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WTI Houston Contract Gains Market Steam

As the US solidifies and expands its position as a premier crude exporter, market interest and participation in a Houston, Texas contract for benchmark West Texas Intermediate (WTI) are picking up. London's Intercontinental Exchange (ICE) partnered with two major midstream firms last year to create the Midland WTI American Gulf Coast futures contract, which despite its name is priced in Houston and trades under the ticker HOU. Unlike previous attempts at building alternative contracts to the headline Nymex WTI futures priced in Cushing, Oklahoma, HOU seems to be gaining traction. According to ICE, average daily volume is over 4,000 contracts. Open interest is currently over 12,500 lots, up 87% from the start of the year, and extends through the end of this year. Sources say there are at least 60 participants active in the HOU trade, most of them commercial players — producers, refiners, and physical traders. HOU allows for delivery into both Magellan Midstream's Magellan East Houston and Enterprise Products Partners' ECHO terminals. This means market players can aggregate cargoes for domestic delivery or export at a single location rather than collecting them at various, competing terminals. Some experts argue that HOU is also simply more efficient for hedging purposes; rather than dealing with multiple differentials such as WTI versus Brent, Cushing versus Houston, and Midland versus Houston, for example, market players can simply use HOU against Brent or Dubai, depending on destination.

Several factors render a coastal assessment such as HOU more relevant for would-be exporters than headline Nymex WTI. For starters, incremental US output is almost entirely destined for export; not only is the US in the midst of a massive rationalization of downstream capacity, but domestic refiners largely have no need of more light, sweet barrels such as those that proliferate in shale plays. In short, production growth spells export growth. Logistics and quality concerns also play a major role. While the pipeline bottlenecks that had pressured Cushing WTI to major, double-digit discounts against Brent have largely been resolved, some experts see use of the inland hub as anachronistic. "That link to Cushing exposes refiners, producers and traders to unnecessary risk in the form of extra transaction costs to unwind the Cushing leg of their hedge positions ... volatility at Cushing that's unrelated to pricing on the [Gulf Coast] where WTI clears to international markets and exposure to pipeline logistics that have no relevance to the [Gulf Coast]," said Jeff Barbuto, global head of oil markets at ICE. Recently built pipelines bring crude directly from the Permian Basin and Eagle Ford to HOU's delivery points. Not only is this a more direct and efficient route, Cushing WTI's quality raises concerns with some market players. WTI at Cushing is usually blended to specifications, but as more unconventional grades enter the blending pool, the resulting barrels can sometimes behave unpredictably within the refinery gate. Deliveries into the HOU contract, in contrast, are essentially "neat" barrels, unblended and direct from the wellhead.

Interest in HOU is likely to keep growing over the near term. Midstream dynamics seems poised to shunt more oil into the Houston market. Meanwhile, starting in June, WTI will be deliverable into the Platts Brent assessment, a development that could send exports higher. The announcement that WTI would be deliverable into Brent already boosted open interest in the HOU contract, ICE personnel said. Longer term, Enterprise itself is building out significant crude export capacity offshore Houston. Currently, exporters' preferred port is Corpus Christi, Texas. Market players cite the ability to load very large crude carriers (VLCCs) close to

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capacity and easy pipeline access to producing fields as key draws for Corpus. However, pipeline space to the port is filling up rapidly. Meanwhile, Exxon Mobil is in the process of starting up its 250,000 b/d expansion to the Beaumont refinery, one designed to process incremental light, sweet crude such as that produced in the Permian. Analysts with RBN Energy note a roughly 800,000 b/d increase in Permian to Houston flows between late 2021 and early 2023. “Unless the pipes to Corpus expand their capacity, much more oil supply will be targeting Houston,” said RBN’s Housley Carr. In the future, Enterprise’s Seaport Oil Terminal (SPOT) will allow for VLCCs to load fully offshore, mirroring the Louisiana Offshore Oil Port further east.
