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FEATURED Q&A

How Hard Will the Oil Price Plunge Hit Latin America?



Oil prices plunged this week at their sharpest level since the Gulf War nearly three decades ago. Economic effects could be severe for oil-producing nations in Latin America. A platform of Brazilian state oil company Petrobras is pictured above. // File Photo: Petrobras.

Q An oil price war erupted this week between Saudi Arabia and Russia, causing prices for the commodity to plunge 25 percent Monday, their steepest drop since the Gulf War in 1991. The start of the oil price war coincided with the first global fall in demand since 2009, according to the International Energy Agency. Which oil-producing nations in Latin America and the Caribbean are most at risk from the situation, and what will be the consequences of such low oil prices on their economic and fiscal stability? How should governments in the region respond? What's behind the price war, and how will the geopolitical dynamics play out this year as they relate to Latin America?

A Lisa Viscidi, director, and Sarah Phillips, assistant, in the Energy, Climate Change & Extractive Industries Program at the Inter-American Dialogue: "Last week, Russia chose not to back OPEC's proposed production cuts, and Saudi Arabia responded by significantly reducing its crude prices and deciding to ramp up output in an effort to maintain market share. While it appears that U.S. shale producers (who have benefited from higher prices resulting from OPEC production cuts in recent years) were the real targets of Russia's decision, Latin America, a major oil-producing region, is also feeling the shock of low crude prices in an oversupplied market. Venezuela will be hit hardest. Already beset by falling production and U.S. sanctions that restrict its potential buyers, state-owned PDVSA has been forced to sell its crude at steep discounts. PDVSA has been selling its flagship Merly heavy crude blend at discounts of as much as \$23 below the Brent inter-

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TODAY'S NEWS

POLITICAL

Colombia Arrests Three Suspected Venezuelan Agents

Colombian authorities arrested three suspected members of Venezuela's Special Action Force, or FAES, in a joint operation. The Venezuelan citizens are accused of planning attacks against Venezuelan opposition members in Colombia.

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BUSINESS

Santander Buying Majority Stake in Mercury TFS

The fintech company employs people in countries including Mexico, Chile and Colombia.

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POLITICAL

Countries Tighten Restrictions on Travel Amid Pandemic

Several countries issued new travel restrictions in efforts to slow the spread of coronavirus. In Bolivia, interim President Jeanine Áñez also called on politicians to work together to fight the disease.

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Áñez // File Photo: Bolivian Government.

POLITICAL NEWS

Countries Tighten Travel Restrictions in Efforts to Fight Virus

Several countries in Latin America tightened travel restrictions and took other measures on Thursday in efforts to fight the spread of the coronavirus, Reuters reported. Argentina's government said it would stop providing visas to travelers and halt flights from countries that have been hardest-hit by the virus, including the United States, China, Japan, South Korea and some European countries. Argentina reported 31 confirmed cases of Covid-19, an increase from 21 the day before, along with one death. Some people in Argentina have contracted the disease locally, though most who had confirmed cases of it had traveled abroad, mainly to Europe. In Buenos Aires, officials said they also would prohibit the public from attending sporting events and other large gatherings, according to state news agency Telam. In Bolivia, interim President Jeanine Áñez said the country would suspend flights to and from Europe, ban gatherings of more than 1,000 people and also close down schools until the end of the month. Some presidential candidates who are running in the country's May election canceled rallies. "This virus does not care where we are from, what our ideology is or our background," said Áñez. "We are all at risk if we do not work together." Three people in Bolivia are confirmed to have the disease. They include a 65-year-old woman who on Wednesday was turned away from several hospitals over fears of the virus' spread. In Peru, President Martín Vizcarra's government suspended flights from Europe and Asia and also banned gatherings of more than 300 people. Vizcarra also said the closure of schools would be extended to colleges and universities, Reuters reported. In Paraguay, the government said it would cancel flights to and from Europe from today through March 26. The country has 26 confirmed cases of coronavirus. In Honduras, which has two confirmed cases, the government said it would restrict entry of travelers coming from Europe,

China, Iran and South Korea. The National Autonomous University in Honduras also said it would halt classes indefinitely. In Costa Rica, which has 23 confirmed cases, the government said it would shutter "at-risk" schools for two weeks and also suspend classes at universities. More than 8,000 hotel reservations have been canceled in the Central American nation, officials said, adding that they expected a 50 percent drop in tourism revenue. In Mexico, however, the government said Thursday that it did not have any plans to restrict international travel or close its borders, Reuters reported. Mexico, which is expecting thousands of North American tourists to arrive for spring break, said it did not see a reason yet for new tougher measures. On Wednesday in the United States, where there are more than 1,300 confirmed cases, President Donald Trump announced new restrictions on travel by people from 26 European countries for a month. Also on Thursday, Fabio Wajngarten, the press secretary to Brazilian President Jair Bolsonaro, tested positive for Covid-19, CNN reported, citing two unnamed sources. The positive test came just two days after Wajngarten met with Trump in Florida. White House Press Secretary Stephanie Grisham issued a statement saying, "Both the President and Vice President had almost no interactions with the individual who tested positive and do not require being tested at this time." Bolsonaro's health is also reportedly being monitored.

Colombia Arrests Three Suspected Venezuelan Agents

Colombian authorities have arrested three Venezuelan citizens who are allegedly members of the Venezuelan government's Special Action Force, or FAES, El Tiempo reported Thursday. The joint operation between Colombia's migration police and the armed forces' counterintelligence unit was planned after the Andean country's migration authorities in January denounced the presence of a FAES unit with the alleged aim of planning and executing attacks against Venezuelan opposition members who

NEWS BRIEFS

U.S. Sanctions Second Unit of Russia's Rosneft

The U.S. Treasury on Thursday sanctioned a second subsidiary of Russian state oil company Rosneft, which the Trump administration has said gives backing to Venezuelan President Nicolás Maduro. The Treasury said it was sanctioning TNK Trading International. "The Trump Administration remains committed to targeting those who support the corrupt regime's exploitation of Venezuela's oil assets," Treasury Secretary Steven Mnuchin said in a statement. Last month, the Treasury sanctioned another Rosneft unit, Rosneft Trading.

Chilean Central Bank to Expand Currency Intervention Program

Chile's central bank on Thursday said it would expand an intervention program that seeks to ensure liquidity and stabilize the peso as global markets fell and regional currencies plummeted over the spreading coronavirus, Reuters reported. A plan to sell as much as \$20 billion in foreign currency interventions was initially scheduled to run through May, but the "worsening financial condition of international markets" prompted the bank to extend the program through January, the bank said.

Peru's Central Bank Keeps Benchmark Interest Rate Unchanged

Peru's central bank kept its benchmark interest rate unchanged at 2.25 percent on Thursday, even as policymakers around the world are cutting rates in a bid to boost economies increasingly hurt by the economic effects of the coronavirus outbreak, Reuters reported. The bank said economic indicators had shown modest growth in the first two months of 2020, but it added that risks linked to the slowdown of global economic activity and the local effects of Covid-19 had sharply increased financial market volatility.

are currently in Colombia. After an investigation by the counterintelligence military unit verifying the information, the three Venezuelan citizens were located in the municipality of Madrid, in the central Cundinamarca department, where they are accused of mounting a spying network that the government of Venezuelan President Nicolás Maduro allegedly led and financed, *El Tiempo* reported. Alejandro Olivares allegedly led the unit, and the other two were identified as Wilnelmy Lourdes Callejas and Herierv José Borja.

BUSINESS NEWS

Santander to Buy Majority Stake in Mercury TFS

Spain-based Banco Santander announced today it had agreed to pay 30 million euros (\$33.54 million) for a 50.1 percent stake in Spanish fintech company Mercury TFS, which employs people in Spain, Mexico, Chile and Colombia, *Vozpópuli* reported. Mercury TFS develops trade finance software for companies. With the purchase, the lender hopes to strengthen its international trade finance platform for firms, Santander said. "Their software enables Santander customers to manage their entire trade finance activity online or via mobile phone," the Spanish bank said in a statement today, *Reuters* reported. This will improve users' experience, response times and quality of services, the bank added, saying the platform will also facilitate the digitalization of internal processes to boost operational efficiency, *Vozpópuli* reported. Santander's head for global payments services, Javier San Félix, will join Mercury TFS' directorate, though the fintech company will retain its director for technology. Santander will retain four out of seven company counselors. "Mercury TFS is a software company with great potential and which has a team with enormous talent, with technical and commercial teams that we will maximize and a great offer of products that we will complete," San Félix said, according to the report.

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national benchmark, which closed at just \$36 per barrel on Wednesday. With Venezuelan production costs averaging \$10-\$12 per barrel, plus royalties, PDVSA is scarcely making a profit on oil sales. Conversely, Mexico will not feel the effects of low oil prices as acutely thanks to its hedging strategy. For 2020, Mexico spent \$1.4 billion on oil hedging—a kind of financial insurance that gives it the option to sell oil at a certain strike price. On Tuesday, Mexico's finance minister said it had secured the price of \$49 per barrel set in its annual budget. Other oil export-dependent economies around the region, such as Colombia and Ecuador, will also suffer from lower prices."

A **Cleveland Jones, professor and researcher at the National Institute of Oil and Gas at the State University of Rio de Janeiro:**

"The plunge in oil prices after the price war between Saudi Arabia and Russia exposed some uncomfortable realities regarding world oil supply. When prices were at levels that allowed profitable production from most major producers, few dared to discuss how production could be rendered at risk by low oil prices. Now, it is clear that prices could fall below the national budget breakeven levels of many countries, and also below the economic costs of production in some regions. Production from some countries is at risk, while that of others will stand out as most resilient to low prices. Production from Russia and U.S. shale plays will also be hurt, but in Latin America, lost revenues will be severely felt in Venezuela, although production will continue regardless, given the need for foreign exchange. Mexico, Colombia and other Latin American countries risk uneconomical production, despite official claims. They are paying the price for not implementing reasonable energy legislation and reforms. However, underlying geological and technical favorability of production in Brazil's deepwater and pre-salt plays, and recent reforms that improved the country's

attractiveness, place Brazil in the forefront of world oil plays, both in production potential and resiliency to oil prices. Prolific wells and production costs as low as \$5.60

“It is clear that prices could fall below the national budget breakeven levels of many countries...”

— Cleveland Jones

per barrel in the pre-salt (\$12.50 per barrel in deepwater plays) ensure that in any price scenario, these regions will remain economically viable and may even assume much greater relevance in the world scenario. Brazil stands to gain while others lose."

A **Chris Cote, energy analyst at ESAI Energy:** "We are optimistic that the effects of Covid-19 on public health and the economy, although now dire, will lessen by the second half of the year, which should lead to a modest recovery in economic activity and demand growth. And now that Saudi Arabia has gotten the world's attention, it is in its interest to resolve this price war with Russia with another production restraint agreement by the end of the second quarter. Of course, they may find it difficult to reverse the events they have set in motion. For Latin America's major oil producers—Brazil, Mexico, Colombia, Venezuela, Ecuador, Argentina, Guyana—low oil prices will have severe effects on the economy, even if the timeline is relatively short. Exporters will have to fight for market share amid Saudi Arabia's production surge while dealing with the consequences of lower revenues. Brazil and Guyana, producing high-quality crude oils that China and the United States will continue to buy, should fare better than the rest. Venezuela is another story: PDVSA will find it close to impossible to sell its crude, given the

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increased availability of similar grades and tightening U.S. sanctions. Nicolás Maduro will try to sustain what is left of Venezuela's economy without its most important source of income, and with his most important ally, Russia, facing its own shortfall in revenue."

A Joel Acosta, director for energy and natural resources at FTI Consulting: "The recent oil price plunge will have an impact on Latin America's largest oil-producing economies, including Mexico, Ecuador, Venezuela, Colombia and Brazil, by affecting their public coffers and their capacity to continue producing oil and gas. However, most of these countries have learned how to protect themselves from scenarios such as this by gradually diversifying their economies and adopting multiple financial/credit mechanisms to stabilize their revenues. Oil rents constitute a significant percentage of the GDPs of Suriname, Ecuador, Mexico, Trinidad and Tobago, and Venezuela. Although oil dependency has decreased significantly in the region over the last decade, these countries are the most vulnerable when political unrest and weak public finances compound single commodity economies, such as Venezuela and Mexico. Sovereign wealth funds, oil hedge programs, contingent credit lines with the IMF and other credit mechanisms will play a key role in maintaining public

finances. For instance, Mexico has made its oil hedge program a habit for almost two decades now. Despite the current administration's receding economy, the Mexican gov-

“ Although state oil companies will continue producing even if it may not be profitable, international oil companies will certainly think twice...”

— Joel Acosta

ernment renewed its 2020 hedging program at \$49 a barrel—the world's largest sovereign oil hedge. Low prices will also dampen investments in E&P projects in the region. Although state oil companies will continue producing even if it may not be profitable, international oil companies will certainly think twice where they allocate their resources. Such is the case of Brazil and Guyana, two of the biggest frontier areas in the region. Thus, increasing public expenditures and cutting taxes, without buying debt, will be key to stimulate economies at this moment."

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

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Advisor Video

Fitch's Shelly Shetty on Latin America's Ratings Outlook

The Latin America Advisor sat down with Shelly Shetty, co-head of Americas Sovereign Ratings at Fitch Ratings, to discuss the coronavirus outbreak, global trade and their impact on Latin America and the Caribbean's economic and ratings outlooks.

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