POTEN TANKER OPINION

Tankers from Texas

U.S. exports are already happening

The rapid growth in tight oil production has created an abundance of light sweet crude in the United States. However, prior to the tight oil boom, U.S. refiners invested many billions of dollars in upgrading capacity to be able to process the cheaper, heavier grades from Latin America and Canada, so they are not the ideal customers for the domestic crude. Under the best case scenario, U.S. refiners would continue to import the heavier grades and shale producers can export the lighter grades to the countries and customers that have a need for it: refiners in Europe and Asia. As we all know by now, the U.S. crude oil export ban, which dates back to the 1970s, prevents this optimization to take place and U.S. producers are forced to sell their crude to domestic refiners at a discount to what these grades may fetch on the international markets. Since last year, the pressure to overturn the export ban has increased. Just last Tuesday, a bipartisan group of senators introduced legislation to lift the ban citing various economic and geopolitical benefits. However, is the official lifting of the ban really necessary or has the industry already found ways around it?

The ban on U.S. crude oil exports is not absolute, Alaskan North Slope crude can be exported, but there is a gentleman's agreement that this will be done on U.S. flag or Jones Act vessels. These moves are rarely economic and therefore few and far between.

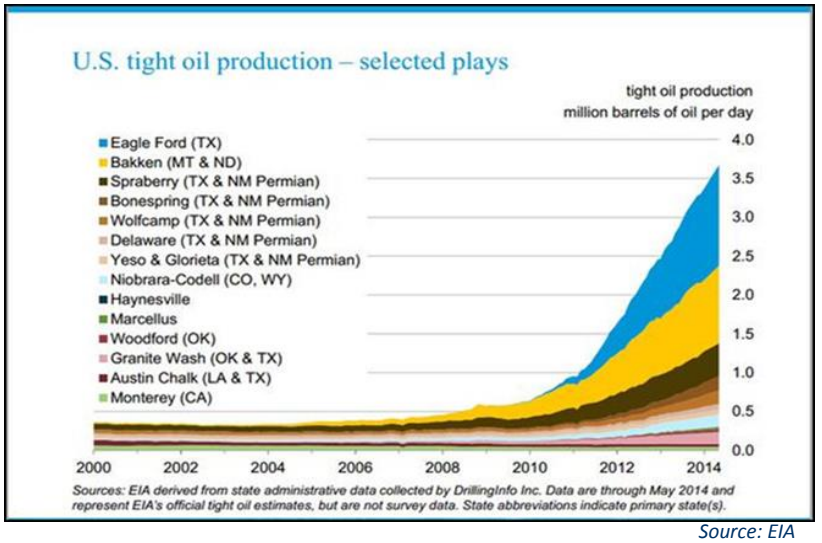
Exports to Canada are also allowed under the law and for many years the U.S. had been moving small volumes (50-60,000 b/d) of crude to its Northern neighbor. By the middle of 2014, the export volumes increased significantly (see Figure 2), as two Canadian refineries changed their crude slate. Valero's 265,000 b/d refinery in Quebec stopped importing light sweet crude oil from Algeria, Kazakhstan and Angola and replaced it with cheaper crude sourced from North America, primarily Eagle Ford crude from Texas. Around the same time, the 115,000 b/d Come By Chance refinery in Newfoundland changed hands. The new owners, a New York-based merchant bank, negotiated a new supply and offtake agreement with BP. Since then, the Come By Chance refinery has shifted from Iraqi crude to U.S. shale oil. Combined, these two developments explain the rapid increase in U.S. crude oil exports to Canada.

In 2014, U.S. producers started to use another (indirect) way to export oil: run crude condensate (ultra-light crude that "condenses" into a liquid after being freed from high pressure wells) through a distillation tower, after which it is considered a refined product by U.S. regulators and can be exported. The target market is Asia, which has close to 1.0 mb/d in condensate splitters, mainly in Japan and South Korea. Condensate exports from the U.S. are competitive with naphtha from the Middle East, in particular in Korea, because no taxes or import duties are payable due to the free trade agreement with the U.S. So far in 2015, U.S. condensate exports range between 40 and 80,000 b/d.

Last, but not least, earlier this year, Mexico applied for a crude oil swap with the U.S. State oil company PEMEX proposes to send heavy crude to the U.S. in exchange for equivalent volumes of light U.S. crude. If approved, this could provide an outlet for an additional 150,000 b/d.

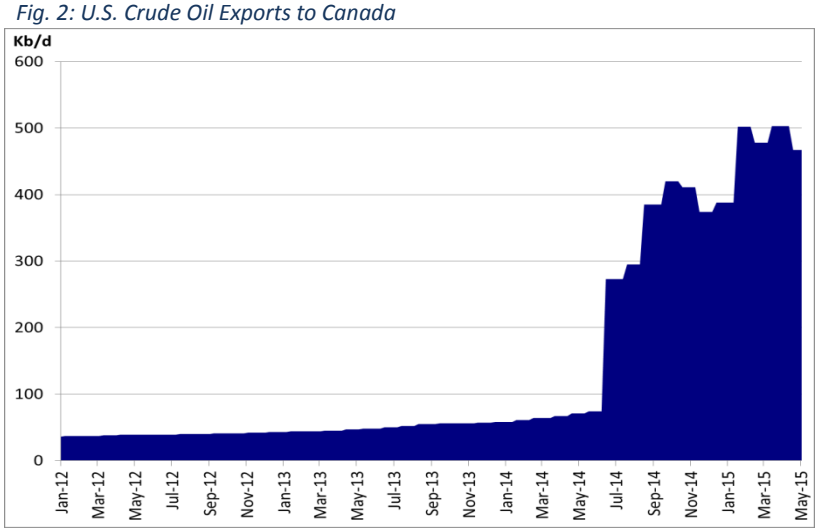
So far, the U.S. oil industry has skillfully managed to balance domestic tight oil supply and demand. However, a full lifting of the crude oil export ban may be needed to accommodate significant additional increases in production.

Fig. 1: U.S. Tight Oil Production



Source: EIA

Fig. 2: U.S. Crude Oil Exports to Canada



Source: EIA