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Study supports accuracy of WTI contract

By Gregory Meyer

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Oil traders and policymakers have criticised the benchmark US oil contract during the last year, after its price diverged sharply from other oil yardsticks. But a new study suggests that its main rival was also distorted.

West Texas Intermediate crude oil futures last year traded as much as $10 a barrel less than Brent, its rival from the North Sea.

But a study, by Craig Pirrong, a respected economist at the University of Houston, challenges the notion that WTI is inferior to Brent. The study was commissioned by CME Group, whose WTI contract at New York Mercantile Exchange is threatened by a shift in market share to Brent.

The study says WTI and Brent futures became less useful as hedging vehicles in the aftermath of the September 2008 collapse of Lehman Brothers. Front-month WTI futures, which at one point traded at an extraordinary $8-a-barrel discount to the same oil delivered a month later, suffered the most.

While the correlation between WTI price spreads and overall US stockpiles weakened in the period, Prof Pirrong's study found that the historic correlations between Brent spreads and US oil stockpiles became negative.

Between late 2008 and early 2009 "the relation between Brent spreads and US stocks was opposite that predicted by economic theory; stocks and Brent spreads moved in opposite directions during this period". The study further said: "This raises questions about whether Brent spreads reflected fundamentals," as captured by inventories in the industrialised nations of the Organisation for Economic Cooperation and Development.

The study's finding contrasts with the view of the International Energy Agency, the western countries' oil watchdog, which has been a strong critic of WTI. It said last year that "inherent logistical flaws" caused by the WTI contract delivery point at Cushing, Oklahoma, "frequently led to a disconnect from international markets".

The dislocation prompted Saudi Arabia, the world's largest oil exporter, to drop WTI as its benchmark for sales in the US. The kingdom now prices its oil against the Argus Sour Crude index, a basket of crude streams produced in the US Gulf of Mexico.

But CME suggested on Thursday that the study's results buttressed its flagship oil contract. "It was very reassuring to know that even when the world oil market upended, overproduced, way overstocked . . . WTI reflected this," said Bob Levin, managing director of energy research. Brent "was showing the wrong signals".

IntercontinentalExchange (ICE), home to Brent futures, declined to comment as officials there had not reviewed the study.

Some oil analysts are unconvinced. Edward Morse, head of commodity research at Credit Suisse in New York, said it is more likely that Brent spreads reflected global market conditions than WTI, "because there are so many times in periods since 2007 when WTI has become divorced".

Nymex February WTI **oil** on Thursday fell 38 cents to $82.80 a barrel. Brent dropped 29 cents to $81.56.

Base metals fell across the board after China tightened monetary policy. LME **copper** moved down 1.5 per cent to $7,550 a tonne.

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