PORTLAND MARKET REPORT

July update

The world's greatest football fiesta is now upon us, and for many this means arguments over how many hours of daily televised sport is acceptable, the distinct but strangely comforting smell of Panini Stickers (we still need 77, 132, 236, 405 and 621 if you have) and of course – if you are an England supporter – the overwhelming sense of disappointment as our supposed "star" players fail yet again (at least we'll know by the time this issue is published…)

The 2014 World Cup started on June 12th and takes place in Brazil, a country that has become an economic power-house over the last two decades and also an energy super-power. Since 2000, the country has annually posted GDP growth of between 5-10% and has recently overtaken the UK as the 7th largest economy in the world. In energy terms, it has been both innovative and radical. 85% of electricity is from hydro-electric power, whilst an incredible 90% of cars run on gasoline/ethanol blends, meaning that carbon emissions are 80% lower than they would normally be as a result of pure fossil fuel consumption. In addition, few people can find too much wrong with Brazil's biofuels industry, as it has none of the negative associations of rainforest degradation (think palm oil plantations in South-East Asia) or the displacement of native food crops (think soya oil in the rest of South America). This is because the food-crop used in the biofuels industry is sugar cane, one of Brazil's traditional agricultural products and a crop that not only can grow on barren lands (unsuitable for other crops) without the need for irrigation, but also produces a waste product (bagasse) that is used for heat and power generation. Happy days!

Much of Brazil's energy innovation harks back to surprisingly enlightened policies from an otherwise unenlightened military regime in the 1970s. The oil crises of that decade highlighted the country's exposure to foreign oil imports and from 1976 it became mandatory to blend indigenous ethanol from sugar cane into gasoline, such that by the 1990s there were no cars leaving Brazilian production lines that ran on gasoline only. Of even more significance to today's energy picture was the development in the 1970s of the oil industry itself and in this area the state owned oil company Petrobras has pretty-well single-handedly transformed Brazil from an economic backwater into a developed economy.

Take a look at Brazil's biggest corporations and Petrobras towers above all others. With annual revenues of $140bn and assets of $313bn, Petrobras is the 4th largest company in the world (based on Market Capitalisation) and on its own accounts for almost 7% of Brazil's GDP! It was not always thus and much of Brazil's oil industry has been developed against a backdrop of limited reserves, when compared, for example, with its northern neighbour Venezuela. Whereas Venezuela sits on approximately 350 years of oil reserves (based on current production rates), Brazil barely has 20 years. But whereas Venezuela has become complacent, eschewing foreign investment and still sucking low value tar sands out of Lake Maracaibo (something it has done for almost 90 years now), Brazil has aggressively developed its oil industry by championing deep-sea technology in the Atlantic Basin and relentlessly focusing on extracting lighter oils for higher commercial returns. Unlike Venezuela and Ecuador, Brazil has resisted the temptation to join the closed shop of OPEC (preferring to trade its oil freely on the open markets) and, most unusually for a state oil company, political influence within Petrobras has traditionally been kept to a minimum and foreign expertise drafted in. The results have been as spectacular as they have been welcome for the Brazilian Exchequer; production up from 1m barrels per day (bpd) in 1985 to an estimated 3mbd by 2015 and a net exporter status (ie, the ability to sell its surplus production abroad) since 2011.

But nothing lasts forever and over the last 5 years, cracks have begun to show in the Petrobras express. Critics draw attention to a growing debt pile (that has quadrupled since 2008) and also like to point out that investment in offshore projects has been at the expense of the national refining industry (combined losses of $17.5bn since 2011). More worrying perhaps though is the increasing use of Petrobras as a political tool by the ruling Workers Party. Imbued by a sense of security that is generated by high oil prices, Dilma Rousseff's party has set price caps across the country, meaning that fuel subsidies are now taking big chunks out of Petrobras' profitability. So not only does Petrobras have to import 225,000 bpd of finished grade fuel (because its refineries can't cope), but these fuels are then sold on at a significant loss – costing the company circa $8bn per annum. Furthermore, there is also a double-whammy effect on Brazil's other great energy success story – the biofuels industry. Having successfully encouraged the country to use alternative fuels, the Brazilian Government now seems hell bent on undermining the industry in an attempt to redistribute wealth via fuel subsidies which make biofuels uncompetitive. In fact of the 400 ethanol plants built in Brazil since 2008, almost 10% have now closed and there are currently no plans for new plants, despite the fact that national fuel consumption continues to grow.

Whether the Brazilian Government is worried by the above is not clear, but having last year seen $64bn of foreign money invested in the Brazilian economy, President Rousseff probably has every right to look to the future with confidence. Most observers would admit that Brazil's continued economic growth will ensure that both fossil fuels and biofuels can happily exist long into the future and with a median income of $12,500 per annum, the 200m strong population of Brazil seems likely to have a great deal of growth left in it. As for Petrobras, as state oil companies go, it is still a pretty good prospect. Minority investors continue to be wowed by the company's huge offshore reserves and in Maria das Gracas Foster (another woman – not bad for a country famed for its machismo), the company has a boss steeped in Petrobras' successful history and hopefully with the necessary intelligence and determination to deal with the politicians. And if the Brazilian Government isn't worried, then the Brazilian people probably won't be too bothered either – at least for the 5 weeks when "*The Beautiful Game*" takes over.

For more pricing information, see page 26

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