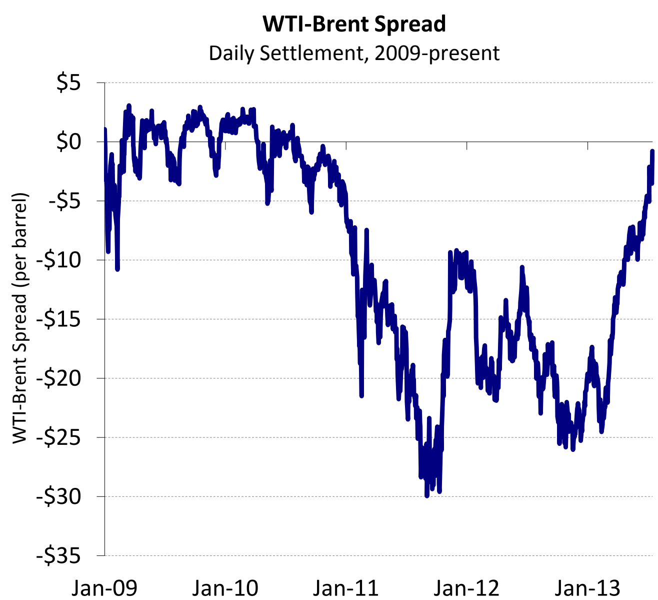
WTI-Brent Spread Reflects Dynamic Refinery and Infrastructure Pictures in US

US economy strengthening…

There is increasing optimism that the economic recovery in the United States is on firm footing and strengthening. Indeed, the main concern articulated by many investors in the US is that the Federal Reserve will start to slow the growth of money supply due to continued economic recovery (see 21 June 2013 *Opinion*).

Part of the reason for the comeback in the US is the rapid growth of domestic crude oil production. This phenomenon has received no shortage of attention from both the press and analysts, and the suddenness of it caused a supply glut within North America as transportation infrastructure struggled to keep pace. West Texas Intermediate (WTI), a popular light-sweet inland crude oil pricing benchmark, consequently fell in relation to the more globally traded Brent benchmark. The so-called "spread" between the two peaked near $30 a barrel in 2011, but has almost returned to parity as of this writing.

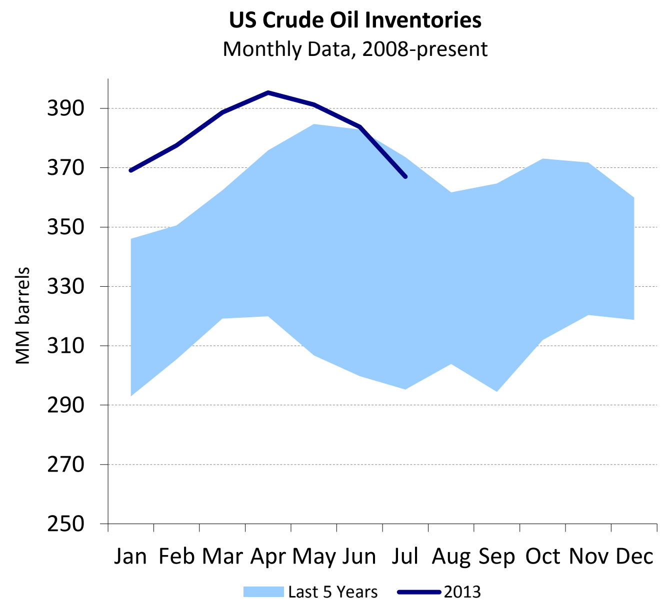
…WTI likewise strengthening against Brent



Source: Bloomberg

The comparative advantage of prolonged periods of low prices had led to record high builds of crude oil stocks in the US. These have substantially dropped off as of late – more so than typical seasonality would suggest – presumably in response to higher WTI prices, higher levels of crude runs, and higher interest rates that have increased the carrying cost associated with crude oil inventories.

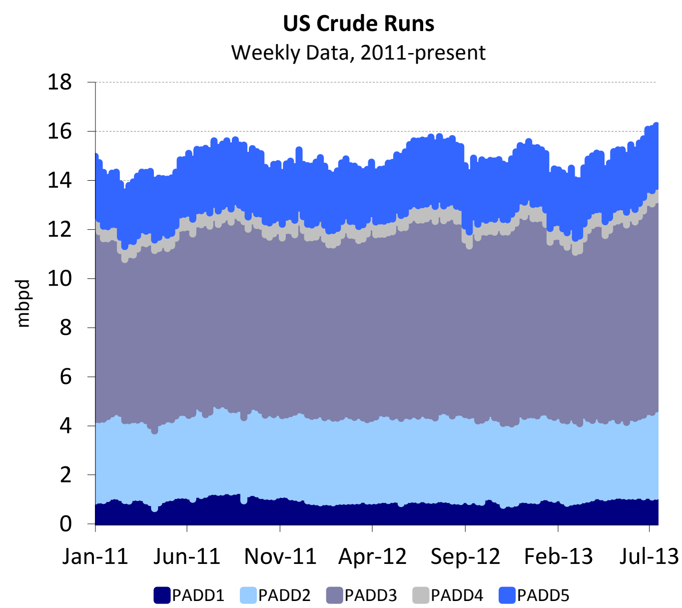
Inventories within five year range for first time in 2013



Source: Bloomberg, US DOE

Macroeconomic growth, advantageous domestic crude oil prices, and a regulatory inability to export crude oil coupled with increased production are the causes of a notable increase in US crude runs, mainly in the Gulf Coast region. A favorable refinery margin environment, particularly when compared to counterparts in Europe, has resulted in the US becoming a larger player in the clean export market (see 26 April 2013 *Opinion*) in turn.

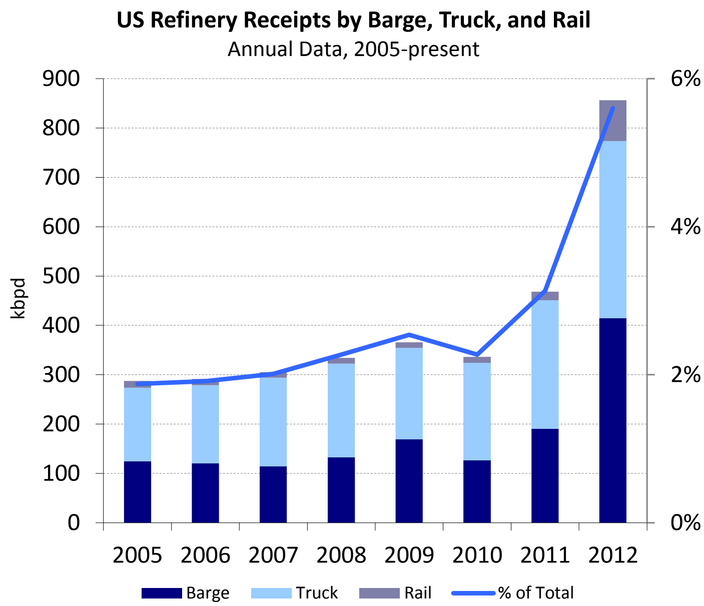
US crude runs at levels not seen since 2007



Source: EIA

The reason for the moderation, however, of the WTI-Brent spread is the maturation of intra-North American transportation infrastructure. Options have seemingly caught up – at least momentarily – to the increase in crude oil production. The amount of crude oil receipts at US refineries by barge, truck, and rail almost tripled between 2010 and 2012, while nominal receipts from tankers have actually declined.

Inland transportation volumes up sharply



Source: EIA

WTI and LLS probably not poised to strengthen much more against Brent

In a climate when crude runs have increased in the US, dirty tanker sectors have missed out on the associated growth in ton-mile demand that may typically have been expected. This has been exacerbated by the ability of lower price crude oil to now make its way to refineries more efficiently. It is unclear if net costs (including the benchmark oil price plus the cost of transportation) to refineries has changed substantially. Tellingly to this point, Louisiana Light Sweet (LLS), which when compared to Brent had remained relatively stable and near parity for much of the recent past, has started to trade at a premium to Brent. This is significant because the delivery point of LLS is seaborne rather than landlocked.

Should this trend of LLS and WTI strengthening against Brent continue, it is possible that Brent and West African grades could make modest gains in the share of crude processed in the US. This would be a positive for dirty tanker demand, and should also prevent the aforementioned spreads from swinging the other direction.

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