PORTLAND MARKET REPORT

September update

Two great sporting events - the 2014 Football World Cup and the 2016 Olympics. Both held in Brazil and both meant to be showcases for the host country's vitality, prosperity and (soft) power. Back in 2014 and on the eve of the World Cup, this was a country on the up. Between 1990 and 2014 Brazil had become an undisputed economic power-house as well as an energy super-power. Annual GDP growth in excess of 5% meant the economy was now similar in size to the UK. The state oil company Petrobras was the biggest company in South America, whilst Vale – another commodity giant – was the continent's largest private company. And to prove that social progress was matching economic progress, this traditional macho nation was headed up directly and indirectly by two women; Dilma Rousseff ran the country and Maria de Gracias Foster ran Petrobras.

What a difference two years makes. Sporting performances from Team GB aside, the Rio games were far from being a success; half-built stadiums, accusations of corruption, a totally disengaged local population and empty seats everywhere (how about selling tickets for a $1 just to fill them?! Just a suggestion IOC…). If the 2014 World Cup heralded the arrival of a confident new economic nation, the 2016 Olympics highlighted just how far Brazil has fallen back over the last two years. Politically the country is a shambles (Rousseff herself being impeached for corruption), whilst the supporting corporate titans of Vale and Petrobras now find themselves in differing degrees of dire straits. Vale is nursing a $12bn loss from 2015 and must also face up to a potentially company breaking $44bn legal suit after a shocking mining disaster that left 17 people dead. Back in the oil world, de Gracias Foster was shown the door long ago and Petrobras finds itself in such an almighty mess that a break-up of the company now seems inevitable.

Much of Petrobras's problems have been self-inflicted with money laundering, political slush funds (mostly for local representatives of Rousseff's Workers' Party) and backhanders to the tune of $4bn, hardly being the markers of a mature and sophisticated corporate entity. Equally a lack of prudence in financial matters saw the company increase its debt pile during the good times, whilst not putting any money aside for the bad times (sound familiar anyone?). And if $50 rather than $150 is the new norm for oil, as most forecasters suggest, then those bad times look set to continue. After all, a new broom at the top can sweep away financial incompetence and misdemeanor, but it can do nothing about the low oil price.

AN UNSERVICEABLE DEBT PILE IN EXCESS OF $125BN AND LITTLE PROSPECT OF BRINGING THIS FIGURE DOWN MEANINGFULLY FOR THE NEXT 5-10 YEARS

Back in 2014 much was made of Petrobras' ground-breaking deep-sea extraction techniques that were enabling access to a previously untapped 60bn barrels of oil reserves in the West Atlantic Basin. But this technology has a monumental cost and the borrowing to fund operations was rapidly adding to the debt pile. All well and dandy when the oil price is $100 a barrel, but as we enter the second half of 2016, what exactly is the point of having bounteous oil reserves when they sit below a 2km strata of rock salt and cost more to extract than the likely value of oil for the next 10 years?! Petrobras' woes are also sizeable in the downstream (refined) sector, where enforced fuel subsidies (by the Government) ensure annual losses of $10bn. Bolt on the losses in upstream (exploration) plus the large-scale devaluation of the Brazilian Reais and no wonder Petrobras now has an unserviceable debt pile in excess of $125bn and little prospect of bringing this figure down meaningfully for the next 5-10 years.

One could easily argue that Petrobras's fall from grace and to a wider extent that of Brazil in general, was an inevitable result of a global commodity boom that was neither of its own creation nor within its control. Just look at those nations that dined out on their indigenous mineral wealth without making efforts to diversify their economies and you have the classic signs of the "commodity curse"; having enjoyed brief but unprecedented riches, the likes of Venezuela, Russia, Nigeria and now Brazil are all facing fiscal trauma of one sort or another, reduced economic stability, less democracy and an abrupt halting of foreign investment.

Where Brazil goes from here will make for an interesting case study (unless you are Brazilian of course). However myriad the country's problems are, they still have the best chance of the Petro-States to pull through without resorting to totalitarian politics. It has a more balanced economy than Venezuela, is less corrupt than Nigeria and is still a far more attractive place to invest than Russia. Equally, commodities in general and oil specifically, have turned Brazil into a global economic force that has transformed the lives of millions of Brazilians. This presents an inconvenient truth for both economists and environmentalists alike, who have struggled to credibly challenge the egalitarian growth model pursued by successive Brazilian administrations, when official UN figures show that levels of extreme poverty in Brazil have reduced from 23% in 1990 to less than 8% in 2010. But now with 25 years of retrospect, the economic fragility and indisputable environmental destruction (oil, mining, logging) that this model has created is difficult to justify if it no longer generates wealth and in fact pushes the country into further debt. *Pra caramba*…Brazil has some seriously tough decisions to make and with the workload that lies ahead, one suspects the Brazilian authorities were only too glad to see the back of the Rio Games…

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