotiations

Argentina on Monday again extended the deadline to reach a deal with international bondholders to restructure $65 billion in foreign debt, and the government said it may sweeten its offer, Reuters reported. The latest self-imposed deadline was set to expire Tuesday. Technically, Argentina is already in default after having missed an interest payment extension on May 22, but both the government and foreign creditors agreed to continue talks after bondholders rejected a previous proposal. The government is evaluating "additional adjustments" to its offer "with a view of maximizing investor support without compromising its debt sustainability goals," it said in a statement, Reuters reported. "We are working on the final amendments to the offer, but the margin that remains for adjustment is thin," said Economy Minister Martín Guzmán, adding that the deadline for talks would again be extended following the offer in order to provide time to draft and sign the final deal. The International Monetary Fund backed the current proposal. In a statement on Monday, the lender said that the new offer is "consistent with restoring debt sustainability" and that there is "limited scope" for Argentina to improve it.

> **"The margin that remains for adjustment is thin."**
> — Martín Guzmán

FEATURED Q&A / Continued from page 3

the 'minimum operating vital' concept to continue to guarantee that production and supply of fuel continues uninterrupted. Accordingly, Ecopetrol closed approximately 300 wells across the country. Considering oil prices, one of the projects that will be most affected is the activities under the strategic partnership with Oxy in the Permian Midland Basin, where they have announced a reduction of between $180 million and $200 million. A great opportunity for Colombia is the development of unconventional reservoirs. Ecopetrol has not indicated if the cuts would affect the development of the pilot projects planned for later this year. That will undoubtedly change the oil and gas scenario in Colombia."

A **Andrés Duarte Pérez, director of variable income at Corficolombiana in Bogotá:** "Ecopetrol's dramatic drop in profits implies there will be fewer resources to pay corporate income tax, reinvest in the company and distribute dividends to its shareholders (it's 88.5 percent state-owned). This being the case, the company must protect its cash position, stabilize its leverage metrics and reduce its capital expenditure (capex), consequently limiting its current and future production, as well as the chance of increasing its oil reserves. Colombia's economy in turn is affected negatively on its current account and its exchange rate, given the relevance of oil exports from Ecopetrol to total exports. Other effects include the reduction of investment and the fiscal impact of reduced corporate income tax ($1.6 billion were paid during 2019) and dividends to be received in 2021 ($2 billion in dividends from 2019's earnings are to be paid by the end of 2020). The swiftness of the company's actions must be recognized, and while it is too early to conclude if plans to face lower oil prices and demand are correct, it certainly appears to be the case, given the reduction expected in capital expenditure, production and costs. The forcefulness of capex cuts depends on international oil prices. Ecopetrol will invest around 80 percent of total capex in exploration and production, the same proportion on a smaller base, affecting expensive production and exploration projects in Colombia and in other countries. Future capex must continue to prioritize its production and reserve additions."

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

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