Translation of Commentary by Emily Medina, EPRINC Fellow
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Mexico, Oil Price War and Coronavirus

In the past week, two disruptive events, the coronavirus and the price war between Saudi Arabia and Russia, have threatened the energy sector, testing our energy security strategy. The international oil price fell 23 percent last week. While the Mexican export mix plummeted 66 percent, reaching $ 17.70 per barrel, the lowest price in 18 years.

The drastic drop in oil demand, first in China - an economic engine - and later in the rest of the world as the coronavirus spread, has caused a destabilization in the energy and economic markets. Unfortunately, Mexico was already in a vulnerable position having faced a technical economic recession in 2019. The forecast for this year looks a lot grimmer. According to international banks, a contraction of 4 percent is estimated.

On top of Mexico's economic situation, and at the worst moment, two of the main oil producers, Saudi Arabia and Russia, having not reached a mutual agreement to cut their production, decided to enter a price war. Worsening the economic chaos from coronavirus.

This administration's approach to energy security has had a nationalist vision with the objective of achieving energy sovereignty and strengthening Pemex. Disruptive events like these show us that no country is oblivious to external market conditions and, consequently, we must implement a strategy appropriate to the dynamism of the current world, taking advantage of our internal strengths and developing new alternatives to compete.

Countries that are more equipped in petroleum storage infrastructure will be able to be more resilient to the oil price war by filling storage inventories cheaply, as is the case in the US where they are currently taking advantage of filling their strategic oil reserve.

Unfortunately, Mexico cannot take advantage of this opportunity because it only has the capacity to store the equivalent of 3 days of national demand. By means of the Public Policy for the Minimum Storage of Petroleum Products (established in the Hydrocarbons Law), the aim was to increase inventory days in order to have greater energy security. However, the government in recent months has removed that mandate.

For Mexico, being a country that imports 80 percent of fuel, it is even more important to have enough storage. As a result of the energy reform, private sector investment in storage has grown in recent years and will continue to grow due to market conditions. However, the speed with which this infrastructure is built depends largely on the granting of permits by the government.

This external shock that we are experiencing should be taken as a wake-up call to continue with the energy security measures proposed in the energy reform. The energy security approach proposed by this administration is inadequate and does not help increase resiliency amid the price volatility that exists today in the energy market.

While we must reduce our dependence on fuels from other countries and streamline our refining processes, which currently have an operating capacity of about 40 percent, we must prioritize investment in production and exploration activities and energy infrastructure for transportation, distribution and storage. The government's decision to build the new "Dos Bocas" refinery located in Tabasco, is economically unfeasible according to the Mexican Petroleum Institute.

On the one hand, we have historically cheap oil prices originating from an oversupplied market, and, at the same time, we have a neighbor in the north with the lowest prices for refined products. On the other hand, the government wants to build a refinery at a time when Pemex has historical economic losses, highly expensive and uncompetitive production in much of its fields, and above all a price environment that worsens the economic outlook for the State productive company.

The government should reassess whether the best destination of Mexican taxpayer's money is in the investment of a new refinery that will cost the nation at least 8 billion dollars and generate small returns.

Mexico's energy security strategy design should put technical and economic factors before ideology. Failure to adapt to current market conditions, particularly during a low oil price environment could continue weakening Mexico's economy and do the opposite of strengthening the state owned oil company.