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PEMEX Earnings Decline in First Quarter; Average Oil Prices Above Target

by LADB Staff
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Despite continued relatively high global oil prices, the state-run oil company PEMEX recorded a decline of 10.1 billion pesos (US$935 million) in the first quarter of the year. The drop is relative to January-March 2006, when sky-high oil prices vaulted PEMEX profits to US$8.1 billion. A number of factors contributed to the decline, including reduced export volume, a lower average oil-export price, higher labor costs, and an unfavorable exchange rate.

A large share of PEMEX profits end up in the Mexican Treasury, but officials are not worried that the reduced profits will affect the 2007 budget, as the price for crude oil remains above target levels for the year. PEMEX said exports were also lagging behind year-ago totals, already reflecting the decline in reserves at the Cantarell oil field.

The Cantarell field, which has been the source of 60% of Mexico's crude oil, is expected to yield 15% less oil this year than in 2006. Mexico's production of crude oil in the first quarter of the year totaled 3.158 million barrels per day, compared with 3.345 million bpd a year ago. The state-run oil company has discovered additional reserves in the deep waters of the Gulf of Mexico but lacks the capital to extract the oil (see SourceMex, 2006-03-22 and 2007-03-07).

Similarly, PEMEX said exports in January-March averaged only 1.711 million bpd, compared with 2.003 million bpd a year ago. The value of exports was reported at 235.9 billion pesos (US$21.9 billion) in the first quarter of the year, down about 6% from a year ago. Oil-export revenues were higher than expected in 2006, resulting in 108 billion pesos (US$10 billion) above what had been projected for the year, the Secretaria de Hacienda y Credito Publico (SHCP) reported published in late January.

Some experts say PEMEX faces a much more serious long-term problem than a simple decline in production and exports. A major concern is the decline in the quality of oil being exported, which increasingly involves the lower-valued heavy crude known as Maya. Energy consultant George Baker, head of Houston-based Baker and Associates, said this is a very risky situation for PEMEX, as the company risks losing some of its market in the US, its main customer.

Stable prices, stabilization fund eliminate budget cuts

The average oil-export price for the first quarter was reported at US$47.34 per barrel, down from US $50.12 a year ago. Still, the average price for the quarter was above the US$42.80 that the Congress used to determine the 2007 budget (see SourceMex, 2007-10-03). There was some concern when the export price of Mexican crude dipped to US$41.95 in January, the lowest level since May 2005.

Finance Secretary Agustin Carstens and other officials said, however, that Mexico could weather lower oil prices because it has saved some of the windfall oil revenue it obtained in the past few

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years. "We do not anticipate having to make adjustments to the budget," as a result of lower prices, Carstens told reporters in mid-January.

The excess revenues have been placed in an oil-price-stabilization fund, which totaled 28.4 billion pesos (US$2.6 billion) as of the end of 2006, that was established by Congress in 2000 to deposit oil-export revenues for use during a time of emergency (see SourceMex, 2001-12-12). "Our actual reserves would allow us to withstand a decline in the global oil price of as much as US$5 per barrel [relative to the target price of US$42.80]," said Miguel Messmacher, who heads the planning division at the SHCP.

SHCP officials said they were uncertain how much excess revenues Mexico would have to place in the stabilization fund or allocate to various programs. For example, strong revenues allowed the federal government to distribute 22 billion pesos (US$2 billion) to various states beyond what had been allocated. "If prices remain stable or are even slightly lower than anticipated, we will still be able to meet our budget goals," deputy finance secretary Fernando Sanchez Ugarte said in January. "But I'm not sure how much we will have for other purposes."

The trends appeared favorable for Mexican crude oil prices as of mid-May. On May 9, the average price of Mexican crude was reported at US$53.08 per barrel.

Mexico urged to rethink how oil revenues are spent

Other analysts say the high prices may be a double-edged sword. "While the increase in prices will benefit PEMEX in the short term, there could be long-term negative consequences," said Arturo Damm Arnal, an analyst at Universidad Panamericana in Mexico City. "There will be less pressure on legislators to enact a comprehensive tax reform that will wean Mexico away from dependence on oil revenues."

Some SHCP officials believe that Mexico must increase its tax collections by the equivalent of 10 percentage points of GDP during the next two decades to counter the reduction in oil-export revenues and still meet expenditure projections. "Mexico is eating up its oil patrimony by devoting revenues to current expenditures rather than investing it in education or infrastructure," said Ugarte.

Then there is the question of how Mexico is spending its windfall. While industry analysts and observers see no problem with devoting a large share of those funds to social programs, a chunk of the money is being spent on nonessential projects, such as a state-of-the-art baseball stadium in Chihuahua. "Petroleum revenue has funded universities, built highways, and provided health care to millions," said the Los Angeles Times. "But it has also paid for a giant flagpole in Nuevo Leon, remodeled churches in Yucatan, and bankrolled swanky government offices in Oaxaca."

Said syndicated columnist Sergio Sarmiento, "We've spent this lottery money in an absurd manner." Additionally, there has been little or no oversight of the distribution of more than US$40 billion in surplus oil-export revenue. Legislators "don't know, much less the citizens, really where it went," said PAN Deputy Moises Alcalde.

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Furthermore, Mexico one of the world's top-five oil exporters is putting a very small percentage of the excess into the oil-price-stabilization fund compared to other oil-exporting nations. Mexico's fund of about US$2.6 billion is only a fraction of the US$240 billion fund created by Norway, which ranks eighth in oil exports. A portion of the money in the Norwegian fund is earmarked for future pension benefits for its citizens. [Note: Peso-dollar conversions in this article are based on the Interbank rate in effect on May 8, reported at 10.80 pesos per US$1.00]

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