DME

FUTURES INSIGHTS

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Oil markets resolute in the face of Omicron
At least for now

OSP
$80.26

TOTAL DELIVERY
13.223 MILLION BARRELS

TOTAL EXCHANGE VOLUME
OIL
100,014 CONTRACTS

ADV
4,763 CONTRACTS

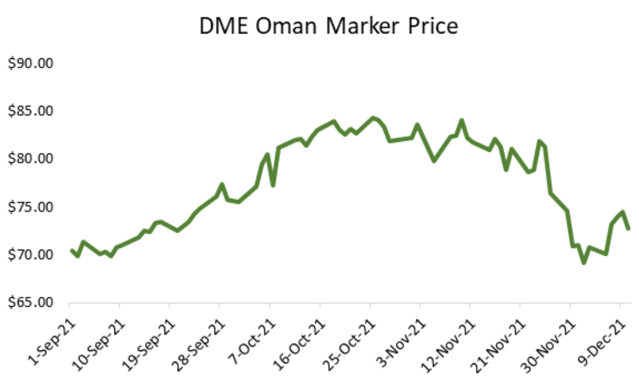
The emergence of the Omicron variant in late November sent oil prices spiraling lower on fears that a fresh wave of mobility restrictions would cut global demand for oil products, but markets so far have showed a high level of resistance to downward pressures.

This paper examines the initial market reaction to the new coronavirus strain.

Price drop

The initial media coverage of the new covid variant sent crude oil prices tumbling by more than $10/b in one day, wiping out nearly three months' worth of oil price gains, which saw the Middle East benchmark DME Oman crude retreat from more than $80/b to below $70/b.

Omicron's emergence came on the back of already weakening fundamentals as oil markets are set to move into a supply surplus during the first quarter of of 2022, while a US-led initiative for the global release up to 80 million barrels of crude from strategic reserves also added to the more bearish sentiment.



Refined products came under even greater downwards pressure, particularly the key transport fuels of gasoline, diesel and jet, which are hardest hit by the threat of mobility restrictions.

However, while the Omicron variant is more transmissible than previous versions, less severe symptoms and effective global vaccine programs have so far helped most major consuming countries avoid the widespread lockdowns of 2020.

Prior to initial reports of Omicron, DME Oman crude had largely been trading at above $80/b since the start of September, reflecting the firm global fundamentals that had lifted prices to seven-year highs.

Markets came under renewed pressure as OPEC+ agreed to stick with its policy of pumping an additional 400,000 barrels per day of oil output in January of the 2022, adding to the 2 million bpd the producer group has already announced between August and December of 2021.

At the height of the downwards spiral, NYMEX Brent futures tumbled to a low of $66/b and DME Oman to $65/b, as the Brent/Oman spread remained relatively stable at around $1/b.

The Oman lows of around $65/b were not reflected in Oman's Official Selling Price (OSP) as the trough came between the DME Oman Marker Prices of Dec. 2 and Dec. 3, by which time prices had rebounded sharply.

Oman uses a monthly average of DME Marker Prices to calculate its OSP.

Outlook

Despite the sharpest plunge in oil prices since April 2020, investment banks Goldman Sachs and Morgan Stanley maintained their bullish view on markets.

Goldman Sachs acknowledged the demand headwinds created by the omicron variant, but noted a number of technical factors likely exacerbated the price selloff at the end of November.

"The crude market is pricing in a far larger demand hit than during Delta – equivalent to no planes flying for the next 3 months.

This, in turn, is exacerbating the supply problems facing all commodity markets."

Morgan Stanley, meanwhile, kept its Brent and WTI forecasts unchanged following the OPEC+ decision, saying it expects Brent to average $82.50/b in the first quarter of 2022 and rise to $90/b by Q3, before easing back to $87.50/b in the final quarter.

The world's key exporters, cooperating under the OPEC+ alliance, also held firm, not only agreeing to increase output in the new year but also raised OSP premiums for January.

Rebound

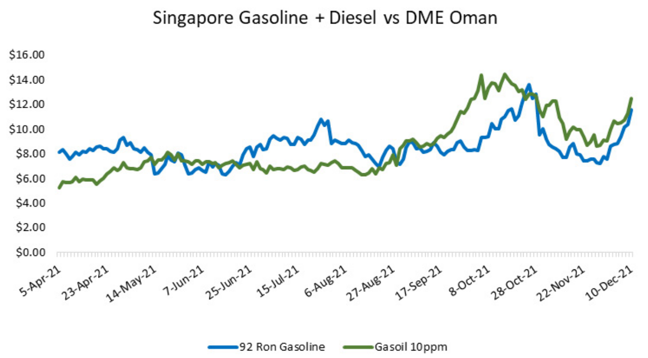
Key exporters including Saudi Arabia and Kuwait, which both use DME Oman in their underlying OSP formulas, raised OSPs above market expectations, in a further sign that demand is expected to hold up moving into the new year.

The demand optimism was underscored with term customers requesting full allocations of Middle East crude for January loading, while refined product cracks have rebounded sharply to above pre-Omicron levels.

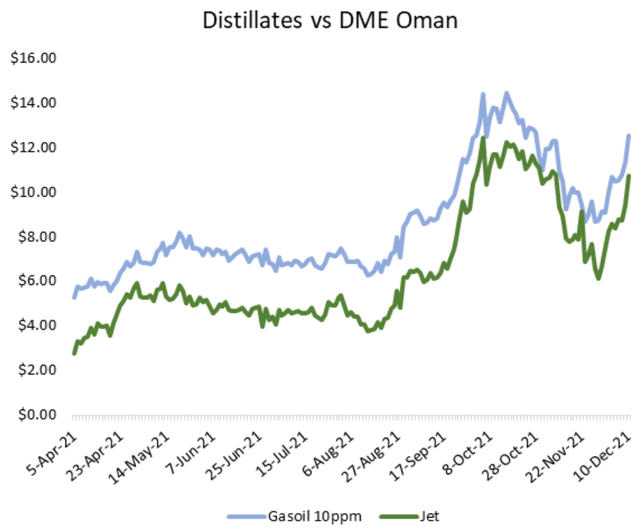
Gasoil (diesel) and gasoline cracks had already been in retreat for most of November, but initial reports of the Omicron variant saw the crack values for the key transport fuels slump to three-month lows against DME Oman crude.

Benchmark 10ppm Singapore gasoil swaps versus DME Oman, comparing front-line DME Oman crude futures against month one (M1) product swaps, had retreated from a post-pandemic high of over +$14/b in October to around +$8.50/b in late November, before rebounding again to double-digit premiums in the second week of December.

Likewise, benchmark 92 RON gasoline M1 swaps reached a post-covid peak of more than +$13/b against DME Oman in October, tumbling to around +$7/b at the end of November and rebounding again to around +$10/b.



The jet fuel market had already been struggling in the fourth quarter and having reached a low of DME Oman +$6/b at the end of November on fears of widespread flight cancellations, cracks have quickly rounded to +$10/b.

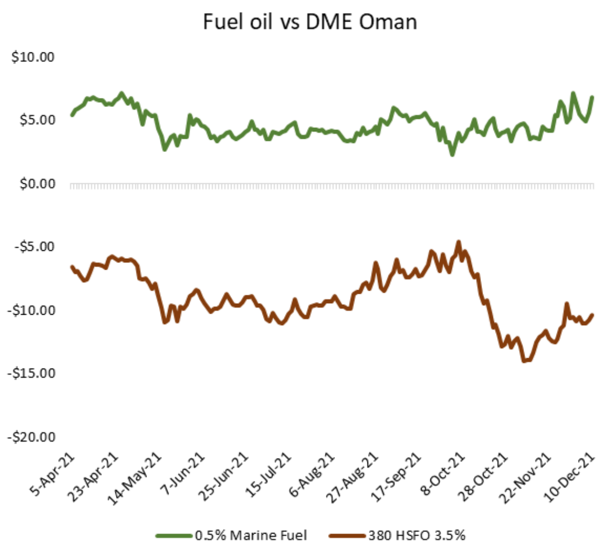


In fuel oil markets, the primary 0.5%-sulfur bunker grade had largely avoided the weaker market sentiment in the fourth quarter, propped up by supply shortfalls and potential demand from the power-generation sector ahead of the crunch northern-hemisphere winter.

By contrast, the 3.5%-sulfur market came under strong downwards pressure during Q4, tumbling to almost minus $15/b against DME Oman in late November, but has since rebounded in line with the broader recovery in oil products

The firmer product cracks allow refiners to lock a profitable margin via risk management tools available on DME/CME's trading platform and cleared via Clearport but oil markets are likely to be gripped by demand uncertainties moving into 2022 and accompanied by high volatility.

Oil markets have initially proved resilient to the new strain of covid and while there are high hopes that further vaccine rollouts will help minimize mobility restrictions, hedging price exposure has become increasingly essential across the energy complex.



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