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U.S. Refiners Still Have Gas in the Tank

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U.S. refiners are heading into the summer driving season at full speed.

Shares of are up 45% year to date, while and are up 39% and 30%, respectively.

The run-up doesn't seem too excessive considering how profitable it has become to sell fuel. The amount that refiners can expect to make from selling two barrels of gasoline and a barrel of ultralow-sulfur diesel minus the cost of WTI crude oil—also known as the 3:2:1 crack spread—has widened to roughly $30 a barrel, up about a third since the beginning of the year. While crack spreads aren't quite near the records set in 2022, they remain well above historical levels.

Disruptions in the Red Sea are helping boost refined product prices globally. Roger Read, equity analyst at Wells Fargo, estimates that the longer voyage time from diverting ships away from the Red Sea around the Cape of Good Hope has added about $2 a barrel to fuel crack spreads.

U.S. refiners have a distinct advantage because they can source crude oil domestically, from Canada and from South America. Moreover, the longer shipping time for all cargoes has boosted sales of bunker fuel, used as ship fuel, helping refiners that sell the product, Phillips 66 pointed out on an earnings call on Jan. 31.

For U.S. refiners, another tailwind is cheap natural-gas prices. While the U.S. benchmark natural-gas futures have rebounded from rock-bottom levels, they are still very low at about $1.85 per million British thermal units, well below the $3.24 average seen over the past decade. Natural gas is a source of energy for refining operations and of hydrogen that refineries use to lower the sulfur content of diesel fuel.

Meanwhile, domestic fuel inventories look tighter than usual at this time of year. In the week ended March 29, motor gasoline inventories were about 3% below the five-year average for this time of year, while distillate fuel inventories were 7% below, according to the U.S. Energy Information Administration.

Ukraine's recent drone strikes on Russian refineries raise the possibility of further tightness for fuel markets. Estimates vary but, as of March 27, figured the attacks have affected more than 900,000 barrels a day of capacity since January. While Russia does have some excess refining capacity, analysts expect that the country may have to start importing petroleum products, tightening the product market. Reuters reported that Russia has increased gasoline imports from Belarus.

Sanctions on Russia further complicate the picture: Because Russia relies mostly on China to replace refinery equipment, repairs can take longer, notes Emma Howsham, analyst at Wood Mackenzie. Investors looking for a hedge against geopolitical risks have snapped up gold, now near a record high, but they could also load up on domestic refiners.

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