LATIN AMERICA: Oil prices complicate outlook

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Abstract

'Winners' and 'losers' from the recent collapse in oil prices.

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Full Text

SUBJECT:'Winners' and 'losers' from the recent collapse in oil prices.

SIGNIFICANCE:The recent precipitate fall in crude oil prices, with the Brent crude price falling below 50 dollars/barrel in January (less than half its September 2014 level), is clearly having a major impact around the world. In Latin America, which includes both oil importing and exporting countries, there will be winners and losers from this development, although in some cases the oil price impact is likely to prove more nuanced.

ANALYSIS: Impacts.

Plunging oil prices are compounding doubts surrounding the regional hydrocarbons sector.

The effect on investment decisions will have a longer-term impact on the region.

The development of alternative energies in Latin America will be hit by the lower prices.

Global oil supply currently exceeds demand, something not seen since the 1990s. Within Latin America, net importers including Central America and Chile will be advantaged by the fall in prices but will face decisions over locking in the prices of future crude and product imports. Among oil exporters, in some cases the reality check of low oil prices could trigger some political changes.

Economic consequences .

Producing countries face obvious potential risks, including:

loss of royalty and taxation income, and a worsening balance of payments;

a major reduction in upstream investment, leading to related cutbacks across the oil sector including associated contractors and manufacturers;

falling output if higher-cost oil is left in the ground as the economics of extraction become negative; and

corporate debt default, as both companies and countries borrow on the basis of current and anticipated oil prices, amid a rise in the cost of dollar-denominated debt.

A significant fall in international prices of crude will undercut the prices of oil products in consuming countries, with associated economic benefits. However, 'alternative' energy will be hit, owing to reliance on high oil prices to support investment to produce energy at a competitive cost (see BRAZIL: Sustainable energy faces rising obstacles - September 22, 2014).

Venezuela and Iran, previously OPEC heavyweights, have failed to persuade OPEC to take action to raise oil prices. Owing to their inability or unwillingness to cut oil production themselves, they have lost influence within OPEC and Saudi Arabia is no longer prepared to be the swing producer.

Regional industry challenges.

With two OPEC members (Venezuela and Ecuador) among the world's major oil producers, along with Mexico and Brazil, Latin America will remain attractive to oil investors but the recent fall in oil prices will constrain potential developments.

Although Brazil has been an exploration success story, production elsewhere in the region has disappointed owing to under-investment, even as subsidy policies have increased product imports.

Elsewhere, countries with a history of offering a challenging environment for private investment (eg, Mexico, Venezuela and Argentina) may find it difficult to attract major new investments, with companies likely to weigh caution against strategic investment.

Regional energy cooperation has seen many agreements signed amid great fanfare. However, the substance has been limited and even arrangements such as the Venezuela-led PetroCaribe have frequently lacked economic durability. In the current challenging environment, it is difficult to see energy integration progressing.

Country-specific implications.

With some exceptions, understanding the need for competitive fiscal, regulatory and policy measures to attract necessary financial and technological resources has often been missing.

International oil companies will be more demanding and it is as yet uncertain whether low oil prices will trigger more government flexibility across the region -- statist agendas will not disappear overnight.

Although US oil companies have traditionally been the major players, they and their European counterparts will be highly selective, with major moves into the region limited:

Venezuela.

Despite having the world's largest proven reserves, Venezuela's output has declined and, absent oil policy reform, the country is likely to become steadily more beholden to China (see VENEZUELA: Oil price compounds PDVSA woes - November 26, 2014).

China is further strengthening its position, recently announcing 26 billion dollars in loans and lines of credit to Venezuela and Ecuador. Venezuela will be the hardest hit by falling prices, but a decline in the import cost of refined products will partially offset losses on oil production.

Mexico.

Mexico is embarked on a long-overdue opening of its hydrocarbon sectors. It is early days and low oil prices could prove a complicating factor, but Mexico may continue to prove attractive to oil majors if the opening continues to progress.

However, there is no guarantee of political will to follow reforms through to a level of granularity needed to attract the scale of foreign investment needed (see MEXICO: Impact of low oil prices will be mixed - December 30, 2014).

Brazil.

Brazil has pinned much of its growth and development hopes on troubled state-controlled oil company Petrobras. There are serious questions whether Petrobras can adequately confront its huge bribery scandal without seriously affecting the rate at which new production comes on stream (see BRAZIL: Petrobras scandal threatens wide fallout - December 2, 2014).

Although crude production is expected to continue rising during 2015, low oil prices and Petrobras's corruption scandal will make 2015 challenging. Delays in posting accounts could constrain Petrobras's ability to raise funds to meet its expenditure target of some 220 billion dollars aimed at boosting production to over 3 million barrels/day (b/d) by 2018.

Overdue domestic product price increases should help to cut its huge product import bill. However, foreign investors' appetite for new exploration acreage in the upcoming 13th bidding round will be tempered by significantly reduced exploration expenditure globally.

Argentina.

The cost of oil product imports will fall but, with its long record of discouraging investment in its oil and gas sectors, Argentina may face difficulties in attracting the investment necessary to develop the massive Vaca Muerta and other shale resources (see ARGENTINA: Hydrocarbons conflict with provinces looms - May 19, 2014).

Argentina needs an estimated 20 billion dollars annually for 20 years, primarily for shale development. However, shale development will struggle to be competitive and Argentina's track record on foreign hydrocarbon investment is poor.

Colombia.

In the present climate Colombia will find it challenging to persuade companies to keep drilling -- critical for its reserve replacement (see COLOMBIA: Oil outlook faces reserves, rebel challenges - June 30, 2014).

Colombia's production slipped below 1 million b/d in 2014. The major oil producers Ecopetrol and Pacific Rubiales have already announced major expenditure cutbacks.

Bolivia.

Bolivia will also be hit but has already moved to cut back expenditure and may see gas into its main market (Brazil) becoming more competitive with Brazilian domestic output.

CONCLUSION: The duration of low oil prices and related perceptions will be critical. Forward Brent oil prices suggest that, although the average has not yet bottomed out, price levels may stabilise during 2015, possibly hardening a little towards the end of year. Irrespective of this, the effects being felt across Latin America will continue beyond 2015.

Details

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