FEATURED Q&A

Is Brazil’s Petrobras Finally Getting on a Firmer Footing?

Last week Petrobras, led by CEO Pedro Parente (C), pictured here in 2016, posted a $136 million loss for 2017, its smallest annual decline in the last four years. // File Photo: Government of Brazil.

Saddled with at least $85 billion in debt, Brazilian state oil company Petrobras faces a difficult path ahead, Fitch Ratings said last month, as it downgraded the company’s debt ratings further into junk territory, to BB- from BB.

Meanwhile, Geraldo Alckmin, the governor of São Paulo State and a presidential hopeful in this October’s national election, said last month he was open to privatizing Petrobras, which already has semi-public ownership aspects. What are the biggest challenges shaping the outlook for Petrobras? What does Petrobras have working in its favor? How well has the company dealt with a multi-year corruption scandal and related governance changes?

Larry B. Pascal, co-chair of the International Law Section of Haynes and Boone, and Andre Berzins, Rio de Janeiro-based attorney: “Petrobras faces a litany of challenges in its efforts to recover from numerous setbacks and obstacles, including billions in debt. Its lowered debt rating will mean higher borrowing costs. Although it has put in place an ambitious divestiture program, laid off thousands of employees and contractors totaling more than 185,000 workers, and recently settled a class-action suit in the United States for approximately $3 billion, it still faces numerous challenges. Its large layoffs have hurt worker morale, and the divestiture program has seen certain sales (such as the Liquigas sale) blocked by the local Brazilian competition authorities. Its international reputation has also been damaged by the Lava Jato scandal, although the company insists it was the victim of official corruption. However, it does retain important advan-

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Trump Bans U.S. Transactions With Venezuela’s ‘Petro’

U.S. President Donald Trump on Monday issued an executive order banning any transactions within the United States involving Venezuela’s new digital currency, the petro, CNBC reported. The order applies to U.S. citizens as well as anyone within the United States. Venezuelan President Nicolás Maduro lashed out at the declaration on state television, decrying Trump’s proclamation as “imperialist.” Venezuela launched its digital currency in February, claiming to have raised billions of dollars in cash through the natural resource-backed petro. The U.S. ban also applies to any transactions with state oil company PDVSA, the White House said in a statement. The sanctions came just two months before Maduro is scheduled to stand for re-election, although the main opposition coalition has boycotted the race. The United States is among the countries that have declared they will not recognize the results, The New York Times reported. Beyond the petro, local governments in Venezuela are seeking their own ways to work around the economic crisis. This month Elorza, a western town near the border with Colombia, began issuing its own currency in a bid to get around the effects of hyper-inflation and a shortage of paper bills, Reuters reported. The currency, called the “Elorzas,” is being sold by local officials to ensure that tourists and residents in the city of 26,000 inhabitants can make transactions, said Mayor Solfreddy Solorzano, a member of the ruling Socialist Party. The mayor’s office receives bolívars by bank transfer or debit card payment and, after taking an 8 percent commission, gives “Elorzas” in exchange, which can be used locally for purchases. Meanwhile, Maduro this week met with Prime Minister Gaston Browne of Antigua and Barbuda to announce that the Venezuelan government will write off half of its $139 million debt with the country stemming from the PetroCaribe program.

Mexican Regulator Calls for Pemex Stock Listing

The head of Mexico’s National Hydrocarbons Commission, CNH, on Wednesday urged the government to float a minority stake in national oil and gas company Pemex on the stock exchange in Mexico, Reuters reported. “Make a constitutional reform. Establish... that Pemex will remain under state control and the majority of the shares will remain under state control. But allow Pemex to place shares in the market and raise capital,” Juan Carlos Zepeda told Reuters during an interview in London. “There is no other alternative to make Pemex successful,” he added. Zepeda’s comments come as the debate over the future of Pemex heats up and presidential hopefuls jockey for position ahead of the July 1 election. The current front-runner in polls, leftist Andrés Manuel López Obrador, known as AMLO, said on Sunday that if he wins the election, he will ask President Enrique Peña Nieto to stop at least two energy auctions scheduled to take place before the new president takes office. “I’m going to ask ... that he doesn’t hand out any more oil blocks, neither onshore or shallow waters, and that he puts a stop to the privatization of oil and electricity sectors,” López Obrador said. While AMLO’s lead in polls may not be enough to ensure his victory on July 1, it is “wide enough that markets should begin to take notice,” Pamela Starr of Monarch Global Strategies told the Advisor last month. [Editor’s note: See Q&A on what an AMLO presidency would mean for Mexico in the Feb. 22 edition of the daily Advisor.]
Japan’s Inpex Ends Dispute in Ecuador for $319 Million

Japan-based oil company Inpex said Tuesday that it had reached an agreement with Ecuador to receive about $319 million in compensation for the termination of contracts related to block 18, Platts reported. Inpex will receive the payments in installments before the end of this year. The block 18 contracts were terminated in 2010 after its subsidiary, Teikoku Oil Ecuador, and its joint partners failed to reach an agreement with Ecuador’s government following a policy change. Ecuador’s government under leftist former President Rafael Correa unilaterally altered the framework of block tracts from a concession, which Inpex acquired in 2008, to a service contract. Inpex is Japan’s largest exploration and production company, with operations in 20 countries. Earlier this month, Ecuador launched a bidding round for foreign companies to develop oil and gas reserves, hoping to attract some $800 million in investment. Rising global prices for hydrocarbons could help fuel interest from international investors in the auction, which is expected to be completed in June, Reuters reported.

Petrobras Posts Smallest Loss in Four Years

Heavily indebted Brazilian state oil company Petrobras last week posted a loss of 446 million reais ($136 million) for 2017, its smallest in the last four years. The company would have made net earnings $2.16 billion, but one-off expenses, in particular a more than $3 billion deal to end a class action filed by investors in the United States, as well as participation in federal tax settlement programs, consumed all profits for the year. Operating income improved due to a 10 percent reduction in manageable operating costs and a 24 percent increase in the price of oil in international markets. “We are on a consistent trajectory of recovery, doing exactly what we set out in our business plan,” said Petrobras’ CEO, Pedro Parente. “The biggest impacts on our 2017 financial statements were non-recurring expenses that have reduced uncertainties and risks in relation to the company’s future.” The company reduced its net debt to $85 billion, the lowest figure since 2012. On Tuesday, Petrobras reported that its total oil and natural gas production in February fell 1 percent compared to January, to 2.69 million barrels of oil equivalent per day. Parente took over the chief executive job in 2016 from Aldemir Bendine, who on March 7 was sentenced to 11 years in prison on corruption charges. Earlier this month, Brazilian presidential hopeful Geraldo Alckmin of the centrist Brazilian Social Democracy Party, or PSDB, said that he would favor privatizing Petrobras if he is elected, Globo reported. “It is necessary to discuss the model” of the business, he told a local radio program. The current governor of São Paulo State, Alckmin has been polling in the single digits, however, and none of the other potential leading candidates has come out in favor of privatization.

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Unconventional Oil & Gas in Argentina

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Principal, Arthur D. Little

Michael Camilleri
Director, Peter D. Bell Rule of Law Program, Inter-American Dialogue

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This event will be in Spanish. Simultaneous translation in English will be provided.

To register, click here.
Peru’s Kuczynski Offers Resignation

Peruvian President Pedro Pablo Kuczynski offered his resignation on Wednesday, a day after the main opposition party released secretly recorded videos that apparently show supporters offering a lawmaker public-works projects in exchange for his loyalty in funding off an impeachment attempt against Kuczynski in December. The president’s announcement that he would step down came ahead of a scheduled session of Congress for Kuczynski, who has been facing impeachment, to answer allegations that his consulting company accepted $782,000 in payments from scandal-plagued Brazilian construction conglomerate Odebrecht a decade ago. At that session, lawmakers had been expected to vote on whether to remove him from office. Kuczynski has consistently denied wrongdoing, including in his announcement Wednesday that he was stepping down. “This has created enormous damage for the country,” Kuczynski said in his televised speech, The Wall Street Journal reported. “For the good of the country, I’m resigning as the president of the republic.”

Lawmakers could accept Kuczynski’s resignation, or they could proceed with the planned impeachment proceedings and remove him from office, La República reported. Kuczynski said there would be an orderly transition of power, with Vice President Martín Vizcarra, who is also Peru’s ambassador to Canada, becoming president. In a posting on Twitter, Vizcarra said he was returning to Peru. “I am outraged by the current situation, like most Peruvians,” Vizcarra said on Twitter.

Can Argentina Replicate the Shale Gas Boom in the United States?

Led by CEO Miguel Galuccio, Mexico City-based Vista Oil & Gas last month announced it will spend at least $700 million to acquire assets that will make it the fifth-largest oil producer in Argentina, with rights to develop vast swaths of acreage in the country’s resource-rich Vaca Muerta shale deposit. Galuccio is the former head of Argentine state oil company YPF, a job he took in 2012 after the government of Cristina Fernández de Kirchner expropriated the company from Spain’s Repsol. How attractive is Argentina for oil and gas investors today? What factors are most shaping the future of Argentina’s oil and gas production? Will business-friendly policies toward the energy sector that were put in place under the current government of President Mauricio Macri stay in place in subsequent administrations?

Isabella Alcañiz, associate professor in the Department of Government and Politics at the University of Maryland: “Mauricio Macri would like to emulate the recent shale gas boom in the United States. Given that Vaca Muerta is the world’s second-largest reserve of shale gas and contains significant oil reserves as well, Argentina remains attractive for energy investors. Recently, the sector received a boost because of a significant drop in drilling costs, greatly resulting from an agreement between President Macri and oil unions. Yet, protests by indigenous activists against increased gas and oil investments in Vaca Muerta have been on the rise since mid-2017. Already, these protests have resulted in the disappearance and death of one demonstrator. Still, investments in the area continue to go up, indicating that lower production costs and the promise of gaining access to massive reserves are overriding investors’ possible concerns over social conflict. The next presidential election in 2019 is still more than a year away. If the ruling Cambiemos party remains in power, we should expect business-friendly policies to remain as well. But the reality is that all future administrations will face strong incentives to seek investments in the sector, and specifically for Vaca Muerta, given its size. If international oil prices continue to recover, we should expect even a Peronist government to offer benefits to energy corporations willing to invest in Argentina, such as the agreement between Chevron and YPF under President Cristina Kirchner.”

But I have the conviction that together we will demonstrate once again that we can move forward.” Kuczynski claimed the recordings that the Popular Force party released had been edited in a “selectively biased way that gave the impression that the government was offering public works in exchange for votes,” The New York Times reported. Some lawmakers said they were angered that Kuczynski did not apologize in his resignation speech. “We hoped that his resignation letter would have at least some self-criticism of the mistakes and crimes he may have committed,” said Broad Front leader Marco Arana. “Instead, he just plays the victim in his letter and doesn’t admit anything.”

A former Wall Street banker, Kuczynski was inaugurated in July 2016, spending a year and eight months as president.
**NEWS BRIEFS**

**Ecuadorian President Sending 12,000 Troops to Colombian Border**

Ecuadorian President Lenin Moreno said Wednesday he is sending 12,000 troops to the border with Colombia to bolster security, the Associated Press reported. Authorities say a guerrilla faction that was once linked to the Revolutionary Armed Forces of Colombia rebel group killed three soldiers and wounded seven others on Tuesday near Mataje in Esmeraldas province, where a military patrol detonated an explosive device. The incident marked the sixth in the area since January, El Comercio reported. Officials say the rebels are now involved with drug trafficking.

**Argentina's Economy Grows 3.9 Percent in Q4**

Argentina’s gross domestic product grew by 3.9 percent in the fourth quarter of 2017 as compared to the same period the prior year, state statistics agency INDEC said Wednesday. The rate of growth was higher than market expectations. “Domestic demand grew at a visibly higher rate than overall GDP,” Goldman Sachs analyst Alberto Ramos told clients in a research note. INDEC also released data Wednesday showing that the trade balance posted a large $903 million deficit in February.

**Guatemala Removes Investigators From Anti-Graft Panel**

Guatemala’s government has removed 11 police investigators working with a panel tasked with uncovering graft, the Associated Press reported Tuesday. The United Nations’ anti-corruption commission chief in Guatemala, Iván Velásquez, who has been at odds with the government of President Jimmy Morales, told journalists that the aim of their removal was “to affect the investigations” that have targeted politicians and their relatives.

**Former Mexican First Lady Cleared to Run for President**

Former first lady Margarita Zavala had secured the needed number of signatures to run as an independent candidate in the country’s July presidential election, Mexican election officials said Friday, The New York Times reported. The wife of former President Felipe Calderón, who governed from 2006 to 2012, Zavala, a conservative, would become the first independent candidate to run for president of Mexico after election laws were changed in 2012. Authorities were unable to verify more than three million signatures on the petitions of left-leaning senator Armando Rios Piter and former Governor Jaime Rodríguez of Nuevo León state, leaving them off the ballot. Both have said they will appeal the signature count. Political analysts predict that Zavala’s candidacy could split right-of-center voters within her former National Action Party, or PAN, whose candidate is Ricardo Anaya. That would likely benefit the current frontrunner in the polls, Andres Manuel López Obrador. The exclusion of Rios Piter could also boost López Obrador. “The fact that a left-leaning candidate like Rios Piter isn’t on the list anymore favors López Obrador without a doubt,” Jesús Cantú, a political scientist at the Tecnológico de Monterrey, told Bloomberg News. Formal campaigning for the July 1 election begins in two weeks.

**Brazilian Central Bank Cuts Rates to All-Time Low**

Brazil’s central bank on Wednesday cut its benchmark interest rate to an all-time low, O Estado de S.Paulo reported. The central bank’s nine-member monetary policy committee lowered the Selic rate by 25 basis points to 6.5 percent. The reduction marked a lowering of 775 basis points the key rate since October 2016, Reuters reported. At the same time, policymakers said they would likely cut the rate again at their May meeting amid low concerns about increasing inflation. The reduction had been widely expected, though most analysts in a recent poll by the wire service thought this cut would be the final one in the bank’s largest loosening cycle in a decade. However, the central bank was explicit in forecasting another cut, saying inflation undershot its target last year for the first time ever.

**Mexican Auditors Open Investigation of Pension Fund**

Mexican federal auditors have opened a probe into Issste, the government workers’ pension fund, Reuters reported on Wednesday. The investigation follows a report by the wire service that revealed the fund had invested more than $20 million in construction firm ICA just before it declared bankruptcy in 2015. According to the report, ICA suspended debt payments just after the purchases. Issste lost most of the investment to a financial restructuring. The news set off widespread anger in Mexico and triggered calls for a public inquiry. “It’s not normal. They invested in a company that was clearly in a situation that put workers savings at risk,” said Araceli Damian, who chairs the Social Security Committee in Mexico’s lower chamber of deputies. In a video posted to Twitter on Wednesday, Issste said it was cooperating with the investigation. The agency, which oversees the fund PensionIssste, has denied that the investments have anything to do with corruption, saying that they made them under the impression the company was not going bankrupt, Reuters reported. Issste triggered the investigation internally, though it will be carried out by employees of the Public Administration Ministry. Pensions regulator Consar evaluated the transactions and said Issste did not violate existing rules. Corruption and mismanagement of public funds have been major themes in Mexico’s presidential race this year, according to El Sol de México.
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tages. It has seen four years of increased production. Moreover, the government has adopted rules to make its operations more flexible, including Decree No. 9,041/2017 which has granted it more flexibility for its participation in the pre-salt area, as well as new rules designed to enhance transparency in procurement. It recently won various new fields as part of the most recent upstream bid round. It remains a dominant actor in the Brazilian market and holds many valuable assets including the deep-water pre-salt fields. Petrobras has ample challenges as it works to restore its financial and operational luster that it previously enjoyed.

Francisco Ebeling Barros, independent Rio de Janeiro-based energy consultant: “Fitch’s downgrade of Petrobras was indeed a big blow for a company that is attempting to re-couple with financial markets. In January, Petrobras agreed to settle a U.S. class-action corruption lawsuit for $2.95 billion, a sum that actually was more than Brazilian courts claimed that the Car Wash corruption scandal had cost the company. With Fitch’s downgrade, Petrobras is learning the hard way that regaining the markets’ trust in order to reduce its debt (such as through capitalizing itself) is much more complicated than it had initially expected. What does Fitch downgrade show us? King oil is not dead, and it will not be dead for many decades to come. Also, the ratings agency is signaling to investors, with all other things held constant, that the companies that succeeded in the second and third pre-salt bidding rounds—such as Statoil and Shell—are also strong competitors for investors’ attention. It also shows that markets want the whole package, and this probably includes the companies’ privatization. It is possible that, by following that line, Petrobras will markedly improve its financial situation. It is an established fact in the petroleum industry that state oil companies and private companies are opposites when one compares financial performance with developmental goals. It is difficult to have both. Thus, if Petrobras follows the path that markets expect it to follow, its social and economic influence in Brazil’s economy will be substantially lower.”

Jeremy Martin, vice president for energy and sustainability at the Institute of the Americas: “It remains to be seen if God is Brazilian, and with Neymar’s latest injury, predict a Brazil World Cup victory at your own peril. But what does seem to be humming along is Brazil’s oil sector and Petrobras’ recovery. It clearly is not back to the Petrobras of the heady early pre-salt days, but the company deserves some of the more positive plaudits it has garnered of late. Long linked to the horrific corruption wracking Brazil, the company and its current leadership have staked out a strategic plan that confronts its debt challenges, liquidity issues and a needed reset in terms of its procurement, as well as cost-reduction efforts. Despite its credit downgrade, some of its international debt offerings have been oversubscribed. Indeed, several market analysts have begun to highlight the company’s upside. In addition to navigating the company through the detritus and out of the ashes that is the Car Wash scandal, Petrobras has increasingly been able to ride the tailwinds derived from a global oil price rally. But Petrobras would not be able to take advantage of the price rally as consequentially if the pre-salt geology had not begun to prove itself so prolific. Brazil’s pre-salt wells are pumping more than 1.7 million barrels of oil equivalent per day. Moreover, one of Petrobras’ signature partnerships and projects in the pre-salt, the Libra field, has declared a breakeven price of $35 with the company’s CEO arguing that its cost reduction plans will reap a $29 breakeven price. For those arguing that is wishful thinking, it bears noting that Shell, another major producer in Brazil to the tune of some 300,000 barrels per day, has said it is confident that it can meet a breakeven price target of $40 in the pre-salt.”

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