WTI Sheds Busted Benchmark Status as Glut Ebbs: Energy Markets
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By Moming Zhou
July 19 (Bloomberg) -- West Texas Intermediate crude is exceeding Brent in trading by the most in 23 months, regaining its status after being labeled as a “broken” benchmark.
Monthly average volume for WTI has surpassed Brent, its closest rival, by 189,000 contracts a day this month through yesterday, the most since August 2011, according to data compiled by Bloomberg. That’s coincided with a gain in price that’s cut WTI’s discount to Brent to the least since 2010. Oil from North America has become more accessible to refiners just as demand there grows faster than in Europe.
New and reversed pipelines and rail links have increased the capacity to move U.S. crude, easing a glut that weighed on prices and prompted Citigroup Inc.’s Edward Morse to describe WTI as a “broken” benchmark as early as 2009. Brent volumes topped WTI’s on a monthly basis as recently as April 2012. U.S. crude supplies have tumbled 27.1 million barrels in three weeks, the most in statistics dating back to 1982.
“The viability of WTI as a global benchmark is back on the rise,” John Kilduff, a partner at Again Capital LLC, a New York-based hedge fund that focuses on energy, said by phone. “We are getting into a position where supplies here will be at least tight, and that is now spurring all kinds of trading opportunities.”
Open interest in WTI, the number of contracts that have not been closed, increased to a record 1.88 million on July 15. The number of contracts outstanding averaged 261,000 more than Brent this month, up from 111,000 in February, according to data compiled by Bloomberg.

$108 WTI

WTI crude for August delivery was little changed today after climbing $1.56, or 1.5 percent, to $108.04 a barrel yesterday on the Nymex, the highest settlement since March 2012. The volume for all futures rose to 1.18 million on July 10, the most since Nov. 16, 2011. Brent for September settlement declined 8 cents to $108.62 a barrel on the London-based ICE Futures Europe exchange as of 3:25 p.m. in Singapore.
The spread between Brent and WTI fell as low as 67 cents a barrel in today’s electronic trading after settling yesterday at 89 cents a barrel, the narrowest close since October 2010. That’s down from $23.44 in February and a record $28.08 a barrel on Oct. 14, 2011. The difference averaged $17.47 in 2012.

"The WTI-Brent spread may hit parity next week as a lot of people are betting on it now," Ken Hasegawa, an energy-trading manager at Newedge Group in Tokyo, said by phone. "The U.S. economy is doing much better than Europe and Asia, including China. Fundamentally WTI will be supported."

'Feverish Contemplation'

The recent history of disconnect between Brent and WTI "ushered in an era of feverish contemplation of the implications of WTI becoming a broken benchmark" in 2010, Morse, Citigroup's global head of commodity research in New York, said in a May 29 report. He forecast that the WTI-Brent spread would narrow to $3 to $4 a barrel in the third quarter, a level it's already passed. It may widen to $7 to $9 at the end of 2014 and through 2015 as the Gulf Coast becomes more glutted, he said in a July 15 report.

In December, the Energy Information Administration, the Energy Department's statistical arm, said it used Brent rather than WTI for the first time to forecast prices in its Annual Energy Outlook. The change was made because of the then-growing price discrepancy between WTI and Brent, EIA Administrator Adam Sieminski said.

WTI interest has also rebounded as the market shifted into a structure known as backwardation, in which futures closest to expiration are more expensive than those for later delivery. August futures' premium to September reached 97 cents on July 10, with volume of the spread contract rising to a record 111,000. It settled at 23 cents yesterday. The spread was negative four weeks ago.

Eye Opening

"The speed that it happened was eye-opening," Tariq Zahir, a New York-based commodity fund manager at Tyche Capital Advisors, said by phone. "A lot of people made money from it but it also caught a lot of people off guard. We also saw severe contraction in the Brent versus WTI spread."

Since the start of 2012, new and reversed pipelines have boosted capacity to Houston from the central U.S. by almost 1.2 million barrels a day, with 850,000 more coming online by the end of the year, according to data compiled by Bloomberg.

Inventories at Cushing, Oklahoma, the delivery point for WTI futures, have dropped 11 percent from a record 51.9 million barrels in January, according to EIA data.

Enterprise Products Partners LP and Enbridge Inc. switched the direction of the Seaway pipeline last year to move barrels to the Houston area from Cushing. Planned expansions by Magellan

Midstream Partners LP’s Longhorn pipeline, TransCanada Corp.’s southern leg of Keystone XL and Sunoco Logistics Partners LP’s Permian Express line will also divert supplies from Cushing.

Rail Shipments

A surge in production from North Dakota and Alberta has outgrown pipeline space and depressed prices, encouraging oil producers and refiners to invest in rail transport.

U.S. railroads increased carloads of crude to 234,000 in 2012 from 11,000 in 2009, according to data from the Association of American Railroads. Shipments gained 20 percent on a quarter-by-quarter basis to 97,135 in the three months ended March 31. A rail car can hold 600 to 700 barrels of crude.

Shipments rose 1.1 percent to 13,203 carloads of petroleum and products in the week ended July 12.

“The expansion of infrastructure has made WTI increasingly relevant to international markets,” Tom Finlon, Jupiter, Florida-based director of Energy Analytics Group LLC, said by phone.

The U.S., historically the world’s biggest oil-consuming country, has also become the third-largest producer as a combination of horizontal drilling and hydraulic fracturing, or fracking, has unlocked supplies in shale formations in states including North Dakota, Oklahoma and Texas.

Energy Independence

Rising oil production helped the U.S. meet 89 percent of its own energy needs in March, the highest monthly rate since April 1986, according to the EIA.

Domestic output climbed to 7.49 million barrels a day in the week ended July 12, the most since December 1990, according to EIA data. Output exceeded imports in the week ended May 31 for the first time in 16 years.

Crude stockpiles surged to 397.6 million on May 24, the most since 1931. They decreased for a third week to 367 million barrels in the seven days ended July 12, the lowest level since Jan. 18, the EIA said July 17.

“WTI is regaining its stature as the global benchmark,” Phil Flynn, senior market analyst at the Price Futures Group in Chicago, said by phone. “The U.S. is going to be one of the biggest producers in the world and is the biggest consumer. You put it all together, what better benchmarks would you want for a global marketplace?”

Flawed Benchmarks

The transportation bottleneck at Cushing may not be completely alleviated until the second quarter of 2014, even with the boost to capacity, Julius Walker, global energy markets strategist at UBS Securities LLC in New York, said by phone. Brent, a gauge for more than half the world's oil, will remain a better measure of global oil prices.

"Both benchmarks have their flaws, but I think Brent will still remain the one that is more reflective of global market conditions," Walker said. "In the U.S., what happens in terms of infrastructure and refining will continue to be important."

Oil production in countries outside the Organization of Petroleum Exporting Countries will expand at the fastest pace in 20 years in 2014, outpacing demand growth, the International Energy Agency said in a report on July 11.

"The Brent-WTI spread and WTI's backwardation curve will have to be reversed," Zahir said. "Fundamentals don't support WTI. The volume that picked up in recent weeks will come down again."

Cushing inventories were 46.1 million last week, above the five-year average of 35 million barrels for this time of year.

"The market has been focusing on weekly change of stocks but eventually it will face the condition that supply is not at all scarce, Harry Tchilinguirian, BNP Paribas SA's London-based head of commodity markets strategy, said by phone. ''There is no fundamental support to keep WTI up there. We should see the WTI-Brent spread widening again.''

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--With assistance from Dan Murtaugh in Houston and Winnie Zhu and Mike Anderson in Singapore. Editors: Margot Habiby, Dan Stets

To contact the reporter on this story:
Moming Zhou in New York at +1-212-617-8956 or
mzhou29@bloomberg.net

To contact the editor responsible for this story:
Dan Stets at +1-212-617-4403 or
dstets@bloomberg.net