(BN) WTI Oil Surges to 14-Month High as U.S. Crude Inventories P lunge

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WTI Oil Surges to 14-Month High as U.S. Crude Inventories Plunge
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(For Bloomberg fair value curves, see CFVL <GO>)

By Mark Shenk

July 10 (Bloomberg) -- West Texas Intermediate crude rose to a 14-month high after U.S. supplies tumbled for a second week as refinery operating rates gained, boosting speculation that a glut in the central part of the country is dissipating.

Futures climbed as much as 2.4 percent after the Energy Information Administration said inventories dropped 9.87 million barrels to 373.9 million, three times more than was forecast by analysts surveyed by Bloomberg. Stockpiles at Cushing, Oklahoma, the delivery point for WTI, fell the most since 2009 as refinery utilization increased to the highest level this year. WTI has moved into backwardation, with futures closest to expiration becoming more expensive than those for later delivery.

"There's no incentive to hold supplies with the market in backwardation," said Chip Hodge, who oversees a $9 billion natural-resource bond portfolio as senior managing director at Manulife Asset Management in Boston. "You are seeing big drops in inventories and that should continue."

WTI crude for August delivery rose $1.83, or 1.8 percent, to $105.36 a barrel at 11:48 a.m. on the New York Mercantile Exchange. The contract traded at $105.04 before the release of the EIA report at 10:30 a.m. in Washington. The contract touched $105.99, the highest intraday level since May 2, 2012. The volume of all futures traded was almost double the 100-day average for this time of day.

Brent oil for August settlement increased 25 cents to $108.06 a barrel on the London-based ICE Futures Europe exchange. The volume for all contracts was 24 percent above the 100-day average.

Disappearing Discount

The U.S. benchmark's discount to its European counterpart, Brent from the North Sea, shrank to less than $3 a barrel for the first time since December 2010, underlining the progressive easing of a supply bottleneck in the U.S. The spread widened to as much as $23.44 a barrel on Feb. 8 before contracting to as little as $2.43 today. It was at $2.70 at 11:48 a.m.

The EIA report was projected to show a 3.2 million-barrel drop, according to the median of 11 analyst surveyed by Bloomberg. The EIA is the Energy Department's statistical unit.

U.S. crude stockpiles have fallen 20.2 million barrels, or 5.1 percent, in the last two reports, the biggest two-week plunge since at least 1982, according to EIA data. Supplies surged to 397.6 million on May 24, the highest level since 1931.

Crude production rose 1.8 percent to 7.4 million barrels a day last week, the most since January 1992, the EIA said. Output has surged as the combination of horizontal drilling and hydraulic fracturing, or fracking, has unlocked supplies trapped in shale formations in the central part of the country.

Cushing Inventories

Cushing inventories dropped 2.69 million barrels to 47 million last week, the report showed. Supplies reached a record

51.9 million barrels in the week ended Jan. 11.

"We're seeing a reordering at Cushing, which is very supportive to WTI," said John Kilduff, a partner at Again Capital LLC, a New York hedge fund that focuses on energy.

"Cushing is no longer a bottleneck as new delivery routes have become available because of investment in pipelines and rail."

Refineries operated at 92.4 percent of capacity, up 0.2 percentage point from the prior week and the highest level this year. Utilization rates usually peak during the summer months when U.S. gasoline demand rises.

Gasoline stockpiles unexpectedly fell 2.63 million barrels to 221 million. Inventories of distillate fuel, a category that includes heating oil and diesel, advanced 3.04 million to 123.8 million. Supplies of both gasoline and distillate fuel were projected to advance 1 million barrels in the Bloomberg survey.

Fuel Demand

Consumption of gasoline increased 1.8 percent to 9.08 million barrels a day averaged over the last four weeks, the highest level since August, the report showed.

"Everything is going for the market right now," said John Kilduff, a partner at Again Capital LLC, a New York hedge fund that focuses on energy. "Refineries are operating at higher rates, which is increasing demand for crude. At the same time, gasoline demand is up above 9 million barrels a day for the first time in a long while."

Oil also gained as political upheaval in Egypt heightened concern that unrest will spread and disrupt shipments from the Middle East. The region accounted for 35 percent of global oil output in the first quarter of this year, according to the International Energy Agency's monthly oil market report published on June 12.

Geopolitical Tensions

In addition to the supply declines, "there are geopolitical tensions, and it's the beginning of a new quarter, and traders have a lot of fresh money to invest," said Addison Armstrong, director of market research at Tradition Energy in Stamford, Connecticut.

The U.S. benchmark oil extended its rally after breaching a technical resistance level on the weekly chart, according to data compiled by Bloomberg. Futures settled above $103.39 a barrel, the 61.8 percent Fibonacci retracement of the decline to
$32.40 in December 2008 from an intraday record high of $147.27 in July that year. Investors typically buy contracts when prices exceed technical resistance.

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