STRATAS ADVISORS

August 24, 2017

Wide Brent-WTI Differential Will Drive Increased US Crude Exports

Stratas Advisors

This excerpt is from a report that is available to subscribers of Stratas Advisors' Short-Term Price Outlook service.

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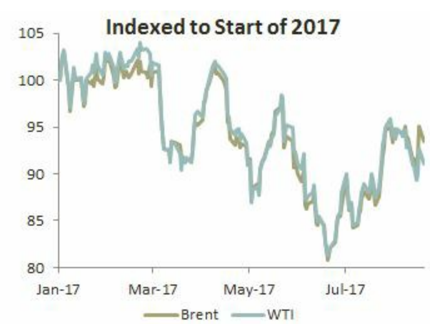
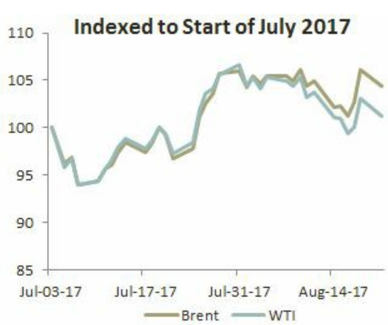
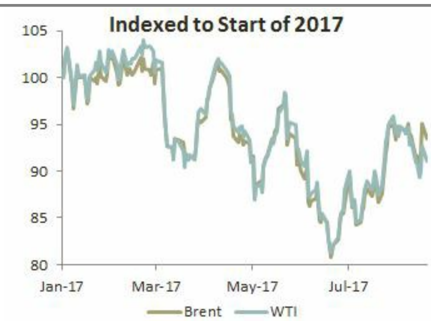
Key Takeaways

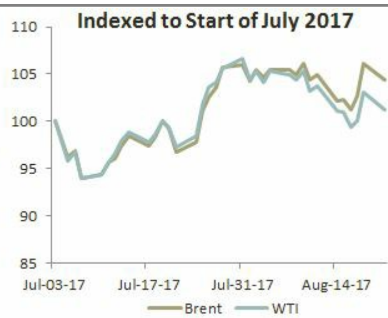
- The Brent-WTI differential has been widening as tighter fundamentals and increased geopolitical risk help Brent to outperform WTI.
- This phenomenon should continue in the near term as the US balance remains looser than global balances.
- The wider differential will likely lead to increased US crude exports to Asia. Increased exports will provide some support to uS crude draws, which typically loosen during fall refinery maintenance season.

Over the last month, the Brent WTI differential has been steadily widening. This is due to gains in Brent pricing outpacing gains in WTI. Since July 21 Brent has increased 8% while WTI has improved only 4% leading to an 83% increase in the Brent-WTI differential. This divergence is especially stark considering how closely Brent and WTI have mirrored each other for much of the year.

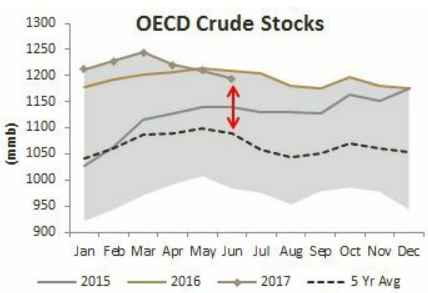


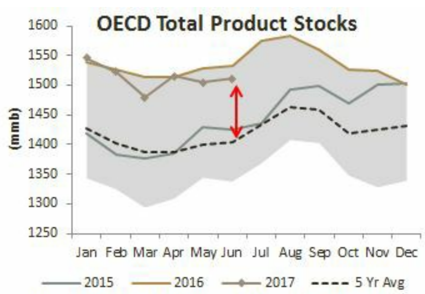


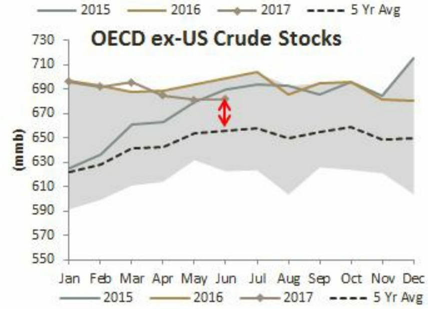


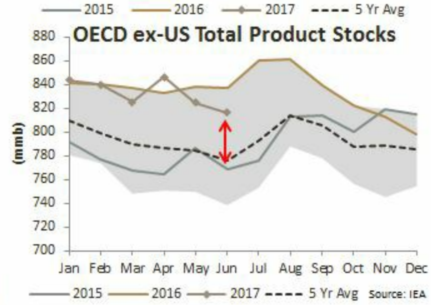


This pricing pattern is not entirely unexpected. The Atlantic Basin, specifically the United States market was by far the most oversupplied globally, due to rising shale production. As low prices and the OPEC supply deal took effect, Stratas Advisors expected the US market to be one of the last to fully tighten. Looking today at OECD stock levels, OECD Asia and Europe have improved considerably but the pace of improvement in the Americas is still lagging. Taking US stocks out of the picture, the global outlook is much better. OECD Total Crude stocks are 9% above the five-year average and total product stocks are 7% above the five-year average. After removing US stocks from the equation, remaining OECD crude stocks are only 4% above the five-year average and total product stocks are 5% above the five-year average. By contrast, US crude stocks are 19% above the five-year average and OECD Europe stocks are only 7% above. While these numbers do leave out non-OECD stocks, they are still a closely watched metric due to the frequency and validity of the data. Returning crude inventories closer to their five-year average is an explicitly stated OPEC goal.



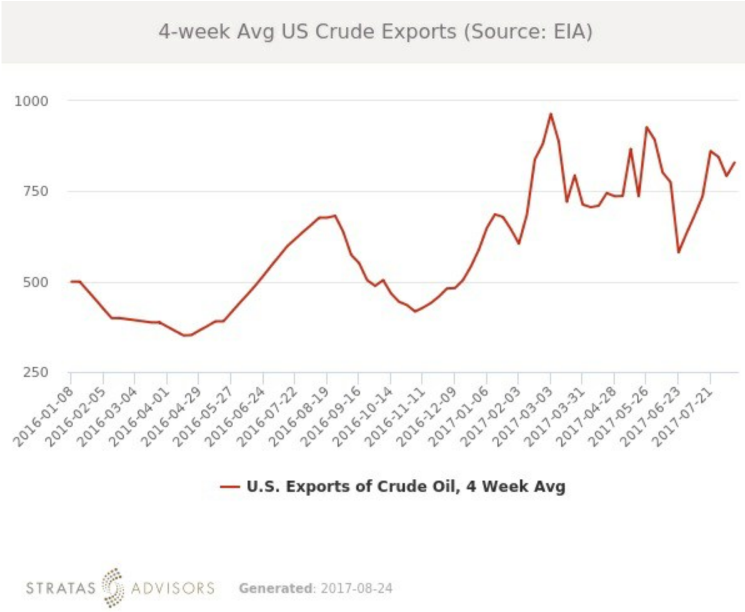






Given that global stocks are closer to normalizing than US stocks, it is no wonder Brent is improving more quickly than WTI. However, fundamental improvements aren't the only factor driving Brent. Brent as the more globally traded benchmark is influenced by geopolitics to a greater degree than WTI. Looking at the Geopolitical Risk Index designed by economists at the Federal Reserve Board, risk has been trending up lately, and is averaging above 2016 levels year-to-date. Increased perceptions of political risk are likely helping to support Brent prices. Brent by dint of its global reach is more affected by geopolitical risks than relatively isolated US supplies. When it comes to supply, sentiment again is on Brent's side. As the global benchmark, Brent reflects the success of OPEC in managing supply. Whereas WTI is under greater scrutiny because of the EIA's weekly data release and the weekly Baker Hughes rig count. This means traders react more quickly and more often to US crude supply news. Just as crude will continue to outperform E&P's in the short-term, it appears Brent will outperform WTI, driven by tighter fundamentals and buoyed by geopolitical risks.

The wider differential will likely translate into increased US exports to Asia, with the current netback appearing to support increased shipments. Higher volumes out of the US will be a boon for producers as fall maintenance season ramps up. Typically with runs falling, balances in the US loosen, and higher exports will provide some support.



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