The Brent to West Texas Intermediate (WTI) spread has fluctuated over the years, with Brent posting a premium to WTI in most cases. For the tanker market, the value of this variance has gained further importance since the removal of the US crude export ban because it provides cargo holders with new commercial opportunities, dictating tanker trading patterns and global tanker demand. In this note, we will discuss our views of the Brent/WTI spread, its impact on US exports and how tanker demand may be affected.

The repeal of the ban on US exports in late 2015 has opened a variety of new markets beyond Canada for US crude oil. In the first five months of this year, crude exports have averaged just under 500,000 b/d with only 61% heading to Canada, down from a 92% average in 2015, according to the US Energy Information Administration (EIA) (Figure 1).

The remaining 204,000 b/d were exported to countries including the Netherlands, Curacao, Singapore, Italy and the United Kingdom. Curacao has been the most popular destination for US crude next to Canada, with exports averaging 54,000 b/d in 2016. Venezuela’s state-owned oil company, Petroleos de Venezuela (PDVSA) utilizes refining and storage infrastructure on the Caribbean island to facilitate the blending of US light oil with its domestic heavy grades for re-export to the East among other destinations.

The Netherlands is the third largest US crude export destination with exports to the European country averaging 39,000 b/d through the first five months of this year. The desire for US crude stems from steady demand at the three large refining hubs of Amsterdam, Rotterdam and Antwerp. Demand for new crude sources outside of Europe is growing amid lower production levels at North Sea oilfields and volatile supply in West Africa and North Africa.

Another major destination for US crude exports is the East as steady volumes to Singapore and Japan have been observed. Data provided by JBC Energy indicates increasing demand for light distillates such as gasoline and naphtha in the Far East and South East Asia since 2013, which is expected to continue. Rising demand for lighter end products in the region could cause Asian refiners to source more light sweet oil from the US; however, with volume swings, that could be exacerbated by changing pricing differentials and transportation costs.

In the summer months of June and July, the market witnessed lower US crude exports, driven by a weaker Brent/WTI spread. In June, Brent posted a discount to WTI for the majority of the month causing the spread to average US $0.45/bbl. Moving into July, Brent was pricing at an average of US $0.15/bbl above WTI. Reported crude fixture activity declined to six total fixtures during June and July, while May recorded five market fixtures. US EIA data further supports this notion as total

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US exports fell 42% in June; however, the late summer widening of the Brent/WTI spread from US -$0.54 to US $2.73 in August reversed this trend.

Market reported crude fixtures out of the US Gulf increased by seven month-on-month, to total nine cargoes for August. This activity is similar to the seven crude cargoes seen out of the US Gulf in April; however, the stem size has increased. The April cargoes averaged over 93,000 tons transported by five Aframaxes, one Panamax and one co-loaded VLCC. The August cargoes were transported on two Aframaxes and seven Suezmaxes. Another trend to note is more US crude cargoes have been destined to the East in 2016 (Figure 2). The wider range of destinations opens opportunities for longer haul voyages and may support overall ton-mile demand.

The increasing interest for US crude within Europe and more recently, the East, is a result of traders taking advantage of the widening spread between Brent and WTI. August fixture data shows that seven US crude cargoes traveled East compared to the two voyages to South America. The recent destination of choice in the East is Singapore as three crude fixtures were reported for August, more than any other month this year. Two of these fixtures were chartered by a major trading house, who has traditionally sourced from the UKC and West Africa to satisfy Asian crude demand. The oil giant took advantage of a wider Brent/WTI spread likely mitigating the higher rates for the longer voyage. In August, the freight rate for a VLCC on the West Africa/Singapore trade averaged US $1.14/bbl while the rate for a Suezmax on the US Gulf/Singapore trade averaged US $2.47/bbl, representing a US $1.33/bbl cost variance. In Figure 3, we can observe the inflection points where the Brent/WTI spread trades above the transportation cost variance, depicting a trading opportunity.

A future widening of the Brent/WTI may occur if Brent-linked production declines and output in the West increase. The International Energy Agency reported that United Kingdom oil production fell by 30,000 b/d to 1.045 million b/d in May, marking the first year-on-year decline in 14 months. North Sea oil supply is expected to remain below 3.2 million b/d for the remainder of 2016 amid maintenance shutdowns and the two week closure of the Brent Pipeline System in October.

Despite some recent calm, supply disruptions continue to be a concern in West Africa as militant attacks have compromised key Nigerian oil terminals, while production levels in Angola remain relatively flat due to curbed investment and operational challenges. Lower oil supply in Europe, coupled with production disruptions in West Africa, could support Brent pricing and further widen the premium to WTI.

In the Western Hemisphere, Canadian oil sands output is expected to recover to 2.5 million b/d before the end of 2016, after devastating wild fires lowered output since May, while US production may have found a bottom as the rig count inches higher. Increasing production could pressure the pricing of WTI-linked crudes and create a higher discount to the North Sea grade, potentially resulting in more Suezmax and Aframax loadings in the US Gulf. Forecasting to the end of 2016, we expect freight rates for a Suezmax on the US Gulf/Singapore trade to average US $3.35/bbl, while rates for a VLCC on the West Africa/Singapore trade is anticipated to average US $1.84/bbl, depicting a US $1.51/bbl cost variance. A further widening of the Brent/WTI spread above this cost variance is expected, potentially opening trading opportunities for cargoes bound for the East. Longer haul voyages from the West to the East would help support ton-mile demand, increasing fleet utilization and potentially adding some support to freight rates in the fourth quarter.