DME

FUTURES INSIGHTS

Issue 40 - February 2023

MARCH CONTRACT

Oman leads the way as Middle East crude soar

OSP
$80.92

TOTAL DELIVERY
20.916 MILLION BARRELS

TOTAL EXCHANGE VOLUME
120,195 CONTRACTS

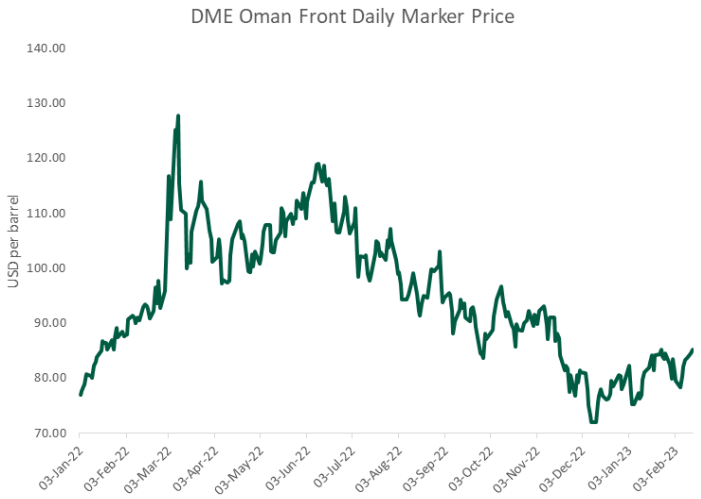
ADV
6,010 CONTRACTS

Oil markets have made a firm start in 2023, rebounding from the lower levels seen in the fourth quarter of last year, but perhaps more eye-catching for Asian markets has been the sharp rise in medium sour crude grades versus Brent.

Global crude oil markets have made a bright start to 2023, underpinned by China's decision to abandon most of the Covid-19 restrictions, in turn igniting a boost to oil demand from the world's largest crude oil importer.

Medium sour crudes, the mainstay of Middle East output and a staple for many refiners across Asia have led the price recovery, comfortably outpacing the North Sea Brent benchmark.

Oman futures trading on the **Dubai Mercantile Exchange** (DME), the primary Middle East futures contract for medium sour crude has led the way, not only in outright price terms, but also making strong gains versus other benchmarks.



Having dipped to a 2023 low of under $72/b in the middle of December, front-month DME Oman prices rallied almost 20% to around $85/b by mid-February, as an increasingly optimistic outlook on Chinese demand lifted crude values.

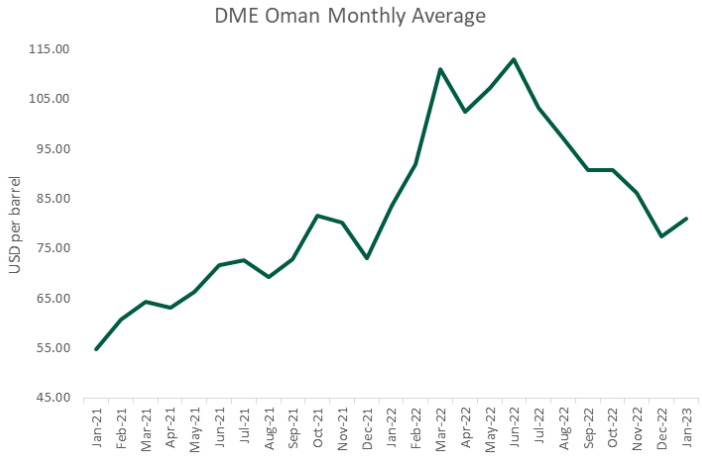
The International Energy Agency sees oil demand growth of 2 million barrels per day (bpd) this year to a new record 101.9mn bpd, fuelled primarily by a resurgent China.

The Paris-based agency lifted its demand forecast by 100,000 bpd in February compared to its previous-month's forecast, with China accounting for around 900,000 bpd of growth this year.

The other key demand driver will be jet/kerosene, which the IEA sees increasing 1.1mn bpd globally to within 90% of pre-pandemic demand at 7.2mn bpd.

OPEC has also raised its demand forecast for oil demand to 2.3mn bpd, reaching 101.87mn bpd in 2023, with around 2mn bpd from China, non-OECD Asia and the Middle East.

By comparison, OECD growth is projected at around 400,000 bpd, still slightly below pre-pandemic 2019 demand levels, driven by the Americas with Europe and OECD Asia flat.

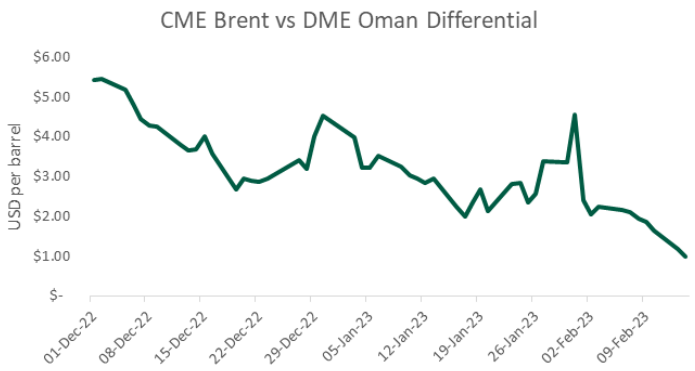


Optimism over demand growth from China and Asia has helped propel medium sour crude prices at a faster pace than North Sea Brent prices, which capture a basket of light sweet grades.

As recently as December the NYMEX Brent vs DME Oman spread was over $5/b, with Europe gripped by fears over an energy crunch as EU sanctions on Russian crude imports were implemented.

However, a mild winter helped Europe avoid an energy crisis and even though Russian Urals exports were re-routed to Asia, demand appetite has managed to absorb around 1.5 million bpd of Russian crude heading to Asia.

India has been the primary buyer with up to 1.4 million bpd of heavily discount seaborne crude processed by the country's refiners since the start of the year.



By mid-January, the key Brent/Oman spread had narrowed to $1/b as Russia announced it would rein in production by 500,000 bpd from March, which will dent Russian volumes heading to Asia.

In addition to increased consumption in China and across Asia, crude demand East of Suez has also been boosted by new refinery start-ups.

PetroChina is preparing to start its new 400,000 bpd Jieyang refinery, while the Shenghong Petrochemical plant will add over 300,000 bpd of demand.

Kuwait's 615,000 bpd Al-Zour has been ramping up in the Middle East since the fourth quarter of last year.

Medium sour crudes have also outpaced light sweet grades such as Brent, as refining margins for high sulfur fuel oil climbed to their highest level of the year by mid-February at around $20/b under Oman, having reached lows of over minus $35/b in the second-half of last year.

The other boost for refiners processing medium and heavy crude has been the sharp downturn in the cost of natural gas.

Many refineries are powered by gas and given the processing of heavier barrels is more energy intensive, lower gas costs boosts demand for heavy and medium crude grades.

In August 2022 Liquid Natural Gas (LNG) prices in Asia reached more than $70/mmBtu, but have since retreated to around $15/mmBtu

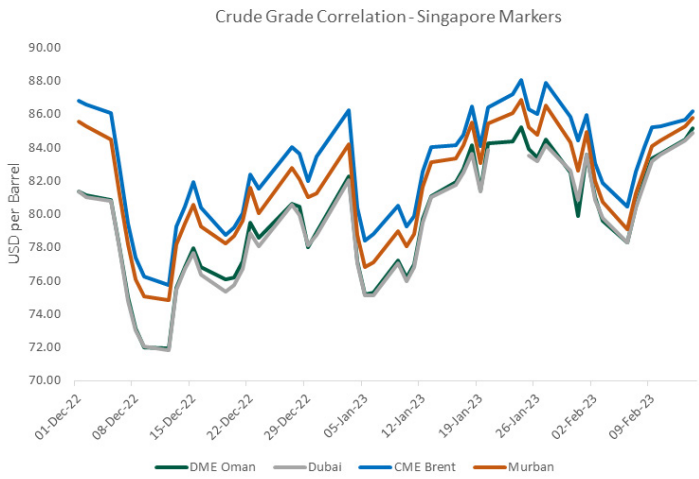
Oman is the most actively traded crude grade in the Asian market, with around 20 million barrels delivered via the DME, while there is also an active secondary market.

Similar-quality medium sour grades such as Upper Zakum are also traded in the spot market, but typically offering little transparency.

The OPEC+ alliance has also kept a tight rein on production this year with a survey from Bloomberg showing overall production slipped by 250,000 bpd to 38.06 million bpd, which was more than 2 million bpd below the group's combined quotas.

OPEC+ producers are expected to keep output quotas stable going forward, although ongoing concerns of an economic slowdown in the US and Europe continue to weigh on oil markets.

Uncertainty around Russia production and exports are expected to set the tone for another volatile year in oil markets, while Brent/DME Oman spreads have already demonstrated the necessity of hedging strategies for 2023.



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