LATIN AMERICA ADVISOR

ENERGY ADVISOR

A WEEKLY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

February 1, 2019

FEATURED Q&A

Will New Sanctions on Venezuela Disrupt Global Trade Flows?

The United States government announced new sanctions against Venezuela's oil sector on Monday, as part of its efforts to pressure Venezuelan President Nicolás Maduro to step down. // File Photo: Venezuelan Government.

Q **Venezuelan leader Nicolás Maduro last week broke diplomatic relations with the United States over U.S. President Donald Trump's endorsement of Juan Guaidó as interim president of Venezuela. Then, on Jan. 28, U.S. officials announced new sanctions against Venezuelan state oil company PDVSA, blocking $7 billion worth of assets and preventing $11 billion in oil exports over a year. How big of an impact will the new sanctions have on Venezuela and its oil sector? What will be the sanctions' economic impact on the United States? To what extent will the fraying energy ties between the United States and Venezuela affect international oil prices and trade flows?**

A **Francisco Monaldi, fellow in Latin America energy policy and lecturer in energy economics in the Baker Institute for Public Policy at Rice University:** "The sanctions are severe, banning any transactions between U.S. entities and PDVSA, including buying Venezuelan crude, selling refined products or diluents for extra-heavy oil or transferring cash. There are some general licenses providing some time for companies to adjust. PDVSA's refining subsidiary in the United States, Citgo, is treated independently of PDVSA, allowing it to operate in the U.S. market, but forcing it to unwind its ties with PDVSA. As a result, Maduro could aim to divert oil exports to China and India. The consequences for the Venezuelan oil sector would be significant given the critical condition in which it already is. Close to half of Venezuela's oil exports, around 550,000 barrels per day, go to the United States, where most of PDVSA's cash flow is generated. A large proportion of the

Continued on page 3

TOP NEWS

ELECTRICITY

Sempra to Sell its Operations in Chile and Peru

The U.S. utility is planning to sell its subsidiaries in Chile and Peru, as well as two additional energy services companies based in the South American countries.

Page 2

OIL & GAS

Mexico Rules Out More Crude Oil Imports: Nahle

Mexican Energy Secretary Rocío Nahle told lawmakers on Monday that the government is not considering importing more oil from Venezuela or anywhere else.

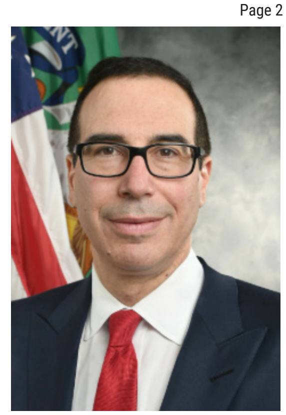
Page 2

OIL & GAS

U.S. Imposes New Sanctions on PDVSA

U.S. Treasury Secretary Steven Mnuchin announced new sanctions against Venezuelan state oil company PDVSA. Proceeds from sales of Venezuelan oil to U.S. companies will be placed into a blocked, interest-bearing account in the United States, Mnuchin said.

Page 2



Mnuchin // File Photo: White House.

OIL AND GAS NEWS

U.S. Imposes New Sanctions on Venezuela's PDVSA

The United States is imposing new sanctions on Venezuelan state oil company PDVSA, escalating efforts to pressure President Nicolás Maduro to step down, the Trump administration announced Monday, the Financial Times reported. All of PDVSA's assets subject to U.S. jurisdiction were blocked, and U.S. individuals and companies were "generally prohibited from engaging in transactions with them," the U.S. Treasury said in a statement. The sanctions do not ban American companies, including PDVSA's U.S-based refiner Citgo, from buying Venezuelan oil, but proceeds will be put in a blocked, interest-bearing account in the United States. "If the people in Venezuela want to continue to sell us oil, as long as the money goes into blocked accounts, we will continue to take it," Treasury Secretary Steven Mnuchin said at a White House briefing, Reuters reported. "Otherwise, we will not be buying it." The sanctions will force PDVSA to find other markets for its oil and different routes into the United States, and U.S. refining companies that had been buying Venezuelan crude will have to find other sources of heavy oil, the Financial Times reported. The United States bought roughly 500,000 barrels a day of crude from Venezuela in the first 10 months of last year. Minutes before the U.S. government announced the new sanctions, Juan Guaidó, the head of Venezuela's National Assembly who proclaimed himself interim president last week with U.S. support, said the assembly would name new boards of directors to PDVSA and Citgo, Reuters reported. In a live national broadcast on Monday, Maduro accused the United States of trying to steal Citgo, adding that Venezuela would take legal actions in response. In a move to sidestep the new U.S. sanctions, PDVSA is reportedly asking major buyers, including U.S. refiners, to renegotiate contracts, Reuters reported, citing four sources involved in the talks. "We are trying to redo the contracts. It is no entirely clear how because customers are being individually called, but we are studying alternatives," a PDVSA source told the wire service. The state oil company is reportedly calling customers and asking them to swap foreign fuel and other products for its Venezuelan crude cargoes, and it is reportedly eyeing the option of asking trading houses to act as intermediaries to indirectly supply U.S. customers, Reuters reported.

All of PDVSA's assets subject to U.S. jurisdiction were blocked.

Mexico Rules Out Importing More Crude Oil: Secretary

The Mexican government has ruled out the option of importing more crude oil after it bought oil from the United States at the end of last year, Energy Secretary Rocío Nahle told legislators on Monday, Reuters reported. "We are not considering importing oil," she said, specifying that Mexico would not buy from Venezuela or anywhere else. Mexican imports of oil-product fell 15.5 percent to $1.38 billion in the last month of last year, according to data released this week by Mexican statistics agency INEGI, Bloomberg News reported. Mexico imported roughly 300,000 barrels of crude in December, according to President Andrés Manuel López Obrador, who took office Dec. 1. López Obrador has repeatedly said he aims to reduce fuel imports from abroad. On Tuesday, Fitch Ratings downgraded the debt of Mexican state oil company Pemex to BBB- from BBB+, citing insufficient investment to restore falling output, The Wall Street Journal reported. Pemex's rating is the lowest investment grade. The company's output averages approximately 1.7 million barrels per day, down from 1.95 million in 2017. At the end of

NEWS BRIEFS

Sempra to Sell Peru and Chile Operations to Boost North American Business

Sempra is planning to sell its operations in Peru and Chile as it moves to increase investments in its North American business, the U.S. utility said Monday in a statement. Sempra will sell its Chilean subsidiary, Chilquinta Energía, the country's third-largest electric utility, and an 83.6 percent stake in Luz del Sur, Peru's biggest electric company. Without providing further details, Sempra added that its two additional energy services companies based in Chile and Peru would also be sold.

Bolivia to Invest $1.45 Bn in Natural Gas This Year, $450 Mn in Exploration

Bolivia is planning to invest approximately $1.45 billion in the natural gas sector this year, with $450 million on exploration efforts, Bolivian state hydrocarbons company YPFB said Monday, EFE reported. Of the exploration budget, roughly $20 million will go toward the Florida-X2D exploratory well, Hydrocarbons Minister Luis Alberto Sánchez said. Earlier this year, Sánchez announced the government had discovered "an ocean of gas" at the Subandino Sur zone.

Argentine Energy Ministry Drafting Changes to Vaca Muerta Regulation: Report

The Argentine energy ministry is preparing a change in regulation at the Vaca Muerta deposit, as it seeks to pay less in subsidies as part of the government's more austere plan to meet its fiscal deficit goals this year, La Nación reported Jan. 25. The government estimates it will pay $2.5 billion in subsidies in 2019. New Energy Minister Gustavo Lopetegui is reportedly making changes to a 2017 resolution that provided incentives for unconventional gas extraction projects at Vaca Muerta.

September, Pemex's debt stood at $106 billion. "We are not surprised [by the downgrade], but we are concerned," Finance Minister Arturo Herrera told reporters, The Wall Street Journal reported. López Obrador has promised to boost investment in the state company, including for the construction of a new refinery. [Editor's note: See related **Q&A** in the Dec. 21 issue of the Energy Advisor.]

Brazilian Gov't to Sell Majority of Petrobras Subsidiaries: Official

Brazil's government is looking to sell $20 billion in state assets this year, including from state oil company Petrobras, President Jair Bolsonaro's secretary of privatization said Tuesday, Valor Econômico reported. The minister, Salim Mattar, said Petrobras would have to give up the majority of its 36 units in Brazil. In related news, Chevron has reportedly reached a deal to buy a Petrobras refinery in Pasadena, Tex., that has a capacity to process 112,000 barrels per day, the wire service reported, citing two unnamed sources. A Petrobras subsidiary, Pasadena Refining System, currently operates the refining facility. A Chevron spokesman declined to comment, while Carlos Monteiro, a spokesman for Petrobras in Rio de Janeiro, told Reuters that a deal would be announced to the market. The refinery was put on sale early last year.

Argentina, E.U. Reach Deal on Biodiesel Exports

Argentina and the European Union have reached an agreement to end a conflict over exports of biodiesel from the South American country to Europe, the Argentine Ministry of Foreign Affairs said Wednesday, La Nación reported. The European bloc will not sanction the exports, but the deal sets price and volume limits, the ministry said. Details are expected to be announced in the coming month. The

FEATURED Q&A / Continued from page 1

exports to Asia do not generate any cash, as they are used to pay off debts with China and Russia. Diverting exports would imply offering discounts and incurring higher transport costs. Also, PDVSA would have to import diluents and gasoline for its domestic market from costlier suppliers. Thus, profits would fall, further worsening PDVSA's cash constraints, leading to further declines in oil production. On the U.S. side, the impact would be less significant. There would not be enough heavy crude, deliverable at the Gulf Coast, from Mexico and Canada, to supply the missing Venezuelan crude. So, a large portion would have to be imported from the Middle East, increasing the price of heavy crudes and reducing profit margins for refiners. Domestic gasoline prices may be affected, but likely not by much. The United States could cushion the impact by selling oil from its Strategic Petroleum Reserve."

A **Javier Coronado, associate attorney at Diaz, Reus & Targ, LLP:** "From now on, all U.S. persons, including U.S. financial institutions, are generally prohibited from engaging in any dealings involving PDVSA, as well as entities owned 50 percent or more by PDVSA. Accordingly, Venezuela's oil trade with U.S. refineries—which are among the few customers that pay cash to Venezuela—will likely experience a significant decrease. Further, the new sanctions block PDVSA's assets subject to U.S. jurisdiction and create additional barriers for the Venezuelan oil industry to access banking services around the globe. The loss of Venezuelan supply will likely raise the price of heavy crude and thus hurt U.S. refineries and gasoline consumers in the U.S. Gulf and East coast. While it is true that OFAC issued a fair number of general licenses to mitigate the impact of sanctions against PDVSA on the U.S. economy, it will take a while before U.S. businesses and financial institutions learn to navigate them. Additionally, some of these licenses depend on the Venezuelan government's willingness to receive oil-related payments in U.S.-blocked accounts. Disrupted energy ties between the United States and Venezuela

> **The loss of Venezuelan supply will likely raise the price of heavy crude and thus hurt U.S. refineries and gasoline consumers..."**
>
> **— Javier Coronado**

could affect trade flows because they force Venezuela to direct its exports to Russia and Asian countries, such as China and India. Further, if Venezuela's ability to preserve the country's oil infrastructure is compromised, the disrupted energy ties between the United States and Venezuela could also affect international oil prices due to a reduction in oil production, especially if oil output in Iran, Libya and Nigeria continues to decrease."

A **Gustavo Coronel, a founding board member of PDVSA:** "The break of diplomatic relations between the United States and the illegitimate Maduro regime will intensify the already-existing disruption of energy trade between the two countries. The significance of the United States' recognition of new interim President Juan Guaidó is still poorly understood. Now, any U.S. oil imports from Venezuela cannot legally be paid to the illegitimate Maduro regime. The U.S. clients of Venezuelan state oil company PDVSA should now deal directly with Juan Guaidó's new government representatives, while demanding the fulfillment of existing oil contractual obligations to the state company, which is still under Maduro's increasingly precarious control. For all practical purposes, this would be equivalent to a 'force majeure' type

Continued on page 6

European Union is expected to ratify the deal in the next few days. Earlier on Wednesday, a European Commission source told Reuters that E.U. countries supported imposing anti-subsidy duties on Argentine biodiesel imports, exempting producers who agree to a minimum price, the wire service reported. The commission is set to impose anti-subsidy duties of between 25 and 33.4 percent by Feb. 28. The European Biodiesel Board, which represents E.U. producers, said the move showed the bloc recognized Argentine export taxes unfairly distorted the international market, Reuters reported. The agreement could help boost the South American country's soybean sector. Argentina is the number-one producer of soy oil, a main ingredient in biodiesel.

POLITICAL NEWS

Opposition Has Met With Venezuelan Military: Guaidó

Members of Venezuela's opposition have held "clandestine" meetings with the country's military, National Assembly leader Juan Guaidó, who proclaimed himself the country's interim president last week, wrote in an opinion piece published Wednesday. "The transition will require support from key military contingents. We have had clandestine meetings with members of the armed forces and the security forces. We have offered amnesty to all those who are found not guilty of crimes against humanity," Guaidó wrote in the piece published by The New York Times. "The military's withdrawal of support from Mr. Maduro is crucial to enabling a change in government, and the majority of those in service agree that the country's recent travails are untenable." Citing protests against Maduro's rule, Guaidó added, "Mr. Maduro no longer has the support of the people." Guaidó, who is leading the effort to remove Maduro from office, also called on "all of Venezuela" to "unite in pushing for a definitive end to his regime," and he urged the support of "pro-democratic governments, institutions and individuals the world over." Several countries, including the United States, have recognized Guaidó as Venezuela's interim president. Maduro's swearing-in for his second term on Jan. 10 followed his re-election last May, which opponents inside Venezuela as well as foreign governments have viewed as fraudulent. On Wednesday, U.S. President Donald Trump called Guaidó to reinforce what the White House has called Venezuela's "fight to regain its democracy," The Wall Street Journal reported. Also on Wednesday, Maduro reiterated his offer to engage in talks with the opposition. Guaidó has characterized that offer as disingenuous, but has also demanded that Maduro uphold any guarantees

ADVISOR Q&A

Which President Will Take Hold as Venezuela's Leader?

Q More than a dozen countries have rejected Venezuelan leader Nicolás Maduro as the country's president since he was sworn in for a second term on Jan. 10, instead recognizing Juan Guaidó, the head of Venezuela's National Assembly, who on Jan. 23 proclaimed himself interim president of the country while free and fair elections are organized. Who is Guaidó, and does he have a legitimate claim to the presidency? What sorts of implications does a dual government scenario have for the country? How likely is it that Venezuela will hold elections in the near future and, if arranged, is the Venezuelan opposition unified enough to win?

A Laura Chinchilla, former president of Costa Rica and co-chair of the Inter American Dialogue's Board of Directors: "Juan Guaidó burst onto the stage of Venezuela's dramatic politics in the most surprising way and when he was most needed. His very assumption as president of the National Assembly was accidental and by default. The position belonged to his party, Voluntad Popular, by process of rotation, and the party's main leaders are imprisoned or in exile. Only five days after his appointment, Maduro was sworn in as president for a second term after being re-elected in a vote plagued by irregularities. With Maduro's legitimacy in question, the constitutional mechanism that establishes the head of the National Assembly as the country's interim president in the absence of a president was put in motion. But Guaidó's swearing-in was more than just a simple application of the Constitution—it was also the result of a dizzying process of popular support forged after his visits to several town councils, which projected him as a reliable politician, with a simple and familiar speech, before a people thirsty for hope and leadership. Time is passing quickly, in favor of Guaidó and against Maduro. In addition to the recognition of several countries' governments, other signs weigh on the worn-out madurista regime, among them the actions of bondholders against the regime and the impediment to withdrawing gold deposits from the Bank of England, as well as the Inter-American Development Bank's support for Guaidó. The stars have never aligned in favor of a transition in Venezuela as they have today: an alert and active international community, a unified political opposition and a leader that has been able to re-sow hope in his people. However, a defining ingredient is missing: the armed forces, on which the survival of the Nicolás Maduro regime entirely depends today."

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

NEWS BRIEFS

Former Guatemalan Chief Prosecutor to Seek Presidency

A former chief prosecutor known for her role in the investigations of several high-level corruption cases in Guatemala, including of former President Otto Pérez Molina and his vice president, Roxana Baldetti, plans to run for president, the Associated Press reported Tuesday. The secretary general of the recently created Seed Movement party announced Thelma Aldana's candidacy Monday night, and the party is expected to officially nominate her at an assembly in March. Guatemala's first-round vote is scheduled for June 16.

Mexico Ends Program to Fast-Track Migrant Visas

Mexico on Tuesday ended a program to issue fast-track humanitarian visas to Central American migrants who recently arrived at its southern border, The Wall Street Journal reported. Roughly 12,600 migrants, mostly from Honduras, applied for humanitarian visas since mid-January, and Mexico has granted nearly 4,000, according to the National Migration Institute. A senior official said migrants seeking humanitarian visas from now on will have to apply at Mexican consulates in their home countries. An official reason for ending the policy was not provided.

Chile's Central Bank Increases Interest Rates

Chile on Wednesday hiked benchmark interest rates by 25 basis points to 3 percent, in line with market expectations, Bloomberg News reported. The central bank board's unanimous decision looked past below-target inflation to expectations for a strengthening economy. Policymakers said their tightening cycle will be "gradual and cautious." Chile's economic activity in November increased 3.1 percent from a year earlier.

he makes during any future talks. U.S. National Security Advisor John Bolton met Wednesday at the White House with representatives of Citgo, Venezuela's U.S.-based refining unit. "The United States is continuing to work to make sure that the economic benefits of Venezuela's resources are not pilfered by Maduro and his cronies. Very productive meeting this afternoon with members of the CITGO executive team," Bolton wrote on Twitter. Bolton's meeting Wednesday with the Citgo representatives came two days after the Trump administration imposed sanctions on Citgo's parent, Venezuelan state-owned oil company PDVSA.

Five Arrested in Connection With Brazil Dam Collapse

Brazilian authorities on Tuesday arrested five people, including three employees of mining company Vale, as part of an investigation into the dam collapse that killed at least 99 people and left nearly 300 missing last week, The New York Times reported. The dam complex, which Vale owns, ruptured Jan. 25, sending a wall of water and mud across the mining company's facilities and nearby homes in the town of Brumadinho in the southeastern Minas Gerais State. The other two people who police detained Tuesday were engineers working for the Brazilian unit of German industrial testing company TÜV Süd, which handled safety inspections of the Brumadinho dam last year, most recently in September, the newspaper reported. Brazilian federal and state prosecutors said in a statement that the arrests and seven search warrants were "aimed at investigating criminal responsibility for the rupture," The New York Times reported. Those who were arrested were individuals involved in the most recent safety and environmental surveys, and they face charges ranging from participating in homicide to false representation and environmental crimes. Also on Tuesday, Vale said it would dismantle 10 dams similar to the Brumadinho dam, halting 10 percent of its annual production, The Wall Street Journal reported. Vale said increasing output at other facilities will offset the loss of production.

ECONOMIC NEWS

Mexico Registers Highest Trade Surplus on Record

Mexico registered its highest trade surplus on record in December despite efforts by U.S. President Donald Trump to curb Mexican exports to the United States by redrafting the North American Free Trade Agreement, or NAFTA, Bloomberg News reported Monday. Total exports amounted to $37.5 billion in the last month of 2018, while imports totaled $35.7 billion, resulting in a trade surplus of $1.8 billion, according to Mexican statistics agency INEGI, El Economista reported. The figure is the highest trade surplus for any month since data collection started in 1999. Automotive exports grew by 7.4 percent as compared to the same month a year ago, reaching $11.5 billion, while oil-product imports fell 15.5 percent to $1.38 billion. "Car production and demand have recovered amid less uncertainty over NAFTA," Marco Oviedo, chief Mexico economist at Barclays, told Bloomberg News. "It seems that the new deal implies business as usual and that car exports should continue to be an important component of trade between the U.S. and Mexico." After more than year of talks, Mexico, the United States and Canada signed their new deal, USMCA, in November. The agreement is still up for ratification in all three countries. [Editor's note: See related **Q&A** in the Oct. 11 issue of the Advisor.]

Ecuador Gov't Issues $1 Billion in Bonds

Ecuador on Monday issued $1 billion of 10-year bonds with an interest rate of 10.75 percent, the Financial Times reported. The placement was well received, but the government is still considering "other potential sources of financing such as international institutions and China," the finance ministry said in a statement. President Lenín Moreno's government aims to raise a total of $8 billion this year. [Editor's note: See related **Q&A** in Monday's Advisor.]

FEATURED Q&A / Continued from page 3

of contingency that would not be able to last long. The pressure on the illegitimate Maduro regime would rapidly become too great and would significantly contribute to its rapid downfall. I do not believe this confrontation would last long enough to influence international oil prices and trade flows, since Venezuela—due to its dramatically decreasing oil production and exports—has not been a major global actor for some time now. On Jan. 28, the United States blocked the Maduro regime from access to $7 billion in Citgo assets and an estimated $11 billion in expected revenues. This places the Maduro regime in a very precarious financial situation because, first, these revenues are indispensable to its survival, and second, Citgo is practically the only lifeline and tangible asset PDVSA still has abroad. While this step will have little economic effect on international prices and the U.S. economy, it likely amounts to a 'coup de grace' for the weakened Maduro regime."

A **Richard N. Sawaya, vice president of the National Foreign Trade Council:** "The Trump administration has implemented a ban on the purchase of Venezuelan crude by U.S. persons to deprive PDVSA of its principal paying customers, U.S. refiners configured to process Venezuelan heavy crudes. Presumably, this sanction has been detailed through the interagency process. It appears the sanction is structured to permit purchases, should the control of PDVSA shift to a transitional government under Juan Guaidó and the Venezuelan National Assembly—a stratagem to increase incentives for the Venezuelan armed forces to defect from the Maduro regime. The sanction includes a wind-down period to minimize supply-chain disruptions in the U.S. refining sector. In any case, a ban on the purchase of Venezuelan crude by U.S. persons—economic coercion—is a tactic that presumably is part of comprehensive U.S. conduct, pursuant to the U.S. government's official recognition of, and support for, the Guaidó transitional government. Given the volumes involved—500,000 barrels a day—the global oil market should adjust in relatively short order. The effect on the Venezuelan population is another matter."

A **Antero Alvarado, managing partner and Venezuela director of Gas Energy Latin America:** "The worst-case scenario for PDVSA is happening now. These sanctions come after a previous escalation at the beginning of last year. Gas Energy Latin America (GELA) estimates that Venezuelan crude exports to the United States amount to less than $11 billion, given current prices and volume. We believe the impact could be of roughly $9 billion in total, including when Chevron stops shipments to the United States. Forty-two percent of Venezuela's exports in the last months of 2018 were to the United States. The remaining 58 percent went to Russia, China and especially India. However, GELA believes only India will be able to pay PDVSA in a 'cashable' manner, given existing debt payments. Undoubtedly, it's a big blow for PDVSA. On the U.S. side, a volume of 450 million barrels per day will have serious implications. The crude that arrives in the United States ranges from upgraded light oil (API of 34°) to diluted heavy oil (API of 16°). Valero, Phillips 66, Houston Refinery, Chevron and Citgo will be the most affected. It is still unclear how PDVSA will bring refined products to Venezuela. The country has a high dependence on gasoline, additives, propane and diesel. Likewise, PDVSA requires naphtha and diluents to produce crude from the Orinoco Belt. This would indeed have a bigger impact than prohibiting Venezuelan crude in U.S. refiners. Short-term results will make the sanctions more effective, since the costs of such measures for Venezuelans, and for Americans to a lesser extent, will be high."

LATIN AMERICA ENERGY ADVISOR
is published weekly by the Inter-American Dialogue
Copyright © 2019

Erik Brand
Publisher
ebrand@thedialogue.org

Gene Kuleta
Editor
gkuleta@thedialogue.org

Anastasia Chacón González
Reporter
achacon@thedialogue.org

Latin America Energy Advisor is published weekly, with the exception of some major U.S. holidays, by the Inter-American Dialogue
1155 15th Street NW, Suite 800
Washington, DC 20005 **Phone:** 202-822-9002
www.thedialogue.org
ISSN 2163-7962

Subscription Inquiries are welcomed at
freetrial@thedialogue.org