

Talk of US export ban on diesel deepens US crude futures' discount to global benchmark

By Georgina McCartney

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HOUSTON, Sept 25 (Reuters) - Washington's talk of a possible ban on diesel exports is widening the gap between US crude oil futures and the global Brent benchmark, a signal that markets expect US refiners to process less crude oil if their diesel output gets stuck at home.

While that may bring some immediate relief to high domestic diesel prices, which this week hit a record \$6.528 a gallon and stirred a political uproar, the bigger discount for domestic crude futures could be a double-edged omen: an indicator of higher gasoline prices to come, while in the longer term diesel prices could also begin rising again.

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As investors price in a scenario where diesel gets stranded in the US, West Texas Intermediate crude futures traded as much as \$12.02 a barrel under Brent futures on Thursday, their largest discount since May 6, according to LSEG data.

Analysts say US refiners could cut their crude runs by as much as 12% if diesel exports are banned, with key storage hubs likely to fill up within a month.

The US is the world's largest diesel exporter, with net exports of about 1.2 million barrels per day, versus production of 5.1 million bpd, according to Morgan Stanley.

These exports have partially plugged the gap from lost Middle East barrels while the Strait of Hormuz remains largely closed. Diesel supplies have also dwindled from Russia, which has repeatedly imposed export bans of its own to tackle shortages that followed Ukrainian drone attacks on its oil refineries.

Wood Mackenzie analysts, in a note on Thursday, said a diesel export ban would redirect a 700,000 bpd oversupply of diesel and gasoil into storage, effectively filling Gulf Coast inventories to maximum capacity in just over a month.

That would force US refiners to cut crude runs by more than 2 million bpd, Wood Mackenzie estimated, to prevent inventories from exceeding capacity — a reduction of 12% of US refinery crude runs at current rates.

The White House on Wednesday denied media reports it was preparing for a 90-day diesel export ban, and US Energy Secretary Chris Wright said a ban would not bring surging prices under control. On Tuesday, however, President Donald Trump said he backed a ban.

In the meantime, Wright has contacted executives at several major American refiners in recent days to gauge support for voluntary restraint on diesel exports, as the Trump administration searches for an alternative to a short-term ban, according to three people familiar with the discussions.

RECORD DIESEL PRICES STIR CALLS FOR EXPORT BAN

Driving the demand for a US export ban is a surge in diesel prices, which have hit records in both the US and Europe. On Thursday, US prices remained elevated at \$6.514 a gallon, according to the AAA, as the US war with Iran disrupts global supplies.

That could spell trouble for Trump's Republican Party in the November midterm elections, by fuelling inflation and putting a particularly heavy burden on farmers, one of the party's key constituencies.

The Iran war is complicating the conundrum in the US oil sector in another way: by boosting shipping costs.

A rise in the discount for US crude relative to European crude, known as the WTI-Brent spread, typically boosts demand for US oil and increases exports, as traders can make a profit through arbitrage by selling it abroad. But that depends on shipping costs.

Rising freight rates and tight vessel availability have dimmed demand for US exports and contributed to the widening WTI-Brent spread, Georgios Sakellariou, freight analyst at Signal Maritime, said.

While the WTI-Brent spread has been trending wider in the third quarter, US crude exports have not risen significantly, according to data from ship tracker Kpler.

Shipping crude from the US Gulf Coast to Asian markets on a very large crude carrier currently costs around \$50 million in freight, according to Signal Maritime, compared with \$16 million before the Iran war broke out and drove up war risk premiums.

The discount that a barrel of US crude would need versus a European barrel to offset shipping costs was previously around minus \$4 a barrel, according to Bob Yawger, director of energy futures at Mizuho. It is now likely double that, at minus \$8, due to surging freight rates, Yawger said.

"International crude is carrying a higher scarcity and logistics premium, while US barrels are struggling to clear abroad at current transportation costs," said Shohruh Zukhritdinov, chief executive at oil trading firm NitroOil.

The WTI-Brent spread has traded exclusively at a \$4 discount or wider since July 7, according to LSEG. Yet US crude exports have remained relatively flat month over month, rising only 45,000 barrels per day from July to August, at 3.72 million bpd, according to Kpler.

On a three-month average basis, US crude exports for September are currently on track to fall for the third consecutive month to their lowest since before the Iran war broke out in February, according to Kpler.

"A wide paper spread is an invitation to test the arbitrage, not proof that the arbitrage is open," said Zukhritdinov.

Reporting by Georgina McCartney, Arathy Somasekhar in Houston, Noel John in Bangalore;
Editing by Edmund Klamann