LATIN AMERICA ADVISOR

ENERGY ADVISOR

A WEEKLY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

July 31, 2020

FEATURED Q&A

What's Driving Latin America's Oil Trade Flows With Asia?

Brazilian crude exports to Asia, and China in particular, soared in the first half of the year. A port in Brazil's Paraná state is pictured above. // File Photo: Brazilian Government.

Q: Brazil's crude exports to Asia soared in the first half of 2020, registering a 30 percent increase year-on-year, while sales from sanctions-hit Venezuela plunged by 35 percent, and Asian imports from Mexico fell by 9.5 percent during the same period, according to Refinitiv Eikon data. What are the most important factors behind the changes in oil-sector trade flows between Latin America and Asia? What accounts for the sharp rise in Brazilian crude exports to Asia, especially to China, and can other Latin American nations keep up with the competition? Are such trends temporary, as the world navigates a pandemic coupled with an unprecedented economic crisis, or are they likely to remain in the long term?

A: Patricia I. Vazquez, independent energy analyst and research associate at the Graduate Institute of Geneva's Center on Conflict, Development and Peacebuilding: "Covid-19 severely hit Brazil, but its impact on the country's oil industry has so far been rather positive. Brazil saw a global window of opportunity when oil demand from import-dependent Asian countries coming out of lockdown started to recover, while Western nations remained closed due to the pandemic. Brazil was there to respond to Asia's demand by offering its high-quality oil at competitive prices, at a time when OPEC+ countries maintained record supply cuts. China in particular increased its oil demand to take advantage of historically low oil prices to replenish its strategic oil reserves. Once the pandemic comes under control and consumption resumes around the world, oil demand and supply fundamentals will likely return to normal. China's strategic reserve replenishment will not

Continued on page 3

TOP NEWS

OIL & GAS

U.S. Reportedly Reconsidering Exemptions to Sanctions

The administration of U.S. President Donald Trump is reportedly re-evaluating diesel-for-crude swaps from Venezuela that are currently exempt from sanctions.

Page 2

RENEWABLES

Enel Receives OK to Disconnect Chile Coal Plant

Chile's energy commission approved Enel Generación's request to disconnect a second unit of the Bocamina coal-fired plant 18 years earlier than initially planned.

Page 2

OIL & GAS

IEnova Confident It Will Receive Key Permit From Gov't

IEnova, led by CEO Tania Ortiz, said it was confident it will secure a key government permit to make a final investment decision on the Energía Costa Azul LNG Liquefaction project in Mexico's Pacific Coast.

Page 2

Ortiz // File Photo: Sempra Energy.

OIL AND GAS NEWS

U.S. Reconsidering Exemptions to Sanctions: Sources

The government of U.S. President Donald Trump is reportedly re-evaluating diesel-for-crude swaps from Venezuela that are currently exempt from U.S sanctions, Argus Media reported July 23. Several companies including Spain's Repsol, Italy's Eni and India's Reliance have been engaging with the Andean nation's state oil company, PDVSA, through diesel-for-crude transactions, with clearance from the U.S. Treasury's Office of Foreign Assets Control, or OFAC. However, senior officials in the State Department and the White House National Security Council are reportedly reconsidering the exemption of such transactions over concerns that they help President Nicolás Maduro remain in power, Argus Media reported. Under the swap deals, Repsol and Eni lift Venezuelan crude as payment for PDVSA's exclusive offtake of natural gas from their Perla offshore field and other debts, and diesel is sent back. Meanwhile, Reliance, which was Venezuela's main diesel supplier in the second quarter of the year, recently resumed the swap arrangement following a pause in June to ensure compliance with sanctions. The United States' sanctions against Venezuela's oil sector were first imposed in January 2019 in a bid to squeeze the government's coffers and exert pressure on Maduro to step down. Since then, the United States has repeatedly toughened the sanctions, targeting oil tankers and individual Venezuelan officials.

Shell Drills Dry Hole in Brazil's Premier Offshore Region

Royal Dutch Shell recently drilled a dry hole in Brazil's premier offshore region, a sign that Brazilian state-run oil company Petrobras might have already secured the best oil deposits, Bloomberg News reported July 23. Shell completed its first well at the Saturno prospect in June, without reporting any discoveries, according to drilling data from the National Petroleum Agency, or ANP. The regulator confirmed at a press conference that it was a dry hole. Shell said it was unable to comment during a quiet period ahead of earnings, Bloomberg News reported. Expectations had been high, according to the report. Shell and Chevron had outbid ExxonMobil with a $780 million signing bonus for the prospect in 2018, and Colombian state-run firm Ecopetrol the following year bought a 10 percent stake in the license for an undisclosed amount. "If you eliminate all these prospects, future production linked to exploratory activities will go down significantly," Marcelo de Assis, the head of Latin American upstream research at Wood Mackenzie, told Bloomberg News. "It will reduce interest in the future bid rounds and increase pressure in more favorable fiscal terms," he added.

IEnova 'Confident' It Will Obtain Key Permit From Gov't

IEnova, the Mexican unit of U.S.-based utility Sempra Energy, said last week that it was confident it will secure a key government permit this year in order to make a final investment decision on the Energía Costa Azul LNG Liquefaction project in the Latin American country, S&P Global Platts reported. During a second-quarter earnings call, CEO Tania Ortiz said there was no fixed date set for when the company expected the export permit from the Mexican government, which is the last piece of information needed for it to make a final investment decision, Natural Gas Intel reported. "I would say I feel fairly confident in the progress we are making," Ortiz said, although adding that the "permitting situation is difficult" given the Covid-19 pandemic. "We are working very closely with the government to obtain the permit we are still missing, and we are quite confident we are going to get it," Executive Chairman Carlos Ruiz said. "We are really optimistic on it," he added. IEnova had

NEWS BRIEFS

Chilean Energy Agency OKs Enel's Plan to Disconnect Coal Plant

Chile's energy commission last week approved Enel Generación Chile's plan to disconnect the second unit of the Bocamina coal-fired plant in May 2022, 18 years earlier than originally planned, Renewables Now reported July 24. The authorization allows Enel Generación to fully turn away from coal in Chile long before the 2040 deadline it had agreed to with the government. Earlier this month, Enel Generación's request to close the Bocamina I unit was also approved. It will take it offline on Dec. 31.

Brazil Contracts 73 Mn Liters in Biodiesel Auction

Brazil's Petroleum, Natural Gas and Biofuels Agency, or ANP, announced last week that the country's 73rd complementary biodiesel auction contracted 72.5 million liters in total, Renewables Now reported July 24. The average price of 4.578 reais per liter in the tender resulted in a final contracted value of nearly 333 million reais ($63.9 million). In all, 24 producers offered some 75.45 million liters in the auction, according to the report.

Man Reportedly Killed in Venezuela During Protests Over Gasoline Shortages

A man was shot and killed on Saturday during a protest over gasoline shortages in eastern Venezuela, according to officials and a local human rights group, Reuters reported. The fatal shooting happened less than two weeks after a similar incident in the Andean nation. Rights group Provea, citing witnesses, said Carlos Chaparro was reportedly shot by a member of the National Guard during protests at a service station in the town of Aragua de Barcelona, in Anzoátegui state. Venezuela has been facing severe fuel shortages due to years of mismanagement exacerbated by tough U.S. sanctions.

originally expected to reach a final decision in the first quarter of the year, but it was delayed due to coronavirus-related shutdowns of government offices, which halted the permit processing. The Energía Costa Azul plant on the Pacific Coast would be the country's first for the export of LNG from a terminal, as well as the first such permit to be granted in Mexico in 20 years, S&P Global Platts reported.

Sycar Planning to Build Ecuador's First LNG Terminal

U.S. company Sycar is planning to build Ecuador's first import terminal for liquefied natural gas, or LNG, with construction slated to start in 2021, Argus Media reported Monday. The company, in partnership with an unnamed LNG trading firm, wants to install a floating storage and regasification unit, or FSRU, to provide regasified LNG to the Thermo Gas Machala gas-fired power plant in the Andean nation's El Oro province. The terminal will also have an LNG truck-filling station, according to Sycar's website. Ecuador's hydrocarbons ministry has reportedly already approved the project, and Sycar expects to complete environmental licensing by the fourth quarter, the company said on its website. "This project is intended to introduce natural gas to the Ecuadorean energy matrix as a phase 1 for a future onshore LNG storage terminal," the website says. Ecuador's government has been looking to diversify the country's power supply sources in recent years, including LNG imports and a possible pipeline for gas deliveries from Peru, as the country is set to face a domestic supply shortage of gas in the next "few years," Juan Carlos Bermeo, the deputy hydrocarbons minister, said last year, Argus Media reported. The shortage is expected due to declining reserves at the Andean nation's only gas field, Amistad, where production is expected to fall to just eight million cubic feet per day within the next four years.

Ecuador is set to face a domestic supply shortage of gas in the next few years.

FEATURED Q&A / Continued from page 1

last forever, and a resumption of domestic consumption in Brazil will leave less crude available for exports. But for Brazil, Covid-19 has been an opportunity to showcase its oil potential, just years before it is slated to become one of the largest producers outside of OPEC. Brazil is already Latin America's number-one oil producer, and its low-sulfur, high-quality oil is produced at a comparatively low cost. In the meantime, Mexico is concentrated on increasing shipments to the United states, and Venezuela's exports are at a nearly 80-year low due to U.S. sanctions that prevent refiners from buying from that country. Politics aside, all the elements are there for Brazil to become a major producer in the near future. But then again, there's Brazilian politics, and a pandemic, to overcome."

A **Margaret Myers, director of the Asia & Latin America program at the Inter-American Dialogue:** "A confluence of factors resulted in the recent boost in Brazil's crude exports to Asia. The 30 percent year-on-year increase was due in part to strategic decision-making by state oil firm Petrobras, for example, which offered Asian refiners competitive deals on relatively high-quality oil. The recent surge in Brazil's oil trade with Asia was also largely the result of a decision by the International Maritime Organization to limit the use of high-sulfur fuel, which took effect in January. As Asian refiners look to supply ships with cleaner fuels, Brazil's low-sulfur pre-salt oil been in much higher demand. Also of note are the strong ties that China and Petrobras have developed over the years. Petrobras is among the top recipients of Chinese policy bank loans to Latin America, with major deals dating back to 2009. China's position as the destination of 70 percent of the country's exports is partially attributable to the carefully cultivated and long-standing relationship between China and the majority state-owned oil company. Whether we see these high numbers materialize month after month depends on the extent to which Brazil's domestic consumption rebounds, as well as whether China continues to build up its Strategic

"The 30 percent year-on-year increase was due in part to strategic decision-making by state oil firm Petrobras..."
— Margaret Myers

Continued on page 6

Former Pemex CEO Lozoya Asserts Innocence in Court

Emilio Lozoya, a former head of Mexican state oil company Pemex, on Tuesday told a court that he was innocent of corruption charges and vowed to denounce those who he said are responsible for his alleged crimes, Reuters reported. The trial is the highest-profile probe so far during the administration of President Andrés Manuel López Obrador, who ran on a promise to root out corruption in Mexico. Lozoya led Pemex from 2012 to 2016 while former President Enrique Peña Nieto was in office. Federal prosecutors accuse him of authorizing outlays worth hundreds of millions of dollars on a defunct fertilizer plant that Pemex acquired from Altos Hornos de México, a steelmaking company he is alleged to have taken bribes from. The heads of the steelmaker have denied wrongdoing. Lozoya is also charged with taking $4 million in bribes from Brazilian construction giant Odebrecht. On Wednesday, he pleaded not guilty to the charges related to Odebrecht. Lozoya appeared in court via videoconference, as he was hospitalized due to anemia upon his arrival in Mexico earlier this month. Lozoya was extradited from Spain, where he was arrested in February after having fled Mexico last year. "I will demonstrate that I'm not responsible or guilty of the crimes attributed to me," Lozoya said in court.

POLITICAL NEWS

Argentine President Launches Judicial Reform Package

Argentine President Alberto Fernández on Wednesday announced a package of judicial reforms, which would increase the number of federal courts from 12 to 46, diminishing the power of those that are currently operating, Reuters reported. The reforms were among Fernández's main promises when he took office last December. Argentina's courts have frequently been accused of bias in recent decades. "I only seek to have the republic that everyone declares, but that some have humiliated," Fernández said in announcing the reforms, the Buenos Aires Times reported. Fernández, who is a criminal law professor, said the move would help the country's justice system regain "credibility." The president also said his government would create an advisory commission comprised of 11 legal experts who will discuss other changes to the country's judicial system. Some analysts see the move as a step toward increasing the number of justices on Argentina's Supreme Court. The reforms would also seek to put in place an "accusatorial" legal system, which lawmakers previously approved, but which former President Mauricio Macri blocked. Several government and judicial officials, including Supreme Court Justice Elena de Nolasco, were present at the announcement, but several prominent officials were absent. Not a single member of the opposition attended Fernández's announcement, the Buenos Aires Times reported. Opposition lawmakers have rejected the reforms, saying they are an effort to manipulate Argentina's court system and promote "impunity" for corrupt politicians. Also among the opponents is Maxi Ferraro, the president of the Civic Coalition ARI. "There is no possibility of serious judicial reform in this difficult social and economic context," said Ferraro. "Much less when a plan of impunity is sought and to break the actions

ADVISOR Q&A

What Tax Reforms Does Latin America Need for Recovery?

Q Countries in Latin America and the Caribbean face a steep drop in tax revenue due to the slowdown of economic activity amid the pandemic and lower prices for commodities, the Economic Commission for Latin America and the Caribbean, or ECLAC, said in a report this month. In addition, tax evasion continues to be a problem for the region, with ECLAC estimating a loss of $325 billion—more than 6 percent of GDP—due to tax noncompliance even before the recession. How important, and controversial, will tax policy become as Latin American and Caribbean countries seek to reactivate their economies in the period ahead? What would the ideal tax policy look like, and which sectors, if any, should see tax breaks during the post-pandemic recovery? How big of a problem is tax evasion in the region, and what can governments do to ensure taxpayers, especially companies, comply?

A **Manuel Baltazar Mancilla, chief executive of México Fiscal:** "It will be of utmost importance to define an adequate tax policy, aimed at strengthening the basic input and industrial sectors, since the service sector can wait a bit. Public policies might become very controversial, especially in those countries whose governments are betting on social welfare at a time when support is required for entrepreneurs. It is necessary to boost GDP and improve the population's purchasing power, which can only be achieved by promoting employment. Tax evasion occurs to a greater extent with property taxes, so perhaps it is time to bet on consumption taxes. If we want to support citizens, we must exempt or reduce the burden on direct property taxes and leave the burden of collection on taxes imposed on consumption, even imposing higher taxes on luxury goods. The more money we leave in citizens' pockets, the more the economy grows, and so also grow tax revenues. Such a measure must go hand in hand with the promotion of the domestic market in each country. It will be key to implement fiscal stimuli with rules that guarantee economic improvement in each locality, with a strict vigilance of tax payments, a situation that can be resolved through electronic control of trade. We need to bet on business investment, coupled with a commitment to job creation and improvement, in order to get back tax contributions that improve everyone's economy as a whole."

> "The more money we leave in citizens' pockets, the more the economy grows, and so also grow tax revenues."
> — Manuel Baltazar Mancilla

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

NEWS BRIEFS

Mexico's Supreme Court Rejects Decriminalization of Abortion in Veracruz

Mexico's Supreme Court on Wednesday rejected an injunction that could have decriminalized abortion in Veracruz state, the Voice of America reported. The high court judges voted 4-1 against removing articles from the criminal code regarding abortion in the first 12 weeks of pregnancy. Abortion in Veracruz is only allowed in instances of rape, with a police report and only within 90 days. Only two of Mexico's 32 states, Oaxaca and Mexico City, have legalized the procedure.

Apache, Total Make Third Discovery of Oil Off Suriname's Coastline

U.S.-based oil producer Apache and joint venture partner Total announced Wednesday that they had made their third oil discovery off the coast of Suriname, Reuters reported. "This is the best well we've drilled in the basin to date, with the highest net pay in the best quality reservoirs," said Apache's CEO, John Christmann. The discovery is seen as critical to Apache's attempts to lower its reliance on the Alpine High venture in the Permian basin in Texas, the wire service reported.

Mexico's López Obrador Eyes Constitutional Change to Boost Pemex

Mexican President Andrés Manuel López Obrador said Wednesday that his government might seek to modify the constitution in the second half of his term to boost state oil firm Pemex and national power company CFE, Reuters reported. He said his government was not currently considering the move, which could potentially reverse the recent liberalization of Mexico's energy market, adding that it could not be ruled out if it became necessary in order to help strengthen the state-run energy firms.

of the independence of justice." However, Fernández administration officials rejected the claims that the reforms would lead to impunity. "We have heard the claims that this reform suits the government or the vice president's bid for impunity. Nothing is further from reality—those currently in the system will continue to have their cases tried by the same judges," said Justice Minister Marcela Losardo.

ECONOMIC NEWS

Mexico's Economy Sees Record Drop, Shrinks 17.3% in Q2

Mexico's economy saw its steepest drop on record in the second quarter as lockdowns to contain the spread of coronavirus paralyzed factories and services, according to data released Thursday by the National Statistics Institute, The Wall Street Journal reported. Gross domestic product contracted 17.3 percent in seasonally adjusted terms from the first quarter and shrank 18.9 percent as compared to the same period a year earlier. Industrial production in the second quarter fell 23.6 percent from the first quarter, while services were down 14.5 percent. Agricultural production fell 2.5 percent. The government shut down activities deemed nonessential throughout April and May, causing the loss of millions of jobs. While gradual reopenings began last month, capacity restrictions have remained in place for most of the country. Mexico has reported more than 408,000 cases of the novel coronavirus, and it has more than 45,000 confirmed deaths. It has registered the fourth-highest number of coronavirus-related deaths worldwide, although analysts say the country's official figures might seriously underestimate the real toll due to a lack of widespread testing. On Wednesday, Gerardo Esquivel, deputy governor of Mexico's central bank, said the country's economy could contract between 8.5 percent and 10.5 percent this year, Reuters reported. "It wouldn't be until 2022 that we would expect to return to the production levels we had before the start of the pandemic," Esquivel said. [Editor's note: See related Q&A in the May 4 issue of the daily Latin America Advisor.]

> **"It wouldn't be until 2022 that we would expect to return to the production levels we had before the start of the pandemic."**
> **— Gerardo Esquivel**

Chile's Government Rules Out Privatizing State Miner Codelco

The Chilean government on Wednesday said privatizing state-owned mining giant Codelco, the number-one copper producer in the world, is not part of its agenda, following a proposal by a small group of lawmakers to sell it off to raise funds amid the economic fallout wrought by the coronavirus pandemic, Reuters reported. An internal document attributed to the far-right Independent Democratic Union party, leaked to Chilean media earlier this week, proposed selling Codelco among a series of measures to raise money to deal with the crisis. "Faced with the statements of some deputies who suggested the privatization of Codelco, I want to say emphatically that it is not part of the government program," Mining Minister Baldo Prokurica said Wednesday. "I totally rule out that there is an initiative in this matter," he added. Chile's chamber of Mines and unionized workers also expressed opposition to the lawmakers' proposal this week. "Codelco is Chile's most important company in terms of contribution to the government's coffers and the country's pride," Manuel Viera, president of the Chilean mining chamber, told local media, Mining.com reported. He said it was "inconceivable" and "irresponsible" to turn to the mining industry whenever the country faced a problem, adding that the sector should be seen as an engine of development, not a "milking cow." [Editor's note: See related Q&A in the May 26 issue of the daily Latin America Advisor.]

FEATURED Q&A / Continued from page 3

Petroleum Reserve. China has been storing low-cost crude at record rates for a number of months now, but a continued build up is unlikely, and China's domestic consumption alone won't sustain current demand."

A **W. Schreiner Parker, vice president for Latin America at Rystad Energy:** "In the first half of 2020, Brazil became a major point of focus for Asia crude buyers, with export volumes for the South American giant up 30 percent year-on-year to Asian markets. The rapid rise of Brazilian crude has displaced other Latin American producers, namely Venezuela and Mexico, whose export volumes to Asia are down 35 percent and almost 10 percent, respectively, in the same time period. Production volumes and security of supply are key to understanding this shift. Venezuelan volumes are down due to government mismanagement and natural decline. The country is now producing fewer than 400,000 barrels per day (bpd) of crude, a precipitous drop from the 2004 high of more than three million bpd. Mexican volumes are also in natural decline, with 50 percent of 2020 Mexican production coming from two mature assets, KMZ and Cantarell. Brazil has seen a rise in production, which is forecast to continue through the next decade, and the Asian market has taken notice. Covid also plays its part. Many Chinese refineries are full conversion refineries and are configured to run on heavy/medium sour. Something important to keep in mind in light of Covid is that lighter grades yield more jet fuel—a very unwanted fuel slate recently. China's refineries, especially teapots, were left scrambling for replacements of heavier crude because of falling production, and Brazil has proven to be an excellent replacement for Mexican and Venezuelan volumes. It remains to be seen if this is a structural or event-driven shift, but Brazil seems to be generally a more reliable long-term source of Latin American crude for the Asian market at this moment."

A **Chris Cote, senior analyst at ESAI Energy:** "Market forces, company strategy, a global regulation to make fuel cleaner and just plain good timing have helped Brazil win market share for China's crude oil imports. First, Brazil just has more supply to sell. New offshore production units ramped up in the second half of 2019 and, though capital intensive to build, they have competitive operating costs. China, as the world's largest buyer, is an obvious place to sell more crude. But Petrobras improved its position with two strategies targeting China. One is buying storage capacity in China—location, location, location. The other is the opportunity created by the new global sulfur cap for marine fuels—Chinese refiners have their own strategy to capture more of the Asian shipping fuel market, and Brazil's low-sulfur crude feeds into that plan well. China's appetite for Latin American crude oil is not zero-sum; the country will buy Venezuela's and Mexico's high-sulfur crudes if they are available and the price is right. And while crude trade flows from Brazil to China may remain comparatively muted for the rest of the year as Brazil deals with outbreaks among rig workers and volatile domestic crude demand, in the longer term they will only grow as Petrobras deepens its investment offshore and increases production."

Editor's note: Last week's edition of the Energy Advisor was revised to omit a commentary on page 3 attributed to Fernanda Delgado, which has been withdrawn. Please find a corrected edition **here**.

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 © 2020

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter & Associate Editor
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
ebrand@thedialogue.org

