INTER-AMERICAN DIALOGUE'S
LATIN AMERICA ADVISOR ▸ ENERGY

FEATURED Q&A

How Would A Chinese Slowdown Affect the Energy Sector?

Q **Chinese banks have lent nearly $40 billion to finance energy-related projects in Latin America since 2005, and Chinese state-owned oil company CNPC has signed agreements worth billions of dollars this year alone in the region. As concerns rise about an economic slowdown in China, how would Latin America's energy sector be affected? In which countries and sectors is China's energy-related investment most significant?**

A **R. Evan Ellis, associate professor at the Center for Hemispheric Defense Studies in Washington:** "The impact is different in petroleum versus renewable energy. It also depends on whether a 'China slowdown' simply means below 7 percent GDP growth or whether the Chinese banking system, burdened by an excess of marginal loans, is pushed into a crisis. Absent a war in the Middle East, decelerating Chinese growth would lower petroleum prices and delay investments across Latin America to bring new petroleum on line. Reserves that are expensive to develop, such as Brazil's offshore 'pre-salt' deposits, would be most affected. Troubled refineries, such as Moin, the Refinery of the Pacific, and Abreu e Lima, would remain paralyzed. Populist oil producers such as Venezuela, already slipping ever deeper into debt, could face a revenue crisis. In Argentina, companies like Chevron would be slower to help the government develop its shale reserves. Yet Chinese national oil companies (NOCs) might buy more companies with Latin American holdings, taking advantage of depressed asset prices. Beyond petroleum, slowing demand in the PRC would accelerate China's push for renewable energy in Latin America, such as the Coca Coda Sinclair and Multiple Rositas hydroelectric facilities, Goldwind and Sinovel wind farms and China Sky Solar's $1.2 billion of investments in Chile. Such projects allow

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Peña Nieto to Unveil Energy Reform Proposal Next Week

Mexican President Enrique Peña Nieto announced Wednesday that he will reveal the details of his energy sector reform bill next week, instead of this week as originally announced. See story on page 2.

File Photo: Mexican Government.

Inside This Issue

ENERGY SECTOR BRIEFS

Venezuela's Oil Exports to U.S. Down Year-on-Year in May

Venezuela's oil exports to the United States declined 16 percent in May as compared to the same month last year, according to U.S. Department of Energy statistics, *El Universal* reported Aug. 1. Overall oil exports were down to 720,000 barrels per day, their lowest level in 10 years. Exports of crude oil decreased by 17.6 percent compared to the previous month, though exports of derivatives were 15 percent higher than in April and 30 percent higher than last year.

Brazilians Travel To Guatemala to Exchange Biofuels Knowledge

Brazilian executives from the biofuels industry traveled Tuesday to Guatemala for a two-day conference organized by the Guatemalan Sugar Growers Association to share their experiences with sugar growers interested in developing the Central American country's alternative energy industry, EFE reported. In 2012, Guatemala's five largest sugar refineries produced 200 million liters (52.8 million gallons) of ethanol worth $150 million, most of which was sold to local businesses, with a small amount exported.

Colombia to Receive Oil From Venezuela Starting in Mid-August

Venezuelan state oil company **PDVSA** said Saturday that they will resume the fuel trade with Colombia, on hold since June, supplying 27 million liters (7.1 million gallons) of oil per month beginning Aug. 15, *La República* reported. The countries are also working on negotiating a special pricing scheme for the border region and on plans to audit gasoline and oil shipments, as Venezuela estimates it loses $1.4 billion per year to fuel smuggling.

Oil & Gas News

Peña Nieto to Postpone Unveiling of Energy Plan Until Next Week

Mexican President Enrique Peña Nieto announced Wednesday that he will wait until next week to reveal the details of his energy sector reform bill, which was expected to be publicized this week, Reuters reported. Observers believe the presentation was delayed so that Peña Nieto can continue negotiations with opposition parties over the proposal's details. Energy reform is a divisive issue in the country, and Francisco Arroyo, a lawmaker from the governing PRI party, said in a Radio Formula interview this week that the bill's announcement was delayed so that the "broadest consensus possible" could be reached, Bloomberg News reported. Another senior party official said, "The president is signing off on details, revising article by article, and wants to present it with more certainty," according to Reuters. Passage of energy reform will require a two-thirds majority of Congress. Peña Nieto will seek changes to the country's Constitution to allow the involvement of more foreign companies in the oil sector, something the opposition PRD party has said it will not support. The PRI's head, César Camacho, said this week that the bill will include changes to the country's energy sector that will allow production-sharing contracts for exploration and output, but will not allow private companies to hold stakes in concessions. Last week, the conservative PAN party revealed its own plan which would modify three articles of the Constitution and allow for private companies to hold stakes in concessions. In addition to reforming the country's oil and gas sector, the bill is also expected to propose changes to the company's electricity sector that would allow more private involvement in energy generation and make changes to subsidy laws, though transmission and distribution will likely stay under state control. In a note circulated Wednesday, Eurasia Group analyst Daniel Kerner stated that "We still expect approval of an ambitious energy reform before the end of the year and don't see the delay as a sign that the government could water down its ambitions due to political resistance."

> "We still expect approval of an ambitious energy reform before the end of the year."
>
> *— Daniel Kerner*

Brazil Creates New Agency to Manage Pre-Salt Fields

Brazilian President Dilma Rousseff on Aug. 2 signed a decree that created a new state-owned company responsible for managing the exploration of the country's offshore pre-salt oil and natural gas reserves, EFE reported. The new agency, **Pré-Sal Petróleo SA** (PPSA), will be located in Brasília and overseen by the Ministry of Mines and Energy. PPSA, which will have initially have 59 million reais ($21 million) of capital, will manage production-sharing and sales contracts, represent the government and carry out the financial and technical evaluation of development and production plans related to the development of the pre-salt fields, according to Agência Brasil. It will not be responsible for carrying out any exploration or production activities. On Oct. 22, the country's oil regulator, the Agência Nacional do Petróleo (ANP), will auction off the first pre-salt operating licenses under a new set of rules which guarantee state oil company **Petrobras** a 30 percent stake in all projects. Last week, Petrobras announced that its total output in June

Rousseff

File Photo: Brazilian Government.

rose 4.8 percent compared to May, with record volumes of crude from pre-salt fields increasingly contributing to total output.

Bolivia Signs E&P Agreement With Gazprom and Total

Bolivian President Evo Morales on Aug. 1 presided over the signing of a $130 million agreement between Bolivian state oil company **YPFB**, Russia's **Gazprom** and France's **Total**, EFE reported. The agreement covers the exploration and production of hydrocarbons in the 785,625 hectacre Azero block in the southeastern Bolivian departments of Santa Cruz and Chuquisaca. YPFB will hold a 55 percent stake in the project, according to Reuters. Luis Alberto Sánchez, YPFB's vice president of administration, contracts and control, called the deal the beginning of a new stage in Bolivia's hydrocarbon exploration. Bolivia has 11.2 trillion cubic feet of proven natural gas reserves, and YPFB estimates that annual investment in the country's oil and gas sector will be $500 million between 2013 and 2017. Spain's **Repsol**, Brazil's **Petrobras** and **British Gas** are some of the other multinational corporations already involved in the country's hydrocarbon sector.

Power Sector News

Panama's President Marks Start of Wind Farm Construction

Panamanian President Ricardo Martinelli on Monday traveled to the Coclé province in central Panama to unveil the country's first wind turbine at the Penonome project, soon to be Central America's largest wind farm, Reuters reported. Martinelli commemorated the beginning of construction on the farm with executives from Spanish-owned **Unión Eólica Panameña**, the project's builders. The $450 million, 135-tower project will produce 220 megawatts of energy by mid-2014 and up to 337 megawatts when fully completed in 2015. It is estimated that the farm will be able to meet 10 percent of the Central American country's energy needs. Rafael Pérez Pire, UEP's director, said, "With the Penonome wind farm, we are going to reduce our reliance on fossil fuels and hydroelectric energy," according to EFE. A little more than half of Panama's energy is produced from hydroelectric sources, which makes the country vulnerable to droughts such as the one that forced electricity rationing in May. Seventy-five percent of Penonome's electricity generation will occur during the dry season, which will help to conserve water. Panama's energy secretary, Vicente Prescott, told Reuters that the farm will have a great impact as "the dry season is when we have the least rain but when we have the most wind." On Monday, China's **Xinjiang Goldwind Science & Technology** announced that they completed a $71 million financing deal to provide 55 megawatts of equipment for the first phase of the farm's construction.

> "We are going to reduce our reliance on fossil fuels and hydroelectric energy."
>
> *— Rafael Pérez Pire*

Featured Q&A

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Chinese banks to invest capital outside of the PRC while generating work for Chinese companies as demand evaporates at home. The panorama changes, however, if Chinese banking enters into crisis. Without capital, Chinese acquisitions and programmed investment in Latin petroleum would disappear at the same time that Chinese credit for Latin American renewables projects and non-energy sectors evaporated."

A **Sun Hongbo, associate professor at the Institute of Latin American Studies of the Chinese Academy of Social Sciences in Beijing:** "China's energy cooperation with Latin America will continue to maintain a stable and rising profile which has little relationship to Chinese economic growth changes in the short term. Chinese oil companies have regarded Latin America as a strategic region in the long term for internationalizing their business, as well as safeguarding China's energy security. According to BP statistics, the oil China imports from Latin America reached approximately 32 million metric tons in 2012, or 9.2 percent of China's total imports. In China's 'go global' policy initiative, the energy sector is a strategic area for Chinese companies to get involved in. China's recent role in Latin America has featured dynamics between Chinese banks and energy companies, who continue to keep their eyes on finding business opportunities in energy-related deals based on their technological advantage, financial liquidity, management capacity and risk assessment. In the next few years, Chinese oil companies expect to tap into the Mexican oil industry while they strengthen their commercial presence in different forms in Venezuela, Ecuador, Brazil, Colombia and other countries. In fact, Chinese energy companies have gone beyond the oil sector in Latin America, extending their cooperation to wind, solar, hydropower and other fields. For example, China's State Grid Corporation has rapidly expanded its business in the Brazilian electricity grid in recent years. It is evident that China's energy role in Latin America will not only be shaped by China's energy interest, but also reshaped by Latin American host countries through their interests, needs and regulatory framework."

> "Chinese oil companies have regarded Latin America as a strategic region in the long term for internationalizing their business..."
>
> *— Sun Hongbo*

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Banco Internacional de Costa Rica and **Banco Espírito Santo de Investimento** led the financing deal, according to a statement on the company's Web site.

Chilean Court Halts Construction of $1.4 Billion Thermoelectric Project

A Chilean appeals court on Aug. 2 annulled the construction permit for the $1.4 billion Punta Alcalde thermal project planned by Spain's **Endesa** which has faced opposition by marine conservation groups and local fishermen, the Associated Press reported. Construction of the 740 megawatt, coal-fired plant was halted due to environmental concerns about air and water pollution. A ministerial group, composed of the ministries of health, economy, agriculture, energy and mining, lifted a previous suspension last December after the project was halted in June 2012 over concerns that it could cause pollution, Reuters reported. The appeals court ordered that the ministerial group resume meetings to hear arguments against the project before ruling on its potential environmental impact. The ministerial group on Aug. 6 announced that it will appeal the court's decision to Chile's Supreme Court because, according to Ricardo Irarrázabal, assistant secretary for the environment, "We believe the ministerial group's decision adheres to the law and was neither illegal nor arbitrary." The project, proposed to be built in Chile's northern Atacama region near **Barrick Gold**'s Pascua Lama and **Lumina Copper**'s Caserones mines, is just one of many projects in the region facing opposition from environmental groups and legal setbacks. Last year, the country's Supreme Court rejected the construction of the $5 billion Central Castilla thermoelectric project in the area over environmental concerns.

The Dialogue Continues

What Is Generating Interest in Nicaraguan Oil Exploration?

Q Nicaragua currently has five onshore and offshore oil exploration projects and within the last month, both Houston-based Noble Energy and Nicaragua's energy minister on behalf of Spain's Repsol announced they will begin drilling wells off the country's Caribbean coast. What is drawing international oil companies to Nicaragua? What are the prospects for finding oil, both onshore and offshore, and does the country's regulatory climate provide the right incentives for oil exploration and development?

A José Bernard Pallais, partner at Arias & Muñoz in Managua: "In addition to the increase in the international prices of oil, Nicaraguan laws regulating the exploration and exploitation of hydrocarbons provide the necessary regulatory framework for international oil companies to contract with the Nicaraguan government and develop exploration projects in the country's territories, onshore or offshore. The laws also provide for some tax incentives for the companies that develop oil exploration and exploitation projects in Nicaragua, which may attract international oil companies to invest. Nicaragua has granted exploration concessions to 1.) Industrias Oklahoma Nicaragua, S. A. (Indoklanicsa) for onshore exploration in the Nicaraguan pacific region, 2.) a subsidiary of Noble Energy for offshore exploration in the Nicaraguan Caribbean Sea and, 3.) a subsidiary of Infinity Energy for offshore exploration in the Nicaraguan Caribbean Sea; and now Spain's Repsol is interested in oil exploration in Nicaragua's Caribbean waters. Regarding the prospects for finding oil: in accordance with the Nicaraguan Ministry of Energy and Mines, Indoklanicsa reported last November that it found oil onshore and is currently evaluating the information of the well in order to determine if it has commercial potential and is planning to drill a new well; Noble is preparing to drill its first exploration well off the country's Caribbean coast; and Infinity is preparing to do seismic analysis in its concession area. This demonstrates that there is oil onshore, and that investors expect to find oil offshore in Nicaraguan territories."

Editor's note: The above is a continuation of a Q&A published in the July 22-26 issue of the Energy Advisor.

Political News

Colombia, Nicaragua Clash Over Disputed Caribbean Territory

The Colombian Foreign Ministry said Tuesday that it had not received a response from Nicaragua to its protest last week about the Central American country's decision to auction off oil exploration blocks in parts of the Caribbean that both countries claim, the *Los Angeles Times* reported. The Foreign Ministry's statement came a day after Colombian President Juan Manuel Santos said in a local radio interview that his administration would soon unveil its plan to keep control of Caribbean waters that the International Court of Justice said last year are Nicaraguan territory. "I can't announce any concrete measure, what I can say is we are going to make a thorough explanation and a series of announcements about how we are going to proceed," said Santos. Colombia is discussing the matter with foreign and domestic law firms in an effort to "protect Colombia's interests," Santos added. In November, the International Court of Justice in The Hague affirmed Colombia's control of Caribbean islands that had been under the country's control since its independence was recognized in 1819. However, the World Court also ruled that thousands of square miles of Caribbean territory east of the 82nd Meridian, which has historically been the countries' maritime border, belonged to Nicaragua. Last week, Nicaraguan President Daniel Ortega said

Santons

File Photo: Colombian Government.

that Colombia's claims to the disputed waters are "false," Colombian newspaper *El Tiempo* reported. The area is believed to have oil and gas deposits and is a prime fishing area for lobster and shrimp. Colombia has said that several treaties, the latest of which was signed by the two countries in 1928, confirm its control of the disputed waters. However, Nicaragua argues that it signed the 1928 treaty under duress during a time that U.S. Marines were occupying the country.

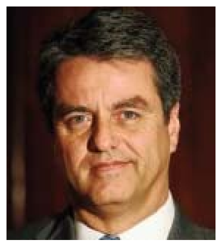
Santos Backs Away From Self-Imposed Deadline on Peace Talks

Colombian President Juan Manuel Santos on Monday backed away from a self-imposed deadline to conclude peace talks with the Revolutionary Armed Forces of Colombia, or FARC, rebels by November, the *Los Angeles Times* reported. Santos had set a deadline of concluding the talks by November, a year after they began. However, in a radio interview Monday, he said the deadline could be extended. "If in November we haven't finished entirely, we'll see where we are, and if we have to prolong the talks a couple of months, we'll extend them," Santos told Caracol Radio in Bogotá. "Deadlines in these processes are totally counterproductive." The FARC employed stall tactics during their last talks with the government, which lasted from 1999 to 2002. In announcing the new talks last year, Santos said they would last "months, not years." In November, Santos is also expected to announce his bid for re-election. The country's presidential election is scheduled for next May. Government and FARC negotiators have reached agreement on just one point of their six-point agenda, agrarian reform. The two sides have gotten bogged down over the second point of the talks, how to guarantee the rebels' political participation. The FARC has sought a constitutional convention to define their political role, while the government has pushed for a framework that would be put to voters in a national referendum. In the radio interview, Santos would not speculate on how many congressional seats the FARC might be offered, the *Los Angeles Times* reported. He also downplayed concerns about providing congressional seats and amnesty to the FARC after decades of insurgency. A majority of Colombians would support such measures as part of a broader peace deal, he said. "When you take all the elements [of an accord] and you add what peace would mean to the country … the people at that point will take the plunge," he said.

Economic News

Regional Trade Accords Threaten Global Talks: Azevêdo

Countries' pursuits of regional and bilateral trade accords are hindering efforts to restart global trade talks, the incoming head of the World Trade Organization said Tuesday, Bloomberg News reported. Policymakers will find it difficult to devote attention to global talks while at the same time engaging in trade talks at the regional and bilateral levels, Roberto Azevêdo said at an event in Rio de Janeiro. "There's not enough time to work on everything," said Azevêdo, a Brazilian who will become the first Latin American to become WTO director-general when he assumes the post next month. "Once negotiations are going at full steam, it'll steal attention from the multilateral system." Nevertheless, Azevêdo added that proposed U.S.-European talks and the Trans-Pacific Partnership can be part of global efforts to lower trade barriers. Such agreements could even be models for future WTO negotiations, he added. Near the top of Azevêdo's agenda when he takes office is the ministerial conference planned for December in Bali. At the gathering, countries will seek to reach agreement on issues ranging from agriculture to concerns of least-developed countries. Azevêdo said that although it will be difficult to find consensus, it is important to show that the stalled Doha Round of trade talks can move forward.



Azevêdo

File Photo: Brazilian Government.

POLITICAL & ECONOMIC BRIEFS

Chilean Judge Rejects Case Against Father of Candidate

A Chilean judge on Monday rejected a request by human rights lawyer Eduardo Contreras to prosecute former Gen. Fernando Matthei for the murder of Gen. Alberto Bachelet during the country's military dictatorship in the 1970s, BBC News reported. Matthei and Bachelet are the fathers of the country's two leading presidential candidates. Contreras has argued that new evidence supports his claim, but Judge Mario Carroza said that there are not enough grounds for the case.

Ecuador's GDP Grows 3.5 Percent in First Quarter, Slowest Since '10

Ecuador's gross domestic product grew 3.5 percent in this year's first quarter, its slowest rate since 2010, according to the central bank, *The Wall Street Journal* reported Monday. During the same period last year, the country's economy expanded by 6.1 percent. Non-oil GDP grew 4.2 percent in 2013 as compared to the same quarter in 2012, but oil GDP shrunk by 4.9 percent. Ecuador estimates that the country's growth rate this year will be 4.05 percent.

Peru's Sol Falls to Lowest Level Against Dollar Since May 2011

Peru's sol dropped against the dollar by 0.3 percent to close at 2.7990 per U.S. dollar on Tuesday, its lowest level since May 2011, Bloomberg News reported. The sol has depreciated 8.7 percent this year amid speculation that the Federal Reserve will scale-back stimulus measures. The country's central bank responded to the drop by selling $10 million of U.S. currency in the foreign-exchange market and 90 million soles of dollar-linked certificates of deposit.

Featured Q&A

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A William J. Norris, professor of Chinese foreign and security policy at the Bush School of Government and Public Service at Texas A&M University: "In general, China's slowdown will affect the Latin American energy sector through two channels: trade and investment. The downturn will be most acutely felt in nations for which Chinese trade demand represents the largest percentage of the nation's total energy exports. It is important to distinguish between trade and investment flows from China into the Latin American energy sector. Obviously, trade is going to be a bit more sensitive to demand shocks. Once a fixed investment has been made, it tends to be much stickier. However, it would not be surprising to see planned investments that have been merely 'announced' or 'pledged' be delayed. China has been a particularly large presence in the energy sectors of Brazil, Venezuela, Argentina and Ecuador. While Brazil and Argentina are much bigger economies that may be better able to weather the downturn, smaller nations that rely heavily on Chinese energy demand (in particular, Venezuela) are in for a rough ride. On the investment side, the most affected projects will be those targeting less commercially viable reserves. To the extent that Chinese capital was willing to fund offshore projects that presented technical challenges sufficient to keep other international investors on the sidelines, more ambitious projects may find it harder to secure capital. Another way to think about this is what does China uniquely bring to the table? If China is willing to fund projects at rates lower than others, or if Chinese capital is less risk averse, or if Chinese demand for energy exports constitutes a significant portion of a nation's total energy exports, these would be the counterparties most exposed to a Chinese downturn."

> "Another way to think about this is what does China uniquely bring to the table?"
>
> *— William J. Norris*

A Philip Andrews-Speed, principal fellow at the Energy Studies Institute of the National University of Singapore: "China's oil imports are likely to keep growing for the foreseeable future as the demand for oil is driven by transport and petrochemicals. Also, the appetite of the Chinese NOCs for new overseas investments shows no sign of abating yet. Indeed, the last four years have seen these NOCs change their focus from Africa and Asia to the Americas, where large, attractive opportunities exist. The current slowdown in China's economy may result in a modest decline in the rate of additional investment into Latin America and a modest decline in the rate of increase of oil imports from the region. In the unlikely event that China enters a sustained period of very low growth (below 4 percent per year), then the effect on overseas investments and on oil imports could be dramatic. Beyond China's rate of growth, there are two things to watch for. The first is any move by China's government to restart the reform of the NOCs and of other state-owned enterprises. This might cause the NOCs' operating and financial environment to become markedly less supportive of overseas ventures. Secondly, if political and regulatory uncertainty in Latin America increases, China's NOCs may choose to direct new investment to other regions."

The Energy Advisor *welcomes responses to this Q&A. Readers can write editor Gene Kuleta at gkuleta@thedialogue.org with comments.*

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