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FEATURED Q&A

How Will New IMO Rules Transform Oil Market Dynamics?

The International Maritime Organization's new rules ban ships from using fuels with higher sulfur contents. // File Photo: International Maritime Organization.

Q New rules established by the U.N. International Maritime Organization, or IMO, that mandate ships to use fuel with less sulfur are set to come into effect on Jan. 1, 2020. The IMO regulations ban ships from using fuels with a sulfur content above 0.5 percent, compared with 3.5 percent currently, in an attempt to improve human health by reducing air pollution. What implications do the new regulations have for the global fuel market? How will the tougher rules affect Latin America's fuel production, and which countries are set to gain or lose the most? How are governments and companies in the region preparing for the change, and what else should they do in anticipation of the new rules? Will the IMO regulations have the desired results?

A Jorge León, member of the Energy Advisor board and energy economist at BP: "On Jan. 1, 2020, the International Maritime Organization's (IMO) new regulation limiting the sulphur content of marine fuels to 0.5 percent comes into effect. The fact that the current limit is 3.5 percent gives a sense of the magnitude and importance of this regulatory change. According to the U.S. Energy Information Administration, global bunker fuel demand in 2018 averaged 4.3 million barrels per day (bpd)—more than 4 percent of global oil demand. High-sulphur fuel, which is not compliant with the new regulations, accounts for almost 80 percent of the total sectoral demand. To comply, ship operations have two options: to invest and install exhaust gas cleaning systems known as scrubbers in order to continue using high-sulphur fuel or to switch to more expensive low-sulphur fuels. While a couple of

Continued on page 3

TOP NEWS

OIL & GAS

Qatar Petroleum Buying Stake in Guyanese Blocks

Qatar Petroleum reached a deal with Total to acquire a stake in two oil and gas blocks offshore Guyana.

Page 2

OIL & GAS

U.S. Extends Chevron's License in Venezuela

The Trump administration extended a license allowing Chevron and several other oil field services companies to remain in Venezuela despite sanctions against state oil company PDVSA.

Page 2

RENEWABLES

Brazil, Paraguay Scrap Energy Deal Amid Controversy

The two countries on Wednesday scrapped an energy agreement they had secretly signed in relation with the Itaipú hydroelectric plant at their shared border. The deal sparked controversy when it was made public last week, leading to the resignation of Foreign Minister Luis Castiglioni.

Page 2

Castiglioni // File Photo: Paraguayan Government.

RENEWABLES NEWS

Brazil, Paraguay Cancel Energy Deal Amid Controversy

Paraguay and Brazil on Wednesday scrapped an energy deal they had secretly signed that has sparked controversy and a legal process against Paraguayan President Mario Abdo Benítez, ABC Color reported. Brazilian Ambassador to Paraguay Carlos Simas Magalhães on Wednesday signed a document that effectively nullifies the energy agreement related to the Itaipú hydroelectric plant at the two countries' border. The deal, which was reached secretly in May and made public just last week, established a timeline for the purchase of energy from the power plant until 2022, Reuters reported. Paraguayan lawmakers and officials said the agreement would be detrimental to Paraguay and cost the country some $200 million, prompting a public outcry that led to the resignation of several Paraguayan officials, including Foreign Minister Luis Castiglioni and Paraguay's ambassador to Brazil, Hugo Saguier. Alcides Jiménez, who had just taken over as head of state power company ANDE and José Alderete, the Paraguayan director of Itaipú, also resigned. The previous head of ANDE, Pedro Ferreira, also quit last week after refusing to sign the agreement, saying it would substantially increase costs for the state entity. Opposition lawmakers have argued that the deal violates the country's sovereignty, Reuters reported. Paraguay and Brazil are preparing for talks to negotiate Itaipú's future ahead of the 2023 expiration of one of the key annexes to the plant's founding treaty.

Ecuador in Search of Private Investment for PV, Wind Projects

Ecuador's government is looking for $400 million in private investments for renewable energy projects as part of a broader plan to change country's energy matrix, Energy and Non-Renewable Resources Minister Carlos Pérez said Tuesday, EFE reported. The government will award concession contracts to private firms to build a photovoltaic plant in El Aromo and stages II and III of the Villonaco wind farm, the first two large-scale projects in the Andean country, Pérez said, Reuters reported. The El Aromo plant would have an installed capacity of 200 megawatts and would help reduce some 128,000 tons of carbon dioxide per year, while Villonaco's capacity would be 110 megawatts and would mean a reduction of 219,870 tons of carbon dioxide per year, EV Wind reported. The two renewable energy projects are part of President Lenín Moreno's efforts to attract more than $6 billion to construct new power plants for both domestic demand and exports to neighboring countries, according to the report. The selection process for the private operator will open by the end of August, and several companies in Germany, Canada, Denmark, China and Japan, among others, have expressed interest in participating, Pérez said. "We mark a milestone by launching two nonconventional renewable energy projects that do not exist in Ecuador today," Pérez said, Reuters reported.

OIL AND GAS NEWS

U.S. Extends Chevron's License to Operate in Venezuela

The administration of U.S. President Donald Trump on July 26 extended a license allowing Chevron and several other oil field services companies to remain in Venezuela, The Wall Street Journal reported. The license would have expired on Saturday, a deadline that sparked debate within the administration over whether to extend it, according to unnamed sources familiar with the matter. Some U.S. officials argued that shutting down Chevron's Venezuela units was a crucial step in the administration's efforts to pressure Venezuelan President Nicolás Maduro to step down, while others believed the company's departure would

NEWS BRIEFS

U.S. Court Rules in Favor of Seizing Citgo Assets

A U.S. appeals court on Monday ruled that defunct Canadian gold miner Crystallex could seize U.S.-based stock of Citgo, Venezuelan state oil company PDVSA's U.S. refiner, to cover $1.4 billion of unpaid debt in relation to the South American country's nationalization of gold fields, Bloomberg News reported. Cash-strapped Venezuela could lose control of Citgo as a result. Opposition leader Juan Guaidó, who is battling President Nicolás Maduro for control of Venezuelan assets including Citgo, has asked U.S. President Donald Trump to bar creditors from seizing the assets.

Unknown Attackers Set Fire to Oil Storage Pools in Colombia: Ecopetrol

A "deliberate" fire at an oil services storage facility in Colombia's eastern Arauca Department set ablaze storage pools containing some 2,600 barrels of crude, Colombian state-run oil company Ecopetrol said Monday, Reuters reported. A blockade in the area prevented firefighters and technical staff from accessing the facility, putting local communities and workers at risk, according to the statement. Ecopetrol did not identify who reportedly started the fire nor why.

Qatar Petroleum Buying Stake in Guyanese Blocks

Qatar Petroleum has reached a deal with French oil company Total to acquire a stake in two oil and gas blocks offshore Guyana, the Qatari firm said Monday, Reuters reported. Qatar Petroleum said it will buy 40 percent of Total's 25 percent participating interest in the Orinduik block, as well as a 40 percent of Total's 25 percent participating interest in the Kanuku block. Tullow Oil holds 60 percent participating interest in the blocks, and EcoAtlantic has a 15 percent interest.

put U.S. energy companies at a disadvantage and pave the way for a greater role for Chinese and Russian operators in the South American country, the newspaper reported. The license renewal allows Chevron to remain in Venezuela, where it has operated for nearly a century, until Oct. 25, when it could be further extended. Chevron had pushed for the extension. "We are a constructive presence in the country," spokesman Ray Fohr said earlier last week, adding on Friday that its Venezuela operations "continue in compliance with all applicable laws and regulations." The U.S. company's share of production in Venezuela was 44,000 barrels of oil and gas a day last year, less than 2 percent of its global output total. Chevron and other U.S. firms' departure from Venezuela could have worsened an already declining production trend in the country, Francisco Monaldi, a fellow in Latin America energy policy at Rice University's Baker Institute, told the Energy Advisor. [Editor's note: See related Q&A in last week's issue of the Energy Advisor.]

Petrobras Cuts 2019 Production Targets For Transparency

Brazilian state oil company Petrobras has cut its 2019 production target, prompting its shares to fall over concerns about how quickly it will be able to accelerate production, Reuters reported July 26. Petrobras had previously forecast its output this year would grow to 2.80 million barrels of oil equivalent per day (boepd) but is now expecting production to average 2.70 million boepd, in line with 2018. "Petrobras has a history of promising and not delivering, and that's why I made a point of lowering the target and setting a more realistic one," Petrobras Chief Executive Officer Roberto Castello Branco told Reuters. "Transparency is always better." Along with the target cuts, Petrobras said in a securities filing that oil and gas production in the second quarter rose 3.8 percent as compared to the previous quarter, to 2.63 million boepd. The increase did not meet investors' expectations, sending Petrobras' São Paulo-listed preferred shares down 2.5 percent on the announcement, Valor Econômico reported. While the news brings "some downside risks to our 2019 estimates due to the delay in ramp up of production in some platforms in Buzios fields, such delays will likely not change the production outlook for 2020," Goldman Sachs analysts wrote in a note, adding that the positive view on the stock remains in place, Reuters reported. Castello Branco said Petrobras' pre-salt area as the company's main growth play, saying more than 60 percent of production this year will likely come from pre-salt.

POWER SECTOR NEWS

IEnova Expects to Close Negotiations With CFE This Year

The Mexican subsidiary of Sempra Energy, IEnova, expects renegotiations over disputed natural gas pipeline contract terms with Mexican state power company CFE to finish by the end

FEATURED Q&A / Continued from page 1

years ago the industry view was that the new IMO regulations were going to pose massive challenges, as the implementation date approaches, it is increasingly clear that the industry will manage to weather the storm. However, it is not going to be a smooth ride. One interesting impact of the IMO regulations is that high-sulphur fuels will be priced at a discount, prompting its use in the power-generation sector and therefore temporarily boosting global oil demand in 2020. For Latin America producers, the new IMO regulations will pose some challenges. Crude production in Ecuador, Colombia, Venezuela, Mexico and part of Brazil tends to be sour (higher concentration of sulphur). It is expected that the price differential between sweet crude oil and sour crude oil will widen."

A **Lisa Viscidi, director, and Sarah Phillips, assistant, in the Energy, Climate Change & Extractive Industries program at the Inter-American Dialogue:** "The IMO's sulfur cap will have far-reaching effects on the global economy. For the global fuel market, this means we will likely see a drop in the price of high-sulfur fuel oil and an increase in the cost of low-sulfur fuels, as demand skyrockets. Because Latin America mostly exports high-sulfur fuel, countries with major refining systems, such as Mexico and Venezuela (the region's first and second-largest fuel oil producers, respectively), will be hit hardest. Both countries produce sour crude, which has a sulfur content of 0.5 percent or higher, requiring a more complex refining process to meet the new standards. Therefore, as demand weakens for high-sulfur fuel, companies such as Pemex and PDVSA will not only see a drop in the price of their exports, but they will also pay more for imports of low-sulfur fuels such as diesel. In Mexico, 30 percent of the total refining output is high-sulfur fuel oil, and the country depends on low-sulfur imports to meet 80 percent of fuel demand. PDVSA's refinery throughout has dropped to only 16 percent amid a lack of investment, but the IMO rules have long-term implications for the company, even if it can revive its refining system. Brazil, however, is the exception, set to benefit from the regulations. As Brazil is one of the few countries in the region that already exports fuel in compliance with IMO regulations, an increase in low-sulfur fuel demand will boost Petrobras' margins. Some nationally owned companies, such as Pemex, have already been trying to mitigate the potential results ahead of the new regulation's implementation. The Mexican Petroleum Institute is developing catalytic

"The IMO's sulfur cap will have far-reaching effects on the global economy."
— Lisa Viscidi and Sarah Phillips

Continued on page 6

of this year, IEnova said last week, Argus Media reported. "The government has clearly stated that they want to reach an agreement soon, and so do we," Tania Ortiz, IEnova's general director, said during the company's first-quarter earnings call. "I would not see this dragging into next year," she added. The government of President Andrés Manuel López Obrador recently called for the renegotiation of seven natural gas pipeline contracts with four different companies, after having requested arbitration to annul force majeure provisions in the contracts in June, The Wall Street Journal reported. IEnova has five natural gas transport contracts via pipeline with CFEnergía, the power company's natural gas trading unit, one of which is for a $2.5 billion undersea natural gas pipeline project that runs from Brownsville in South Texas to the Mexican port of Tuxpan. The Mexican government has objected to the force majeure payments it must make on pipelines that have been delayed and are not yet delivering fuel for different reasons, including conflicts with local communities. López Obrador has called the contracts "unfair" and argues they favor private operations at the expense of the CFE, The Wall Street Journal reported. "While the desire to use more domestic resources and save money is understandable, we see very little chance for success if the case is taken to arbitration," Pedro Niembro, senior director at Monarch Global Strategies, told the Energy Advisor last month. "It would appear that the López Obrador administration may have belatedly recognized this as well, having announced a last-minute effort to establish informal negotiations among the affected contractors," he added. [Editor's note: See related Q&A in the July 19 issue of the Energy Advisor.]

ADVISOR Q&A

What Factors Are Weighing on Mexico's Economy?

Q **Mexico's industrial output declined 2.1 percent in May as compared to April, the country's National Statistics Institute said July 12. The sharpest drop in industrial output in a decade, the statistic was among recent data that suggest the country's economy slipped into a recession in the second quarter, following a 0.2 percent contraction in the first three months of the year. What factors are most weighing on Mexico's economy? What does Mexico need in order to return the country to growth? How well is President Andrés Manuel López Obrador managing the economy, and how would a recession affect his agenda?**

A **Charles Seville, senior director for Americas sovereigns at Fitch Ratings:** "Mexico's overall output has stalled, as shown by the economic activity indicator for May. As ever, the data present a mixed picture. Households are continuing to spend, and manufacturing and exports (7 percent higher year-on-year in May) are holding up. U.S. growth remains supportive. Investment is the main weak spot. Part of this may relate to global trade uncertainty, but domestic policy considerations are also weighing on sentiment. Business confidence is still in positive territory but has weakened. Microeconomic policy interventions by the government have increased uncertainty in some areas. Actions to tackle some of the weaknesses in Mexico's business environment and reduce corruption will take time to pay off. Moreover, monetary and fiscal policy are also tight. Real interest rates are among the highest in the region, yet core inflation is still higher than the central bank would like. Lower government spending is subtracting from activity. We expect this effect—typical of the first year of a presidential term—to fade. Public investment has been cut over successive years, but higher investment, not to mention some proposed programs, will be difficult to accommodate within the current fiscal framework. Pemex will receive more resources to carry out a revised business plan. The company announced that it had stabilized crude production in the second quarter, although we think it's too early to celebrate. A still relatively new administration faces a classic trade-off between maintaining the confidence of investors in the policy framework and supporting the economy. So far, it has chosen the former. Meeting the fiscal target of a 1 percent of GDP non-financial public sector primary surplus is within reach in 2019, but meeting a higher target in 2020 may prove challenging. We expect Banco de México will cautiously start cutting rates this year, helped by a more dovish global rates picture."

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

POLITICAL NEWS

U.S. DHS Chief Meets With Guatemalan Officials

The acting secretary of the U.S. Department of Homeland Security met Wednesday with Guatemalan officials to discuss the details of the "safe third country" agreement that representatives from the two nations signed last week, the Associated Press reported. According to the Guatemalan government, the agenda for Acting Secretary Kevin McAleenan's visit to Guatemala City included a meeting with the Central American country's interior minister, Enrique Degenhart, who signed the controversial deal last Friday at the White House. "Looking forward to working to expand the partnership between Guatemala and the U.S. to stem the flow of illegal migration and

NEWS BRIEFS

Brazil, U.S. in Talks Over Trade Deal: Economy Minister

Negotiations over a trade deal between Brazil and the United States, the two largest economies in the Americas, are officially underway, Brazilian Economy Minister Paulo Guedes said Wednesday following a meeting in Brasília with U.S. Commerce Secretary Wilbur Ross, The Wall Street Journal reported. Ross also met with Brazilian President Jair Bolsonaro, whose administration is reversing policies that have traditionally kept Brazil's economy closed. Guedes said many sticking points remain to be discussed regarding a potential bilateral agreement with the United States, including on products such as ethanol.

Amazon Eyes Argentina as Possible Site for Data Hub: Former U.S. Ambassador

Amazon is considering the construction of a huge data center in Argentina, its largest in Latin America, former U.S. Ambassador to Argentina Noah Mamet told the Buenos Aires Times in an interview published Wednesday. The U.S. tech giant will be making a decision in the next six months to a year, Mamet said, adding that he has been collaborating with several U.S. firms, including Amazon, to explore investment opportunities in the South American country. Amazon is also reportedly considering Chile for its data hub.

Brazil's Central Bank Cuts Interest Rates for First Time Since Last Year

Brazil's central bank on Wednesday cut the country's benchmark Selic interest rate by a half percentage point, to 6 percent, the Financial Times reported. The reduction was the first since March 2018. Economists have repeatedly lowered their economic growth forecasts for Brazil.

disrupt human smuggling and transnational criminal organizations," McAleenan said in a tweet. The meetings in Guatemala came a week and a half ahead of the second round of the country's presidential election. Presidential candidate Sandra Torres and her opponent, Alejandro Giammattei, were also reportedly scheduled to meet separately with McAleenan. Guatemala's Constitutional Court last month barred President Jimmy Morales' government from signing the "safe third country" deal with the United States, but Morales' government ignored the ruling and signed it anyway. The deal would require many of the Central American immigrants passing through Guatemala to apply for asylum there instead of continuing to the United States. Torres has said Morales' government should not have agreed to the deal, since the current president is due to leave office in January. Additionally, Torres said Guatemala lacks the resources to care for its own people, "much less to have foreigners here and attend to them." For his part, Giammattei said the deal will be difficult for Guatemala to fulfill, adding that Guatemala's Congress should have been consulted about it. However, U.S. Ambassador to Guatemala Luis E. Arreaga called the agreement "a bold new approach to reduce irregular immigration." He added, "The status quo is not sustainable. Guatemalan children and families have fallen victim to a dangerous cycle of human smuggling that puts the most vulnerable populations at risk. This, in turn, is tearing at the fabric of local Guatemalan communities." Contingent on Trump's approval, with the deal going forward, Guatemala could see "increased overseas private investment, U.S. development assistance and additional U.S. investment," said Arreaga. Morales' government signed the deal after U.S. President Donald Trump accused Guatemalan officials of going back on their word to agree to it and threatened to impose tariffs and other penalties on the Central American nation. Economic analyst Hugo Maúl attended one of the meetings with McAleenan Wednesday in Guatemala City and said the discussion included the scope of the deal. "In general terms, Guatemala's institutional weakness was recognized, as well as the problems we already have with corruption, drug trafficking and economic stagnation," said Maúl, the AP reported.

ECONOMIC NEWS

Mexico's Economy Ekes Out Small Gain in Second Quarter

Mexico's economy grew modestly in the second quarter, as compared to a contraction in the previous three-month period, with a gain in services offsetting stagnant industrial production and lower agricultural output, the National Statistics Institute said Wednesday, The Wall Street Journal reported. GDP rose 0.1 percent in seasonally adjusted terms in the April-June period, as compared to a 0.2 percent contraction in the previous quarter. Services increased 0.2 percent, while industrial production was

> **It's the same broad picture of economic stagnation."**
>
> **— Alberto Ramos**

flat and agricultural production dropped 3.4 percent from the first quarter. While it avoided falling into a technical recession, which is defined as two consecutive quarters of economic contraction, Mexico's economy increased just 0.2 percent in the first six months of this year, as compared with the first half of last year. "We know the economy is going well, and that the country is well," President Andrés Manuel López Obrador said after the figures were made public, El Universal reported. But many economists don't share such a rosy outlook. "Over the last weeks, that's all the market has been talking about," Goldman Sachs' Latin America economist Alberto Ramos told The Wall Street Journal, referring to recession forecasts. "But whether the number is slightly negative or slightly positive, it's the same broad picture of economic stagnation." The economy was growing at about 2 percent, and now it's not growing, Ramos added. Many analysts have lowered their forecasts for Mexico's economic growth this year, down to less than 1 percent from 2 percent in 2018, according to The Wall Street Journal.

FEATURED Q&A / Continued from page 3

units, which process heavy crude into more valuable, lighter oil products."

A **Remi Piet, senior director of Infrastructure, Energy & Natural Resources at Americas Market Intelligence:** "The new regulations from the International Maritime Organization were needed, as each container ship is estimated to produce the same amount of pollution as 50 million cars. The decision will increase the demand for low sulfur oil and diesel, leading to a surge of prices for both fuels and a sharp decline in the demand for traditional bunker oil to comply with lower sulfur requirements. Mexico, Ecuador and Venezuela—Latin American countries that mostly export high-sulfur fuel oil and import gasoline and diesel—are likely to be the most negatively affected by this shift. Unlike North America or Europe, most refiners in Latin America have not yet invested in sulfur reduction capabilities, putting them at a disadvantage to comply with the new regulations. Moreover, since most Latin American countries subsidize their gasoline and diesel, these new regulations will deepen budget deficits if national governments decide to maintain their incentives without passing the additional costs to the maritime sector. Reducing subsidies would lead to union protests and an additional strain on already fragile companies. Enforcement of the new regulation is the responsibility of each country, leaving the possibility open for disobedience among historically rule-breaking regions such as Latin America and Africa. Flag states, the top three of which are Panama, Liberia and the Marshall Islands, are unlikely to have the capacity or the will to carry out inspections. Nevertheless, optimistic projections expect 100 percent compliance by 2025, mainly because of large fines looming as a threat."

> **"Mexico, Ecuador and Venezuela ... are likely to be the most negatively affected by this shift."**
> **— Remi Piet**

A **Chris Cote, analyst at ESAI Energy:** "The new IMO sulfur cap will drive a tremendous shift in global shipping demand away from high-sulfur fuel oil toward cleaner fuels, primarily diesel. As a result, diesel prices will rise relative to crude oil. With Mexico and Brazil's fuel prices now tied to international benchmarks, consumers, rather than governments or national companies, will bear the brunt of the price increase. Latin American refiners face a tradeoff: while the diesel supplied will fetch a higher price, the high-sulfur fuel oil produced, considered a byproduct of producing diesel and gasoline, will lose value and weigh on margins. Mexico in particular will struggle to find a market for the large volumes of fuel oil it produces. The value of Venezuela's crude, already depressed through sanctions, will sink further, due to its very high sulfur content. Brazil, meanwhile, is increasing production of low sulfur crudes that should fetch a premium on international markets. Of course, the size of the overall shift depends on how strictly the regulation is enforced at ports around the world. Latin America may be a particularly low-complying case, as ports in the region have less sophisticated inspection technologies and less experience enforcing such rules compared with the United States, Northwest Europe or East Asia."

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

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Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter
achacon@thedialogue.org

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Subscription Inquiries are welcomed at
ebrand@thedialogue.org