



Exporting US Crude in a Glutted Market

The U.S. Congress appears to have a spending bill that will lift the US crude export ban. We do not expect a significant net increase in exports for two years. In the meantime, crude will flow in and out of the country for quality balancing.

The U.S. Congress appears to have fashioned a bipartisan deal to lift the U.S. crude oil export ban, and the White House has signaled it will not veto the resulting legislation. If this moves forward, U.S. oil producers will be free to sell crude oil all over the world (rather than just to Canada). Yet, they will be selling into a remarkably glutted global market, which has struggled with a 1.8 million b/d surplus in 2015. The result has been a substantial drop in global crude oil prices this year. Looking forward, even with a dramatic price-driven drop in U.S. crude oil production, slower global demand growth and higher Iranian exports will sustain a global surplus of at least 600,000 b/d in 2016. This assumes no new supply disruptions.

Ironically, in 2016 when U.S. production will fall heavily and offer the most probable path to higher prices, the right to export will be granted. Republican legislators must recognize that a significant increase in exports is unlikely in the current market, but that greater trading flexibility within the global market will benefit U.S. producers in the long-run. Meanwhile, Democratic legislators and the White House will get (among other things) the extension of renewable tax credits, which coincides nicely with the high expectations coming out of the Paris Climate Accord. Furthermore, the juxtaposition of more Iranian exports with a ban on US exports was becoming a political liability for the Democrats in an election year. With this deal, that issue should disappear.

When Will the Market Welcome U.S. Exports?

There are two ways to think about the question of when and how much U.S. crude can be absorbed by the global oil market. The first is simply based on volume. Is there enough demand in the global market to absorb additional barrels and/or is there enough surplus in the U.S. to weaken domestic prices and open the arbitrage to cover transport to the foreign market. As the chart below shows, we do not expect an exportable surplus of LTO to emerge much before 2018. Without that surplus, the U.S. price discount will not reappear and encourage exports to a “higher priced” global market unless producers proactively discount their crude below market prices, but that is hard to do in such a weak price environment. That does not mean there will be no exports. Some export cargoes will move within vertically integrated company systems, and traders will move cargoes when temporary price arbitrage opportunities arise. There will be some quality swapping with light crude exported and medium crude imported, but that will only happen after shale production recovers. In sum, the global surplus and low global prices will limit if not prevent any net increase in U.S. crude exports, at least until 2018. Even after that, the foreign market for U.S. crude will be modest given slowing global demand growth and ample supplies in the Arab Gulf. U.S. crude exports beyond Canada may end up little more than a quality balancing exercise.

This brings us to the second way to think about U.S. exports: through the lens of crude oil quality. When the global supply of light sweet crude oil is combined with the global supply of segregated gas condensates, there is tremendous global supply of light hydrocarbons (even without Libyan exports). These ample light hydrocarbons exist in a market, which has seen at least a decade of refining investment designed to refine medium and heavy crude oil. Those refineries are not looking for light crude. Furthermore, many of the refineries in developing Asia that have “simple” configurations, run medium crude to manufacture fuel oil. As a result, outside of the U.S. there is actually a surplus of light hydrocarbons. Ironically over the next couple of years, it is the U.S., which will need light crude oil (see chart).

When the time finally comes for significant U.S. exports of LTO, they will have to be priced competitively to move them into a foreign market that is long light hydrocarbons.

