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Guest post:

Mexico's energy industry gushes with investment opportunity

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Mexico's government recently passed reforms repealing important limitations on oil and gas ownership introduced in 1938.While these reforms will reshape Mexico's energy industry over the next few years, they will also bring about investment opportunities in the energy industry throughout the rest of Latin America.

The proposed privatization of Pemex, the state oil company, would open up 17 per cent of currently producing oil fields to foreign exploitation and allow foreign companies to bid for development rights to 79 per cent of Mexico's reserve fields. In addition, the stateowned Federal Electricity Commission (CFE) is set to face competitors. Mexico's energy industry, which was in decline due to the dire need for improved technology, investment and reserve management, is now gushing with investment opportunity that will be principally supported by investors from the US and Canada. However, there will also likely be great interest from investors worldwide.

According to the U.S. Energy Information Administration, Mexico ranks among the top 10 countries for recoverable shale oil and shale gas. Mexico is also the third largest exporter of oil to the US, and the second largest pipeline importer of natural gas from the US.

These are attractive numbers to companies such as Exxon, which is making its first investments in Mexico in 75 years, undertaking offshore oil exploration. This is noteworthy given that deep water wells typically represent an investment of over $1bn with a 5-10 year time horizon.

There will be several rounds of bidding for oil franchises. In round one, some more challenging offshore and shale sites (including those adjacent to the Eagle Ford field in Texas) are up for bid for development by Pemex in tandem with foreign or private partners. In the second round any uncommitted fields are open to all bidders. The contemplated third and fourth rounds are also expected to generate very significant investments and pump billions of dollars into Mexico's economy.

Then investors will start looking outside of Mexico, and at potentially more risky investments fueled by the region's volatile political history. For energy poor Latin American nations like Chile and Peru, the fall in oil prices has clearly been helpful but for countries like Venezuela, Brazil and Colombia, the decline in prices has been worrisome.

The major oil producers are Venezuela, which has by far the region's largest reserves, then Mexico, followed by Brazil, Colombia and Ecuador. Venezuela has been particularly hard hit by the recent downturn in oil prices because so much of its state revenues depend on oil exports, which have been at best stagnant and made worse by the high levels of sovereign debt.

Petrobras was the shining star of Brazil, but has been hard hit by a mix of political interference, the need to subsidize domestic consumption and, recently, intervention in the bidding process for oil licenses and allegations of corruption. There is no doubt that the current levels of political uncertainty are affecting investment interest. Given its reserves are exceptionally difficult to extract, any deterrence is unwelcome. Brazil needs enormous investment in energy infrastructure development, as the country has some critical weaknesses in its power supplies. Its electricity grid – which draws heavily on hydroelectric power – is in dire need of a massive overhaul.

Oil has also been key for Colombia, whose national oil company is the largest in Latin America. As tensions in Colombia have fallen away, the amount of foreign investment has increased markedly. It is an active oil exporter but in consequence is running its reserves down quite rapidly. In Ecuador, oil is a substantial proportion of the country's exports, but ironically, because it does not have sufficient domestic refining capacity, the country has to import refined petroleum products.

How Mexico's energy reforms play out will be enormously influential on Latin America's economic outlook for both energy producers and consumers.

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