DME

FUTURES INSIGHTS

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OSP
$66.40

TOTAL DELIVERY
11.878
MILLION BARRELS

TOTAL EXCHANGE VOLUME
92,653
CONTRACTS

ADV
4,633
CONTRACTS

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The futurization of Middle East crude oil prices

Regional producers are increasingly using futures prices to price oil

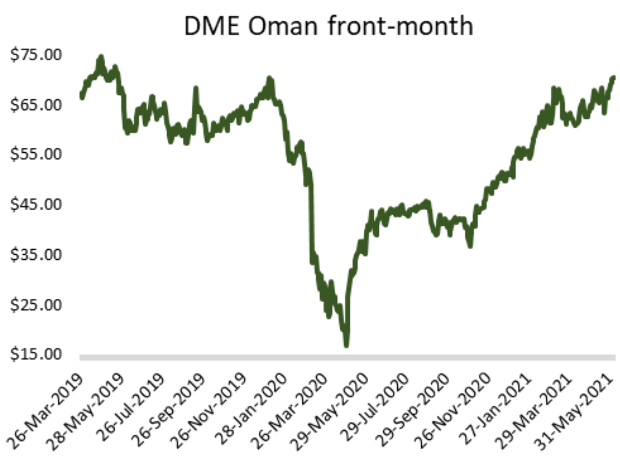
Middle East benchmark oil prices for August traded above $70 per barrel in early June for the first time in more than two years, amid growing optimism over the global demand recovery as vaccine programs are rolled out, lifting oil prices comfortably back above pre-pandemic levels.

Oman crude oil futures trading on Dubai Mercantile Exchange have now rallied by over 300% since tumbling to around $17/b at the height of the global pandemic in April 2020.

More recently. DME Oman is up by around 30% since the end of January when prices were below $55/b.

DME July futures contract expired at $68.03/b on May 31st, nearly $3/b up from the June-contract expiry in April.

On a month-average basis, July-loading crude was at a two-year high of $66.40/b, up from the June average of $63.19/b.



While the finance ministries of the 23 nations that make up the OPEC+ producer group will breathe a sigh of relief, as higher prices go some way towards balancing budgets, the trading market focuses more on spreads and grade differentials.

Outright prices typically grab the headline, but Official Selling Prices (OSPs) against the underlying benchmark play a prominent role in the spot market and since the COVID-19 pandemic, OSPs have been a major device in helping to rebalance global markets.

National Oil Companies (NOCs) have an array of economists, analysts and marketers to monitor and analyze supply/demand fundamentals to set differentials against the underlying benchmark.

These OSPs have always been a keenly watched indicator by refiners and traders, with the monthly trading cycle for the spot market essentially starting once OSPs have been released.

Futurization

Historically, Dubai and Oman prices were produced by Price Reporting Agencies (PRAs) serving the region as benchmarks for OSPs.

In a natural progression, Oman was launched as a futures contract by DME in 2007, leading to Oman becoming the first producer in the Middle East to sell 100% of its crude production against a futures contract.

This helped to kick off a trend of Middle East crude oil pricing moving towards oil futures, in a process known as ‘futurization’.

Saudi Arabia, Kuwait, Bahrain and Dubai are among regional oil producers now using DME Oman futures in OSP formulas.

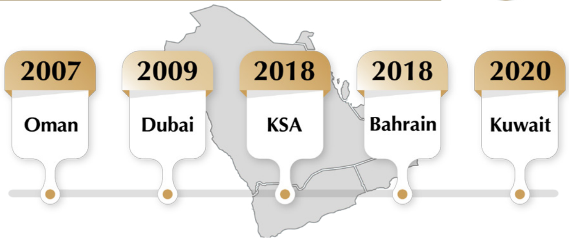
Meanwhile, ADNOC’s decision this year to switch from cash Dubai to the newly-launched Murban futures contract traded on Abu Dhabi’s IFAD exchange firmly tipped the balance towards futures pricing, and many analysts expect the trend to continue

Of the major export grades, only Iraq’s Basrah Light (1 million barrels per day plus of production) is still fully pricing against legacy PRA prices, although may be joined by Iran if sanctions are lifted in the future.

Iraq’s SOMO has indirectly been a trailblazer towards futures implementation and was among the first Middle East NOCs to conduct an extensive study into futures markets, initially prioritizing an upgrade of its exports facilities.

Some market watchers say that SOMO’s Basrah Light would potentially make an ideal physically-delivered futures contract, particularly with the huge infrastructure investments to transition the Basrah export terminal into a world-class facility.

NOCs Pricing Over DME



Historically Saudi Aramco has assumed the role of regional/OPEC leader and announces its OSP differentials ahead of other Middle East producers.

Typically, this will be in the first week of the new month, setting a differential to the underlying benchmark for the following month.

For example, Aramco will inform customers of differentials versus underlying benchmarks for July-loading crude in early June.

The underlying benchmark plus or minus the differential is the price customers will pay for crude in July.

However, the underlying benchmark will reflect the 'trading month', and given that Middle East crude trades on a 'Month +2 basis' the underlying price in July will reflect September-loading barrels; or M+2.

Grade	May	June	July	Change
To US (ASCI basis)				
Extra Light	1.60	1.80	1.80	0
Arab Light	0.85	1.05	1.05	0
Arab Medium	0.15	0.35	0.35	0
Arab Heavy	-0.30	-0.10	-0.10	0

NOC trading companies

Increasingly, NOCs have also started up trading companies, although the trading arms are kept as stand-alone entities and while an increasingly important part of the overall strategy, are not kept within the core production/refining business.

As such, the trading entity will be a 'price taker' in the same way other customers are, rather than have any influence or input into OSPs.

Oman's OTI, Aramco's ACT and ADNOC's AGT are all household names in the trading markets these days; involved not just in crude oil, but all through the value chain of refined product and petrochemicals.

Middle East NOCs are emerging from the pandemic with a clean bill of health, and set to assume an ever-growing role in the pricing and trading of oil.

*effective July 2021 DME will publish regional OSPs on its website

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