

2016 Americas Crude Viewpoints & News Round-up

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Viewpoint: LLS poised to be future standard for exports

Houston, 19 December (Argus) — Light Louisiana Sweet (LLS) may become the pricing standard for what will be an increasingly busy US light crude exports market in the future, thanks to the way quality specifications are enforced on the crude.

In US pipeline markets crude quality is traditionally determined at the final delivery point. This is particularly true for US offshore produced oil, where any one of several types of crude can be sent to market via offshore pipelines. This means a grade's stream quality can vary constantly. Quality can also suffer because of the increase in blending along the Gulf because of the surge in onshore shale crude production and higher Canadian heavy crude imports.

LLS is different, however, in that it is the only US pipeline grade that has strict quality specifications measured at the point of injection into the 1.2mn b/d Capline pipeline in St James, Louisiana. Capline specifications include a limit on metals, microcarbon residue, light ends and total acid number (TAN), which is much stricter than the traditional API degrees and sulfur content specifications used as guidelines for stream quality. This means LLS is the only widely-traded US domestic grade to have an actual set of specifications to which sellers have to consistently blend.

US crude exports have so far varied widely in both quality and destination. But foreign buyers have started to show a preference for consistent quality, moving away from Domestic Sweet (DSW) purchases in favor of West Texas Intermediate (WTI). WTI arrives at the US Gulf coast directly from the production fields in west Texas, segregated from other crudes so as to keep its quality neat. This makes WTI a better quality barrel with more consistent specifications.

DSW is light crude blended at Cushing, Oklahoma, and [one of several grades that can] price the Nymex light sweet crude futures contract. The DSW blend is usually made up of very light crude from shale producing regions and heavy Canadian grades. DSW quality has deteriorated such that many buyers decided to forgo the DSW discount to WTI at the US Gulf coast and instead pay up to purchase better quality WTI.

This preference for stable quality could open the door for LLS, with its stricter quality specifications, to become the light crude export of choice as the US export market becomes more sophisticated.

While LLS is also a blended grade, it benefits not only from agreed upon specifications but also from the years of experience that

sellers have blending to that spec. In the past, LLS was a blend of imported grades such as Algerian Saharan Blend or Nigerian light crudes. But for years now, sellers of LLS have been successfully blending US shale oil into LLS. They are able to do so not only in Louisiana, where the grade is priced, but also at export hubs such as the Houston, Texas, area, making LLS a desirable export blend for both foreign buyers and domestic crude sellers.

Viewpoint: Colombian crude heads to US West coast, Asia

Houston, 29 December (Argus) — A rise in competing crude supplies at the US Gulf coast pushed Colombian heavy crude exporters to ship more Vasconia and Castilla Blend crude to the US west coast and Asia. But west coast deliveries are becoming less profitable and the arbitrage to Asia more difficult to work.

Vasconia prices weakened versus its main US west coast competitor Alaskan Northern Slope (ANS), while a widening Brent-Dubai spread supported the Castilla Blend arbitrage to Asia. Vasconia's average discount to ANS for delivery to Los Angeles through the Petroterminal de Panama (PTP) pipeline was \$2.60-\$4.06/bl in the first half of this year. Vasconia's delivered discount to ANS has since narrowed to \$1.30-\$2.30/bl in the second half of the year so far.

Colombian crude has served as incremental supply for California refineries, but Vasconia exports through the PTP to the US west coast rose from January through June.

Colombian exports can move from Covenas through the Panama Canal, or through the PTP and then load on vessels to the US west coast and other destinations in Asia and South America. The majority of Colombian crude volumes are put in Panama storage for re-export.

A total of 26.3mn bl of Vasconia was exported from Covenas to Panama between January and October, with 71pc of that volume re-exported to the US west coast. Over the same period, 11.8mn bl of Castilla Blend were exported from Covenas to Panama, with 10pc re-exported to the US west coast.

In the second half of the year, volumes of Vasconia re-exported to the US west coast showed signs of decline, in line with a narrowing Vasconia discount to ANS.

Between July and October, an average 1.5mn bl of Vasconia was exported to the US west coast from an average 2.1mn bl between January and June.

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Colombian crude was regularly re-exported to Asia and South America from Panama storage. Of the 26.3mn bl of Vasconia placed in storage through October, 29pc was re-exported to Asia and South America, compared with 90pc of the 11.8mn bl of Castilla Blend.

Average volumes of Castilla Blend re-exported to the US west coast in the first half of the year were the same as between July and October. But the widening front-month Brent-Dubai swaps may have encouraged more re-exports of Castilla Blend to Asia, specifically, in the first half of the year compared to the second.

The Brent-Dubai front-month swaps spread ranged between \$3.60/bl and \$4.40/bl from January through June, a higher spread than the \$3.10/bl to \$3.90/bl from July through December to date.

A widening spread in the past has meant crude differentials on the Pacific coast for Latin American grades have fallen with competing Asian grades based on Dubai.

Though west coast deliveries are becoming less profitable and the arbitrage to Asia more difficult to work, Potential Opec production cuts next year could push refiners in Asia to look for medium and heavy sour crude alternatives from Latin America like Vasconia and Castilla Blend.

New fuel oil spec adds uncertainty to Maya price

Houston, 16 December (Argus) — A pending change to the price formula for Mexican heavy sour Maya crude shipments to the US Gulf coast will likely add cost and uncertainty to the grade.

Beginning 1 January, the official formula price for Maya uses a new quality specifications for fuel oil at the US Gulf coast, which comprises 40pc of the Maya price formula to the Americas. Rather than using No. 6 3pc fuel oil, the new formula will use RMG fuel oil, which has a 3.5pc sulphur content and is trading in the spot market at around a \$1/bl premium to No. 6 fuel oil.

PMI — the trading arm of Mexican state-controlled Pemex — weakened the formula price adjustment, or K-factor, used in the Maya price calculation by 85¢/bl in January from a discount of \$3.45/bl in December to a discount of \$4.30/bl. This was likely PMI's attempt at countering the impact on the final January price of Maya resulting from the switch to RMG fuel oil.

While formula prices are often inadequate as proxies for physical prices, the Maya price has appeared disconnected from actual US Gulf coast markets for many years. A key reason is the sour crude used for 40pc of the price formula is based on the price of West Texas Sour (WTS) crude at Midland, Texas. WTS trade volumes in the spot market have been limited — averaging about 59,000 b/d since the start of 2016. The price of the grade, which does not trade at the Gulf coast, tends to be more reflective of economics at the US Midcontinent.

With 80pc of the Maya formula price based on a crude grade that

does not reflect coastal value and a new, higher-priced fuel oil, Maya could be entering into a period of volatility. Ultimately the Maya price could move further away from the reality of spot markets for heavy sour crudes at the US Gulf coast.



Pemex favoring crude exports over refining

Mexico City, 21 December (Argus) — Mexican state-run Pemex is processing less of its declining crude oil production and prioritizing crude exports, reflecting a combination of operational and commercial dynamics.

Last month Pemex distributed a total of 2.090mn b/d, sending only 37pc or 783,000 b/d to its refineries and exporting the balance of 1.308mn b/d, according to preliminary data from Pemex's exploration and production division covering the 1-27 November period.

In 1-29 November 2015, Pemex had distributed 44.8pc or 1.06mn b/d of a total of 2.365mn b/d to its national refining system, earmarking the remaining 55.2pc or 1.305mn b/d for export.

Mexico's refinery runs are at record lows this year, a trend that Pemex executives vow to reverse in 2017.

In October, Pemex's six domestic refineries processed 802,100 b/d, 4.6pc more than in September but still 24.4pc below the October 2015 level.

Among the factors driving this trend is the increasingly heavy quality of Pemex's crude production. The company says the heavier crude it is extracting does not suit its ageing refineries, which were built to process lighter grades. Plans to upgrade the refineries and install cokers that would enable them to process heavy crude have fallen victim to sharp budget cuts since oil prices collapsed in 2014.

From a commercial perspective, Pemex may be better off exporting crude and importing gasoline and other oil products from more efficient refiners on the US Gulf coast.

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Between January and October 2016, Pemex imported an average of 472,500 b/d of gasoline, 12.5pc more than it did in the same period last year.

Yet recent scattered fuel shortages point to underlying logistical risks. This week the company said inclement weather delayed fuel imports at the Gulf port of Tuxpan, sparking a deficit in some parts of the country, including Mexico City.

The enduring backstory is Pemex's declining crude production. According to the same preliminary company data for 1-27 November, Pemex produced 2.075mn b/d of crude, 1.3pc less than in October and 8.9pc below the same month last year.

Barring crude imports, the smaller production pie translates lower overall refinery utilization.

The government is hoping its 2014 energy reform that revoked Pemex's monopoly will begin to jolt these trends in 2017, beginning with fuel supply.

Starting this year, companies other than Pemex can open retail stations and import fuel, ahead of a gradual price liberalization. Energy regulator CRE unveiled a regional timetable for the price adjustments in a presentation today, in anticipation of open seasons



for Pemex storage and pipelines in early 2017 that should help to ease bottlenecks in the underserved market.

"We are significantly underinvested in oil transport and storage," CRE president Guillermo Garcia Alcocer said at the presentation this morning.

Mexico's fiscal framework remains an obstacle. As of 12 December, the energy ministry had awarded 386 import permits for up to 329bn liters of gasoline and diesel. With the exception of small volumes bound for the mining sector, permit holders say a Special

Tax on Production and Services (IEPS) has prevented them from launching imports, effectively retaining Pemex's import monopoly on motor fuels.

Viewpoint: US Fed to wrangle over commodity limits

Washington, 29 December (Argus) — The US Federal Reserve may need to decide by early 2018 whether to move ahead with a proposed regulation that would make it more costly for large banks to trade and store physical commodities such as crude, natural gas and gasoline.

The regulation, proposed in September, would require banks involved with physical commodities to collectively hold an estimated \$4.1bn in additional capital. The rule would also prohibit many large banks from owning or investing in commodity-related infrastructure. The Fed wants the rule because it worries the cost of an oil spill or other accident associated with commodities might be large enough to destabilize banks and the broader financial system.

The Fed last week gave the public an additional two months to comment on the rule, until 20 February 2017. But the five existing members of the board, all nominated by President Barack Obama, will be under pressure to decide whether to finish the rule sometime that year as the leadership of the agency shifts toward nominees that might oppose the regulatory changes.

President-elect Donald Trump will be able to nominate two unfilled spots at the agency once he takes office on 20 January. The next spot at the agency is not scheduled to open up until 2020, but Fed chair Janet Yellen and vice chair Stanley Fischer might elect to leave the agency soon after their leadership positions expire in 2018.

Oil and gas companies are already raising concerns that compliance costs from the rule will drive banks to wind down some of their commodity trading. This could reduce market liquidity, increase hedging costs for businesses and concentrate risks among a smaller number of market participants, those companies say.

US refiner Philadelphia Energy Solutions, which owns a 330,000 b/d refinery in Philadelphia, Pennsylvania, on 20 December told the agency that the proposal would limit competition and "sap innovation and creativity" from commodities markets. The refiner said banks affected by the proposal are "sophisticated" market participants that use their expertise to help commercial businesses hedge their risks.

The Natural Gas Supply Association, a trade group that represents natural gas producers, in comments filed on 15 December said the proposal would reduce bank participation in commodity markets and could translate into higher energy prices for consumers. The affected banks have a "unique role" in commodity markets because they are more willing to meet counterparty demand for hedging, the group said.

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Democrats and public interest groups are supporting the regulations, which they say will prevent unfair trading and reduce market instability. Former congressional staffers Elise Bean and Tyler Gelasch, who worked for former US senator Carl Levin (D-Michigan) when he co-authored a report on commodity trading, on 22 December sent comments applauding the rule, which they said would protect US taxpayers from risks associated with commodities trading.

The Fed said it does not have a schedule for finalizing the proposed regulation.

Viewpoint: WTI Midland gets boost from export demand

Houston, 30 December (Argus) — Export demand for US light crude helped West Texas Intermediate (WTI) at Midland reach its strongest premium to the US benchmark light crude price in Cushing, Oklahoma, in more than 14 months.

Foreign buying interest is expected to continue, but increased west Texas production may weaken WTI Midland against volumes of the grade at Houston.

January WTI Midland reached an \$1.37/bl premium to WTI Cushing on 19 December, which besides its highest level since September 2015. For most of 2016, front-month WTI Midland has been at a discount to the benchmark, averaging 9¢/bl below for the year.

WTI Houston is averaging about \$1.40/bl over the benchmark for 2016 thanks to its ability to compete more directly with foreign crude since the US lifted export restrictions in December 2015.

WTI is piped from west Texas to Magellan's East Houston terminal and can be loaded onto vessels from other Houston locations. But this quarter, WTI began to be shipped from west Texas on Plains All American Pipeline's 250,000 b/d Cactus pipeline to Occidental's new 300,000 b/d crude export facilities in Ingleside, Texas, near Corpus Christi.

This new outlet is boosting WTI demand in west Texas, supporting WTI prices in Midland. The Oxy terminal provides direct water access and avoids Houston Ship Channel congestion. The additional demand also has helped to narrow the WTI Midland discount to WTI Houston.

The spread averaged about \$1/bl for the January trade month, from about 90¢/bl for December. Before that the spread averaged about \$1.60/bl this year.

The Opec decision to cut production by 1.2mn b/d starting in January is helping to boost Atlantic basin North Sea crude prices relative to US domestic benchmark WTI at Cushing, Oklahoma, making US crude exports more economical to foreign buyers. The February US light sweet crude futures price has been hovering around a \$2/bl discount to Ice Brent since 1 December.

And recent foreign crude buy tenders have shown an interest in US domestic crude. Venezuelan state-owned PdV is awarding a tender for three 550,000 bl cargoes of US WTI or Domestic Sweet Blend (DSW) for delivery later in December. Peruvian state-owned Petroperu issued two tenders in December to purchase a total of four 380,000 bl of crude for January and February delivery, with WTI Midland listed as a deliverable grade for the first time.

But WTI quality crude from west Texas is expected to rise in coming months, which may weigh on WTI Midland prices relative to coastal light crude. Permian crude production is projected to increase by 37,000 b/d in January from December, to its highest level of 2.1mn b/d, according to the US Department of Energy.

Monthly production has been increasing since declines in August and September, but January is the greatest projected jump since February 2016, when output rose by about 44,000 b/d from the prior month.

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