DME

FUTURES INSIGHTS

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OSP

$54.79

TOTAL EXCHANGE VOLUME

103,056
CONTRACTS

TOTAL DELIVERY

13.723
MILLION BARRELS

ADV

5,424
CONTRACTS

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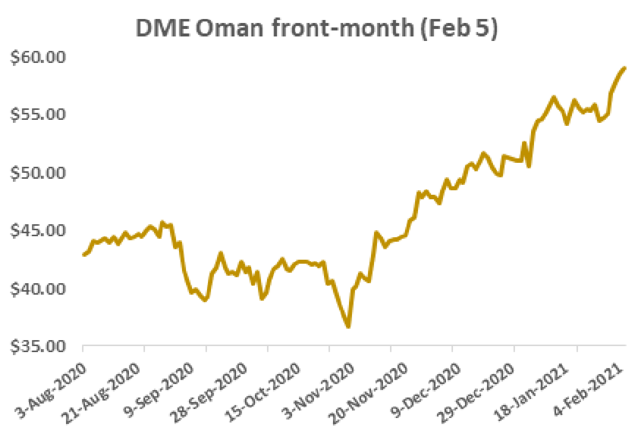
Forecasting the Future

As oil prices continued on their upwards trajectory moving into 2021, analysts scrambled to revise forecasts higher.

This article examines the relative merits of forecasts and futures markets in relation to price outlook or as a risk management tool.

2021 has already seen a flurry of revised oil price forecasts, as the speed of the market rebalancing has taken many by surprise and spot prices have rallied by around $20 per barrel since the beginning of November.



Leading investment bank Goldman Sachs, who had already issued a bullish commodities forecast in November of 2020, on January 11 of the new year advanced its year-end $65 per barrel crude oil forecast to as early as July 2021.

Likewise, UBS raised its forecast to $63/b for second-half 2021 and while other revised forecasts (such as the U.S. Energy Information Administration) have been more cautious, the trend has been higher across the board.

The upwards revision in price forecasts has largely followed the rally in spot and futures values, which have seen prices increase along the curve.

But that raises questions such as do forecasts largely reflect the futures curve, or do futures react to market forecasts?

Also, does a forecast or a futures curve act as a better guide to prices in the months to come?

Opinions vary

Forecasters go to great lengths to track supply/demand fundamentals across the energy complex, but of course these models can be thrown off course by unexpected events – the most extreme of recent times being the COVID-19 pandemic.

But ultimately, a forecast is in an opinion of the most likely course for prices going forward – albeit an opinion supported by reams of data and analysis.

Most revised forecasts tend to come after a move in futures, although some banks/analysts will publish a 'breakout' forecast, such as Goldman's bullish outlook in November when oil markets were still floundering.

Of course, market participants may trade on forecasts and if enough traders take the same view, futures prices may align with forecasts.

But a futures curve is not a prediction of where prices will be in the future, but a tradeable value that allows risk managers to lock in a value.

Ask 10 traders for a futures price on WTI crude oil in 12-months' time and assuming the traders access the WTI futures curve at approximately the same point in time, then the answers will be consistent with each other.

But ask the same 10 traders for a price forecast in 12 months' time and the chances are you will get 10 different answers.

At any given point in time opinions vary, prices don't.

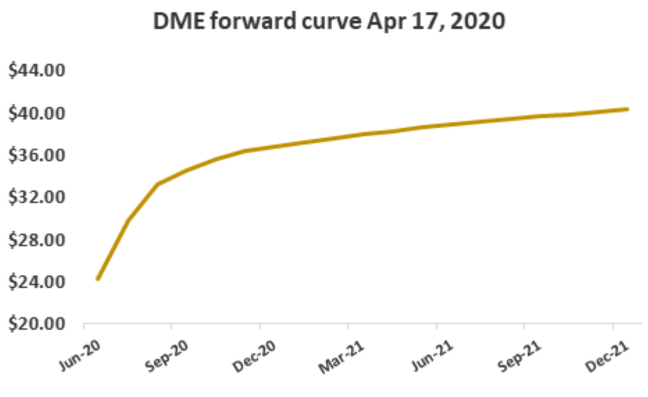
So if an airliner needs to lock in the future price of jet fuel purchases, or a refiner needs to hedge the crude/heating oil crack then the futures market will provide the appropriate hedging tool.

Both forecasts and a futures curves can act as a guide for market direction, although of course there are no guarantees.

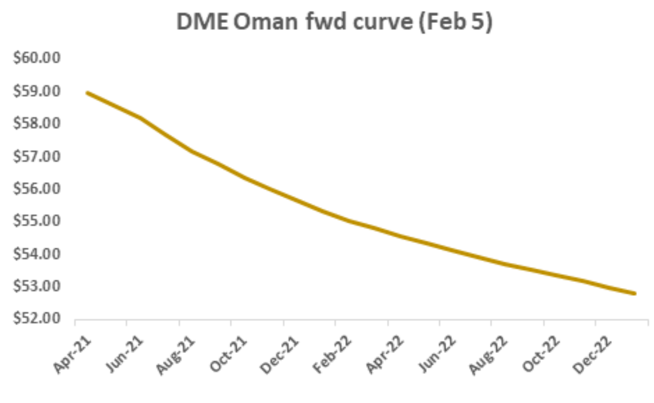
At the height of the CIVID-19 demand destruction in April 2020, oil prices slumped to 20 year lows and DME Oman briefly dipped below $20/b.

Markets reached a record contango structure in April, pointing to a strong rebound in oil prices.

And while the futures curve reflected the subsequent strong rebound in prices, the market moving into 2021 largely outpaced earlier futures curves.



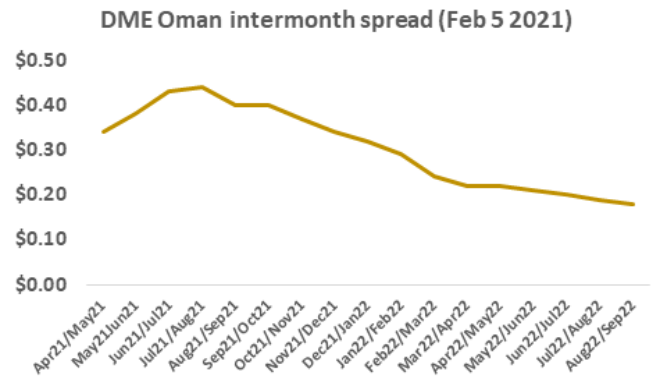
At the height of the covid-19 pandemic the Oman futures curve pointe to a strong recovery



Markets returned to strong backwardation moving into February 2020

A futures curve is also a key indicator of relative strength of the prompt market compared to prices further out.

This is reflected in the current market structure (Feb 2021), as demand outstrips supply and global inventories continue to fall.



Intermonth spreads moved up to $0.40/b over the summer months

Summary

At a glance, futures curves and forecasts may seem circular, reflecting each other as traders transfer knowledge gleaned from forecasters into futures.

But a futures curve is a snapshot in time of where market participants are currently willing to transact.

The price is uniform for all market participants and a price can be locked in at that point to help manage risk against future volatility, or used for mark-to-market purposes.

While forecasters may indeed get the price right, a forecast is not as useful for planning purposes of mark-to-market.

A forecast could indeed prove correct, and some analysts have better track records than others.

But one thing for sure is that either a forecast or a futures curve will not predict with any surefire certainty where oil prices will be at a certain point in time.That will be determined by fundamentals, which are constantly changing.

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