DME

# FUTURES INSIGHTS

Issue 39 - November 2022

## DECEMBER CONTRACT

# Russian sanctions cause major shakeup for Middle East crude

**OSP**
$90.79

**TOTAL DELIVERY**
15.217 MILLION BARRELS

**TOTAL EXCHANGE VOLUME**
113,703 CONTRACTS

**ADV**
5,414 CONTRACTS

*The up upcoming European ban on Russian crude shipments has primarily focused on the impact for Europe and Asia, but the Middle East is also going through a major upheaval that will have a significant impact on arbitrage flows, pricing and hedging strategies.*

The EU has imposed sanctions on seaborne imports of Russian oil that will start on 5 December.

On the same day, the EU and UK are set to prohibit companies from providing shipping, financing and insurance for tankers carrying Russian crude unless the oil is sold within the price-cap guidelines that officials are expected to publish later in November.

In preparation for the new rulings, the diversion of Russia's crude exports to Asia is already gathering pace, with record volumes of seaborne Russian oil destined to the region's refineries and storage tanks as shipments move away from Moscow's core European export market.

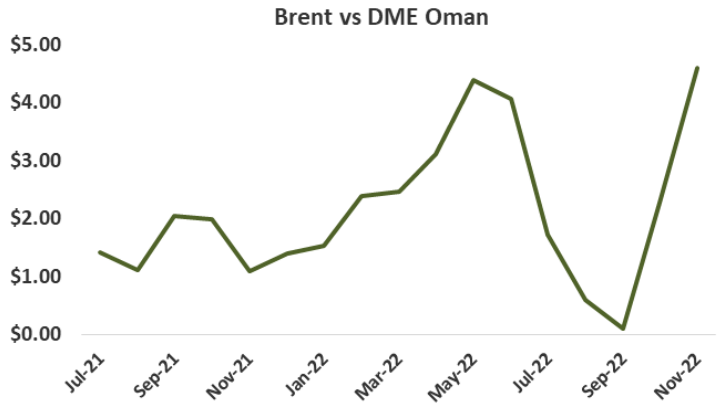
This in turn is having a major pricing impact on crude oil spreads, manifested in the key Brent/DME Oman marker, while intermonth spreads have also retreated sharply for Middle East crudes.

Russia has indicated it could reduce oil production in December and beyond by 1.5-1.7 million barrels per day to approximately 9 million bpd, according to analysts at Russia's Energy Development Center, leaving European refiners scrambling for replacement grades.

The key Brent/DME Oman spread, which is a measure of Middle East medium sour crude against North Sea light sweet, has seen major volatility since the first quarter of 2022.

As the market adjusts to sanctions the spread has widened out firmly in favour of Brent, as European refiners face crude shortfalls, while Asia is increasingly finding itself with a surplus of crude.

Nymex Brent futures versus DME Oman futures averaged around parity as recently as September, but in the first half of November averaged more than $4.50/b, reaching $5/b by mid-month.




## Flows

Close to 70% of crude loaded onto tankers at Russian ports is now heading to Asia, compared to around 40% in the weeks before Russian troops launched into Ukraine in February, with most of the shipments destined for China and India.

Russia has surpassed Iraq and Saudi Arabia as India's largest supplier of oil, according to vessel tracking companies, as Asia's third-largest economy cashes in on steep price discounts caused by sanctions against Moscow.

India has historically bought most of its oil from Iraq and Saudi Arabia, but Russian imports have surged since Russia's invasion of Ukraine.

While Russia supplies to Asia will in part displace Middle East barrels, on the flipside a shortage of crude in Europe created by the lack of Urals will leave refiners there scrambling for alternatives as Russian crude has historically made up about a 20% of Europe's crude diet.

## Middle East role

However, the Middle East is strategically positioned to effectively balance markets both East and West, and is increasingly diverting oil to Europe.

Saudi Arabia's oil minister recently noted that Aramco's supply of crude and products to Europe had nearly doubled over the past year from 490,000 bpd to 950,000 bpd in September, with volumes set to increase further over winter.

Analysts said that Saudi is positioning itself to supply even more oil to Europe as traditional buyers of Russian barrels look to diversify ahead of sanctions.

Another alternative is Iraq's Basrah Medium, which is typically blended with lighter grades in order to produce Urals lookalike crude.

Kpler shipping data tracked close to 377,000 bpd of Basarah medium bound for Europe in October, compared with around 129,000 bpd in December 2021.

While Oman Blend would also make an ideal replacement for Urals, the grade is largely processed as baseload crude by Asia refiners, which will likely limit arbitrage opportunities to Europe.

However, as the only medium sour futures contract for Middle East crude, Oman fulfils the role of marker crude for the region, reflecting relative values in the Middle East/Asia versus prices in Europe.

## Discounts

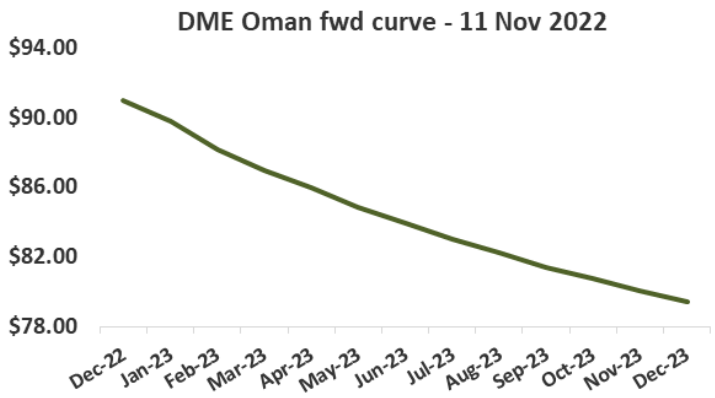
Flows of Russian oil into Asia have been aided by huge discounts available as Western firms largely shun Russia. But Goldman Sachs said in a recent report that the initial huge discounts on Russia barrels in the immediate aftermath of the invasion of Ukraine have narrowed sharply.

The bank noted discounts for Russian oil reportedly reached $40/b, but have since narrowed closer to $5-10/b in recent months.

Goldman also noted that tanker freight rates have roughly tripled globally since the war, with the redirection of Russian barrels only half-complete at present, adding this is most severe for clean tanker markets where almost the entirety of Russian exports was previously undertaking the short journey to Europe.

Another impact of additional Russian crude into Asia has been the flattening of the forward curve, particularly the key M1/M3 spread, which is closely monitored by Saudi Aramco and other Middle East National Oil Companies for setting Official Selling Prices.

The spread was regularly trading at $6-7/b over the summer months, but the potential supply glut caused by re-routed Russian crude has seen M1/M3 DME Oman retreat to below $3/b in November, the lowest since April, although still relatively high by historical standards.




Saudi Aramco has cut its Official Selling Prices (OSPs) for most December-loading crude to Asia, largely in line with expectations after backwardation in the underlying DME Oman benchmark narrowed.

For Aramco's key customer base in Asia, differentials for the flagship Arab Light grade were cut to Dubai/DME Oman +$5.45/b for loading next month, versus +$5.85/b for November cargoes.

However, the shortage of crude in Europe saw Middle East sellers increase OSPs for December, including Arab Light, which was up $0.80/b at +$1.70/b over Brent futures

## Conclusion

The market has clearly entered a new paradigm and the Middle East is set to play an even more pivotal role in balancing global markets. While this has created new arbitrage routes, volatility between crude benchmarks is set to increase, making hedging essential.

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