Analysis: Rising US crude oil exports complicate rebalancing efforts

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One reason for the bearish narrative gripping the oil market of late has been that draws in US crude stocks have essentially come at the expense of the rest of the world.

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US crude exports have surged this year -- averaging more than 1 million b/d in April, the second most on record -- driven by the significant discount of US crude prices relative to global benchmarks.

The weakness of ICE Brent's term structure compared with NYMEX crude can be seen as a symptom of the glut that has been exported out of the US to the rest of the world that, in turn, has weighed on the oil complex.

The recent plunge in oil prices that began May 25 saw crude futures drop roughly $7/b through last week, while the contango widened across time maturities for ICE Brent and NYMEX crude.

Moreover, the contango for ICE Brent has now become wider than that of NYMEX crude, which for later-dated contracts had not been the case since late November when OPEC announced a deal to cut supplies starting January 1.

ICE Brent's front-month/12th-month spread averaged minus $1.84/b last week, which was 35 cents wider than the same spread for NYMEX crude.

Over the five trading sessions ending May 24, that ICE spread averaged minus 46 cents/b, compared with minus 92 cents/b for NYMEX crude.

That switch in relative strength from ICE Brent to NYMEX crude came amid a drop in US crude stocks that lasted eight straight weeks through May 26.

Analysts surveyed Monday by S&P Global Platts expect crude stocks fell 2 million barrels last week. But the same analysts expected a 3.5 million-barrel decline for the prior week, only to be surprised by a 3.3 million-barrel build for the week ended June 2.

WHAT'S DRIVING US CRUDE EXPORTS?

New infrastructure, like the 520,000 b/d Dakota Access Pipeline, has reduced costs to move crude to the Gulf Coast, while major projects are underway at USGC ports that will increase the region's export capacity.

While these outward flows have served as an outlet for rising US crude production, they have also displaced other barrels that have struggled to then find a home.

There were around 5 million barrels of North Sea crude on stationary tankers floating in the North Sea last week, according to cFlow, Platts trade flow software.

Further pressure on Forties crude differentials could eventually open up arbitrage flows to Asia, which has been more constrained this month given lackluster interest among Asian buyers.

In May, there were five VLCCs loaded with Forties headed to Asia, which sources said was unlikely to be matched this month.

At the heart of this dynamic has been US crude production, which has climbed 548,000 b/d since the end of 2016 to 9.318 million b/d the week that ended June 2, according to EIA estimates.

The recent trend, however, has been one of slower growth with output up just 4,000 b/d over the last four reporting periods.

That is by far the smallest increase during a four week stretch so far this year, and a far cry from producers adding more than 100,000 b/d every four weeks in January and then again from late February through mid-April.

PRODUCT DEMAND IN FOCUS

Another factor behind US crude draws was refinery utilization, with crude runs setting all-time highs twice this spring.

That type of strong activity is unusual for this time of year, as refinery utilization usually peaks in the summer.

US refinery utilization has averaged 93.5% of capacity over the last five weeks, compared with 90% over the same period a year ago.

Analysts are looking for the utilization rate to be unchanged last week at 94.1%. By comparison, the run rate for the same period a year ago equaled 90.2% of capacity.

Although helpful in tightening US crude balances, such strong run rates create products that must also be absorbed by the market either domestically or via exports.

The concern that product demand could falter surfaced in last week's EIA data when implied demand figures for both gasoline and distillates dropped by more than 500,000 b/d on a week on week basis causing stocks to build.

Coming at the onset of the summer driving season, the bearish data on refined products caught the market off-guard, likely serving as the catalyst behind last week's sharp sell-off.

Traders will be paying close attention again to products this week, particularly demand figures, which could have a bigger impact on oil futures than crude stocks.

Analysts are looking for gasoline stocks to have fallen 600,000 barrels last week. The five-year average shows inventories nearly unchanged for this reporting period.

So far this year, gasoline stocks have increased 4.9 million barrels to 240.3 million barrels, compared with an average decline of 9.8 million barrels during the same period from 2012-16.

DISTILLATES EXPECTED TO BE LITTLE CHANGED

Even after a build of 4.355 million barrels the week that ended June 2, distillate stocks stood at 151.088 million barrels, which was 10.597 million barrels less than at the end of 2016.

That comparison, however, can be misleading because a build of over 10 million barrels occurred the last week of 2016 setting a high baseline for the purpose of calculating year-to-date changes.

In fact, compared with the week that ended December 23, distillate stocks sit at a deficit of just 500,000 barrels, despite inventories having drawn 14 of the last 17 reporting periods.

Analysts expect distillate stocks rose 200,000 barrels last week. The five-year average shows inventories nearly flat for the same reporting period.

On the Gulf Coast, stocks of low and ultra low sulfur diesel have been unable to shed surplus barrels this year with the regional refinery utilization averaging more than 95% over the last eight weeks.

Greater exports would help draws stocks lower, but also place additional supply onto the global market.

The arbitrage economics look favorable for delivering ULSD from the Gulf Coast to Northwest Europe and Mediterranean markets.

The number of expected arrivals from the USGC to Mediterranean in June is expected to hit a 10-month high, as two tankers en route to Northwest Europe were redirected over the last week, according to cFlow.