DME

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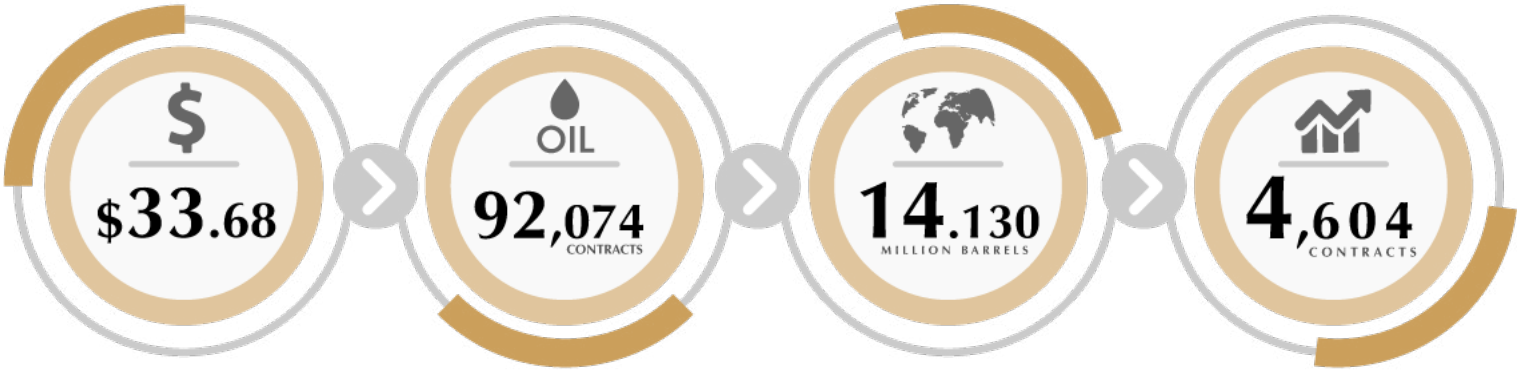
FUTURES INSIGHTS

Oil Markets rebalance, China leads the demand recovery

East of Suez futures oil benchmarks lead the way

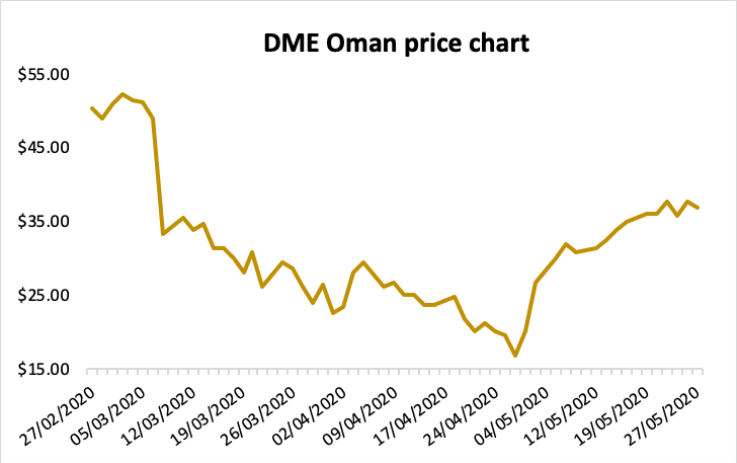
JULY 2020 CONTRACT



OSP | TOTAL EXCHANGE VOLUME | TOTAL DELIVERY | ADV

The coronavirus pandemic saw oil demand tumble to multi-decade lows in the second quarter of 2020 as around 90% of the world's population came under some form of lockdown or social distancing.

Oil prices collapsed to 20 year lows in April but a combination of record production cuts led by the OPEC+ cuts and an upswing in demand has underpinned the strong recovery during May.



Historically the market would look towards the North Sea Brent price as the lead indicator for any price recovery, but benchmarks in Asia have been the clear market leaders during the price rebound – fueled by China's recovery to near-normal demand levels.

Asia price recovery

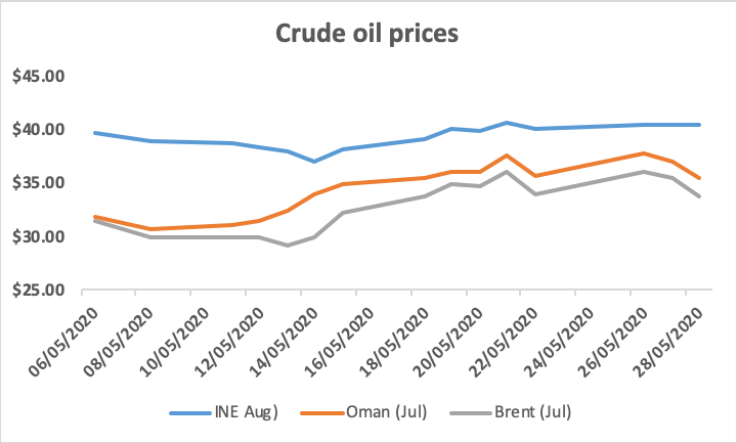
During the first half of May both Brent and DME Oman futures for July delivery were hovering in the low $30s per barrel, reflecting the rebound from the sub $20/b levels seen during April.

But several Middle East crude oil grades, including Oman, can be delivered against China's INE sour crude contract.

This means that crude loading in the Middle East during July could be delivered against the August INE contract, when factoring in shipping times to China.

August INE has been trading close to the $40/b mark since the start of May, opening up arbitrage opportunities for Middle East barrels into China.

In addition to Oman, other deliverable Middle East sour crudes include Iraq's Basrah Light, Abu Dhabi's Upper Zakum and Qatar Marine.



Until now physical deliveries into INE have been very low, with most contracts closed out before expiry. However, the expansion of storage facilities available for INE deliver has increased the likelihood of more contracts settled physically, according to traders.

According to figures published by INE, Basrah Light accounts for the largest share in INE bonded tanks, but Oman, Upper Zakum and Qatar Marine are also in-tank. Reuters noted that INE-warranted capacity has increased to 57 million barrels in Q2, including adding tanks from Sinopec, PetroChina and private refiner Shandong Hongrun Group.

Basrah Light crude for June loading traded at a record premium of $4.70/b above the Official Selling Price (OSP), in part reflecting arbitrage possibilities into China.

China leads demand recovery

Prior to the Covid-19 pandemic the world was consuming just above 100 million barrels per day (mbd) of oil, a figure that includes NGLs (natural gas liquids) and condensate.

Reports put demand destruction at the peak as high 30 million bpd, and second-quarter 2020 lost demand is expected to average at around 14 million bpd.

But the low prices have led to a huge buying spree from China, hence prices in China leading the price recovery - and in turn underpinning prices across the Middle East, Record cuts from the OPEC+ producer group has also had a major impact on reestablishing the supply/demand equilibrium.

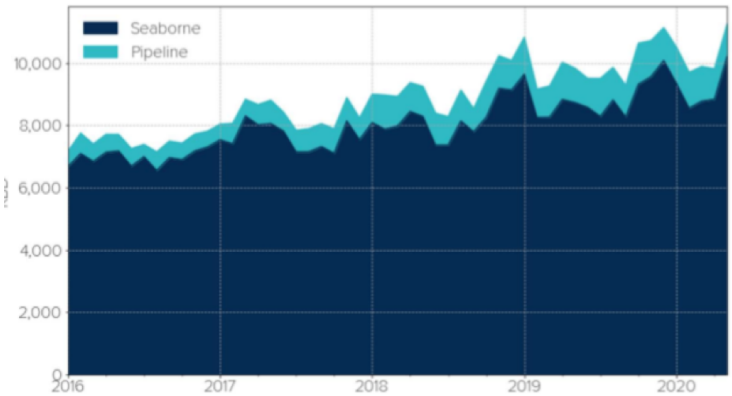
Bloomberg counted some 117 crude oil tankers en route to ports

in China during late May, which the report noted could add up to more than 200 million barrels of cargo.

OilX, which provides oil data analytics counted Chinese imports at near record levels over 11 million b/d, or a monthly increase of more than 1 mil b/d. In its monthly China Crude Import Tracker, OilX noted the following key takeaways.

Key takeaways:

- May crude imports rebounded in May to 11.11 mb/d, close to record highs, after a monthly increase of over 1.2 mb/d
- Although we do observe a steady recovery in throughout in Chinese refineries, the increase in imports was partially driven by Shanghai INE crude futures trading at a premium over other deliverable grades[1]
- Furthermore, independent refineries have remained active in crude oil procurement most likely due to lower crude oil prices



The majority of Oman crude oil is refined in China, which helped prices rebound faster than its North Sea benchmark counterpart.

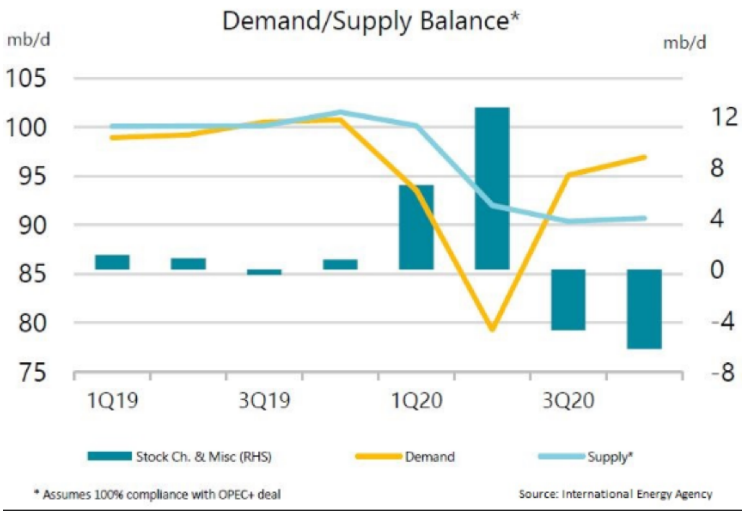
Brent has played catch-up with Oman during the latter part of May but in early June Oman was still trading at around $2/b over Brent, with European demand recovery more sluggish than Asia.

Global demand picture

The strong price recovery in the second half of May has led to a more positive outlook for oil in 2020, with a number of analysts raising price forecasts for the rest of the year.

Morgan Stanley expects crude prices to recover to $40/b later in the year, forecasting a sharp rebound in in demand.

The investment banks expects global demand back at 97 million mbd, leading to an undersupply of 4 to 6 million bpd.



Asia leads the price trend

But what is clear from recent trends, the global oil market will increasingly look to Asia and the Middle East for price direction, and Europe will become the follower.

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