DME

FUTURES INSIGHTS

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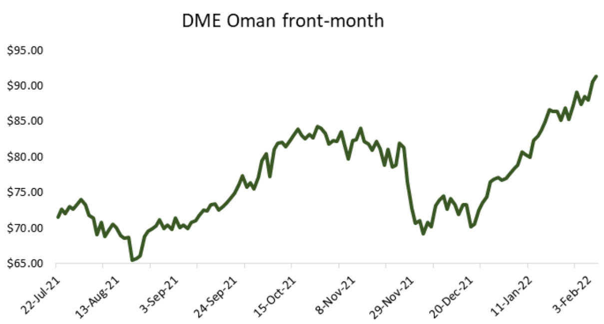
Forward structure, measuring market strength

$83.62	14.624 MILLION BARRELS	108,374 CONTRACTS	5,419 CONTRACTS
OSP	TOTAL DELIVERY	TOTAL EXCHANGE VOLUME	ADV

As oil prices continued on their upwards trajectory moving into 2022, DME Oman market structure has widened to multi-year highs, indicating tight supply/demand fundamentals moving forward

Benchmark crude oil prices have largely been on a one-way path in recent weeks as the sharp rally lifted oil markets to levels not seen since October of 2014. The Middle East medium sour Oman crude trading on Dubai Mercantile Exchange has surged by over $20/b since December 20 to stand at a seven-year high of $91.38/b on February 7, or a gain of 30%.

Oil prices had slumped from the previous November highs as the Covid-19 Omicron variant spread rapidly across the globe, but with strain having milder symptoms than the Delta variant and less impact on oil demand, attention has quickly refocused to the supply side as global demand heads back towards pre-pandemic levels.



Shortfall

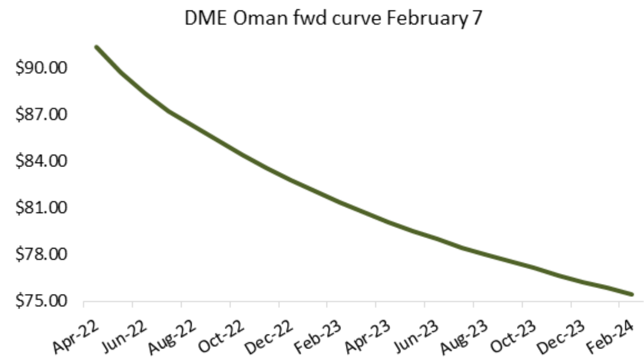
The OPEC+ producer alliance has been aiming to increasing output at a rate of 400,000 barrels per day since August 2021, but a number of producers, particularly those from outside of the Middle East, have been unable to keep up on output targets. Collectively, by the start of 2022 the group was some 800,000 bpd behind on announced increases, while Saudi Arabia and the UAE were said to be the only two producers still sitting on significant spare capacity and in a position to continue with the output hikes going forward.

Adding to supply woes, concerns that any escalation in the standoff on the Russian/Ukraine border would impact on Russian oil and gas exports also helped to propel oil prices to multi-year highs.

Structure

Supply-side concerns have manifested in the forward curve, where prompt prices are at steep premiums to crude oil for delivery at later dates, referred to as backwardation. The opposite, in which prompt prices are cheaper, indicates plentiful supply and is referred to as contango.

The one-year DME Oman forward curve, currently measuring the Apr22/Mar23 spread settled at more than $11/b on February 7, compared to around $6/b at the start of January and a seven-month low of around $4.50/b in early December.



The steep forward curve suggests that the market is expecting a continuation of the tight supply/demand balance moving forward. Market structure is a crucial indicator of fundamentals and used extensively by traders, producers and refiners to manage price risk, and to hedge forward positions. A futures curve, in contrast to a forecast, represents tradeable prices that can be hedged against price movements in the future.

OSPs

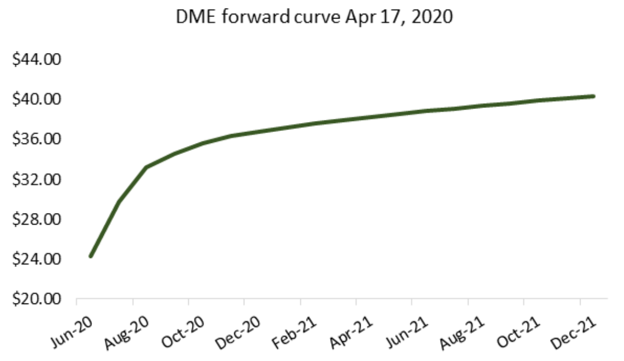
The forward structure is also used as a key metric by Middle East oil producers in setting Official Selling Prices (OSPs), which collectively price millions of barrels of crude every day against the DME Oman marker price.

Saudi Aramco, the world's largest exporter of crude oil, uses DME Oman futures in conjunction with Dubai physical assessments, to price its oil exports to Asia. Its team of experts analyze market fundamentals to set OSPs for term supplies, and the M1/M3 spread is a key metric in determining if differentials are increased or reduced.

In early February Aramco announce increases to OSPs for term customers lifting oil in March following the steep increase in market structure and healthy refining margins, particularly underpinned by firm gasoil and jet.

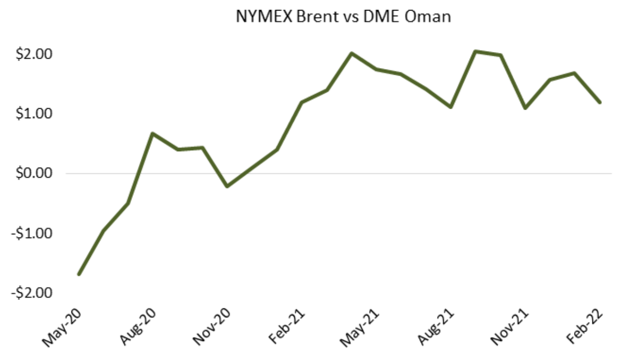
DME Oman M1/M3 spread averaged almost $1.70/b in January, compared to around $1.10/b in December, while the same M1/M3 spread has increased to $3/b in the early part of February.

For comparison prices, oil markets registered a record contago structure at the height of the Covid-19 pandemic in the second quarter of 2020.



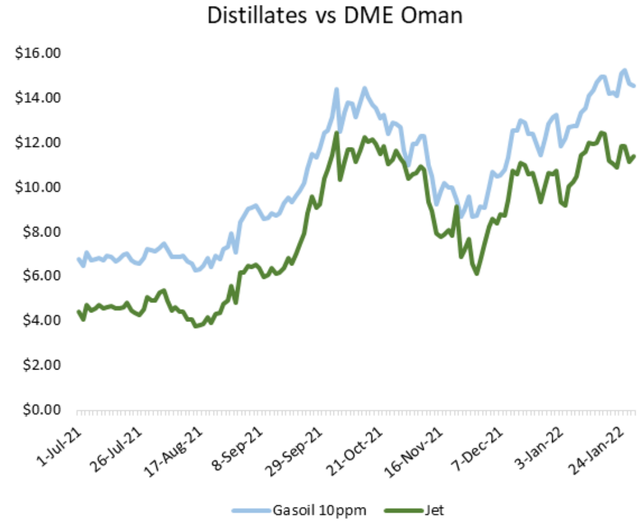
The recovery in oil consumption has largely been led by demand for transport fuels, primarily gasoline and diesel, while the recovery in jet fuel demand has been much slower.

As a result, the lighter Brent crude has generally outpaced medium sour grades such as DME Oman, although the recent weeks the broader supply concerns has seen Oman gain on Brent, narrowing the key Brent/Oman spread.



DME Oman futures have also gained against the Dubai physical market since the start of the year, with spread widening out to around $0.40/b in early February, having traded at around parity for most of 2021.

Oman has been underpinned by the higher yield of middle distillates compared to Upper Zakum, which has been setting the Dubai physical price as the lowest of the five grades that make up the Dubai basket of crudes.



Distillate cracks have soared since early December

Summary

Going forward, increased crude supplies will be essential in maintaining an equilibrium in oil markets, but the current market structure suggests supply-side concerns will continue to dominate.

OPEC+ aims to return to pre-pandemic levels later this year, but current backwardation indicates that the broader market sees the producer group facing an uphill struggle.

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