



Why Has the Differential Between Brent and West Texas Intermediate Narrowed?

Description

One of the greatest challenges for energy investors to understand is why various benchmark oil blends trade at different price differentials. Among these, the most significant — and hence most important to come to grips with — is the price differential between the two major industry benchmarks: West Texas Intermediate (WTI) and Brent.

WTI, which is a form of light, sweet crude, is used as the primary benchmark for oil sold in North America. Brent, which is a slightly heavier light, sweet crude, is the principal international benchmark. The price differential between the two key benchmarks has converged significantly in recent weeks. At the start of 2018, it was US\$6.64 per barrel and expanded to over US\$8 a barrel late May, but since then it has closed to less than US\$5. This is good news for the North American energy patch and especially those drillers producing light crude, which is benchmarked to WTI.

Now what?

The reasons for this are quite simple. North American oil supplies are constrained at a time when they are growing internationally. A combination of pipeline constraints in the Permian as well as the [Syncrude facility](#) going offline in Canada, which could sideline up to 360,000 barrels daily until the end of July, caused North American oil supplies to decline at a time when international supplies are growing. The reason for greater global oil supply was the decision by OPEC and Russia to open the spigots, adding up to one million barrels daily to international energy markets.

A narrower differential is good for North American oil producers, because they receive higher market prices, but it does make North American oil exports less attractive. That differential could widen once again when Syncrude recommences operations and the pipeline bottlenecks in the Permian, which have caused the expansion of U.S. shale oil production to slow, are eliminated.

There is also the very real risk that international oil supplies could be disrupted because of Venezuela's rapidly deteriorating oil output, renewed fighting in Libya, and Trump's moves to cut off Iranian oil exports. Some analysts believe that because of those and other supply-side issues, OPEC and Russia will be incapable of bringing the full one million barrels promised to market.

For these reasons, the price differential between WTI and Brent futures for January 2019 has widened to almost US\$9 a barrel, or nearly double the current differential.

So what?

Firmer WTI and a lower discount to Brent, even for a short period, will be beneficial for North America's light oil producers, including **Baytex Energy Corp.** ([TSX:BTE](#))(NYSE:BTE). It owns and operates acreage in what is considered to be the sweet spot of the Eagle Ford basin, which produces light, tight crude and is responsible for just over half of its total oil output.

Unlike light oil producers operating in Canada, Baytex's Eagle Ford production is sold at a significantly lower discount to the WTI benchmark. For the first quarter 2018, it came to just over 3% compared to almost 10% for the Canadian light oil benchmark Edmonton Par. Baytex is focused on expanding its Eagle Ford production at a rapid clip, which will allow it to fully benefit from higher prices. This, in conjunction with the [planned merger](#) with Canadian light oil producer **Raging River Exploration Inc.** (TSX:RRX), makes it an attractive investment.

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