Crude Exports Top 1 Million Barrels/Day to Plug OPEC Gap

Volumes unsustainable in the near term.

Morningstar Commodities Research

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Data Sources for This Publication

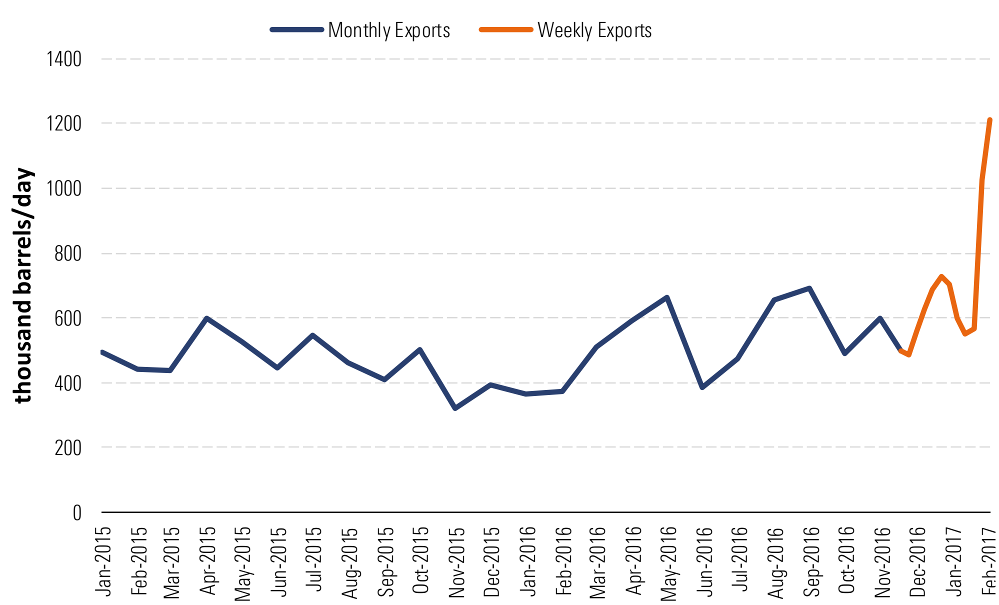
- U.S. Energy Information
- Administration, CME Group

To discover more about the data sources used, Click Here.

Dramatic Jump

U.S. crude exports jumped dramatically in the first two weeks of February 2017 to over a million barrels/day according to weekly data from the Energy Information Administration (see Exhibit 1). Such growth was unexpected by the market after exports showed scant evidence of growth and averaged a little over half a million bbl/d through November 2016 per the latest monthly data. This despite Congress having lifted 1970s-era regulations restricting crude exports except to Canada at the end of 2015—raising prospects for growth. Volumes in the weekly EIA reports show increases in December and January and then a jump to 1 million bbl/d during the week ending Feb. 10 and 1.2 million bbl/d for the week ending Feb. 17, 2017. This surge has come about, at least partly, in response to production cuts implemented by OPEC in January 2017. By filling this gap, the U.S. has temporarily assumed the role of swing producer. Yet as we explain below, crude exports remain opportunistic in the near term—responding to price drivers rather than becoming systematic in nature.

Exhibit 1 U.S. Crude Exports

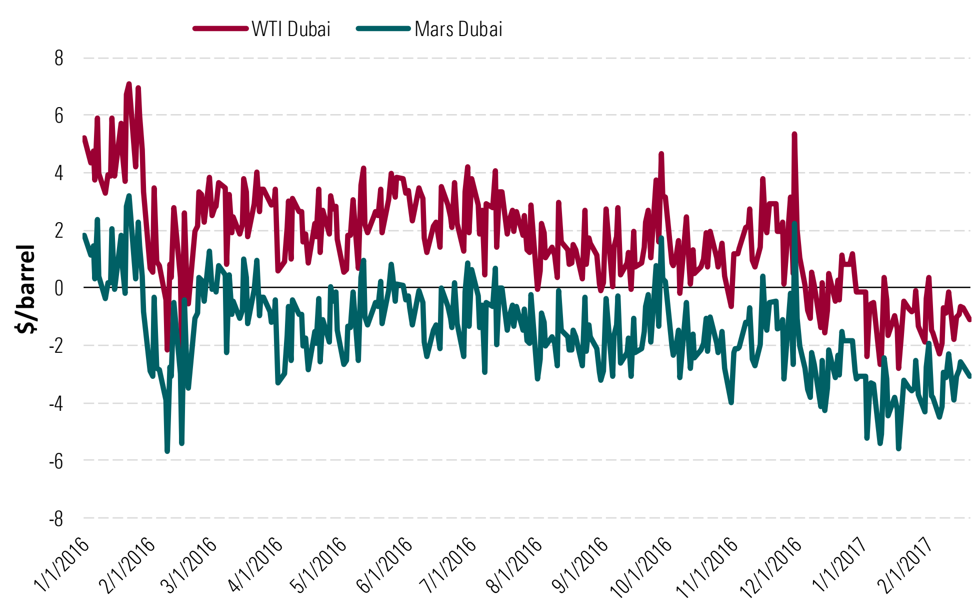


Source: EIA

How the U.S. Became a Swing Producer

Market sources indicate that a good portion of February's increased export volume from the U.S. (and from Europe) is headed to Asia, where it is needed to fill a gap left by OPEC cuts. OPEC and other producers, including Russia, decided last year to cut production by 1.8 million bbl/d during the first half of 2017 to prop up prices. To best preserve their income, producers chose to cut cheaper heavy sour crudes over lighter more expensive grades—leading to a shortage of heavy sour crude in Asian markets where OPEC producers normally sell these crudes. The result was an increase in prices for heavy crude in Asia, including the regional benchmark Dubai grade. Dubai prices traded at a premium to U.S. benchmark West Texas Intermediate, or WTI, for the first time in a year, and the Dubai premium to Gulf of Mexico heavy benchmark Mars crude was even wider (Exhibit 2)—justifying the freight cost to Asia. At the same time, seasonal refinery maintenance at plants along the Gulf Coast reduced throughput and left surplus heavy crude produced offshore in the Gulf of Mexico like Mars and Southern Green Canyon available for export.

Exhibit 2 Crude Premiums to Dubai



Source: CME Group

Not all heavy crude bound for Asia to fill the OPEC gap has come from the U.S. Other crudes such as North Sea Forties have also been shipped east to take advantage of higher prices. A tightening in the North Sea crude market has also widened the regional marker crude Brent's premium over WTI to about $3/barrel over the past few weeks. That Brent premium has also encouraged more exports of light U.S. crude, contributing to the record February volumes. As we detailed in our December note (see OPEC and NOPEC Cuts) U.S. crude export volumes have normally been tied to premiums for Brent crude over WTI because both are light sweet crudes and the U.S. generally has a surplus of light shale crude available for export. So at the same time as we have seen rare exports of Gulf of Mexico heavy crude, the Brent premium has justified several shipments of light crude from the Gulf Coast. Some of these cargoes are also headed to Asia—for example, Trafigura and BP are said to have shipped cargoes of Eagle Ford crude to Singapore and China. But other export cargoes making up February's record volumes are blends of light U.S. crude with heavy overseas barrels from Venezuela or Colombia (see our May note Venezuela Buying U.S. Exports for more on this topic) that are customized to meet specific refiner needs.

No Grand Plan

What should be noted is that despite record volumes, U.S. crude exports remain opportunistic, driven by price arbitrage and negotiated by traders on a cargo-by-cargo basis. There is no grand plan to systematically export U.S. crude. This contrasts with the growth during the past year in U.S. exports of liquefied natural gas (see our December note Shale Invasion – LNG Across the Pond) or liquefied petroleum gas (see our recent note Exports Balance Propane). In both cases, midstream companies have purposely built export infrastructure backed by investment from term shippers committed to regular export volumes. For the crude market, there have been build-outs of dock infrastructure for exports (see our recent note Houston Infrastructure), but term shippers with intent to export regular volumes have not committed to back these investments.

No Natural Surplus

Plans to systematically export crude would require surplus production looking for a home as seen in LNG and LPG. Although domestic production is increasing again as prices rise in response to OPEC cuts, the U.S. still imports roughly 8 million bbl/d of crude. Export barrels are usually light crude that Gulf Coast refiners don't need because their plants are configured to process heavier barrels. Every export barrel competes first in the domestic market with imports—there is no natural crude surplus waiting to be shipped overseas. As shale production increases (assuming prices stay attractive) then we expect domestic refiners to absorb more light crude—either through blending or reconfiguring their plants—further pushing out imports. Exports will continue to occur when arbitrage windows open, as currently experienced in response to OPEC tightening the international market by cutting production.

Future Prospects

Looking forward several years, imports could be significantly reduced by increased domestic production such that surplus barrels need to be exported on a sustained basis. At this point, we would expect to see purposely built export infrastructure. That would include deep-water ports capable of loading very large crude carriers and, for example, pipelines to the West Coast to allow competitive crude exports to Asia. Before then, though, the U.S. crude market must navigate the stormy waters of the proposed Border Adjustment Tax, which will distort market pricing and affect both new production and the volume of exports in ways that aren't clear yet.

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