DME

FUTURES INSIGHTS

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Global oil prices and the energy crunch

OSP
$72.78

TOTAL DELIVERY
10.319
MILLION BARRELS

TOTAL EXCHANGE VOLUME
103,430
CONTRACTS

ADV
4,925
CONTRACTS

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The Global energy crunch hit the front pages in October as fears over potential winter shortages. This paper looks at the impact on oil prices.

Global energy markets during the early part of October have largely been dominated by natural gas and, to a lesser extent, coal, as the looming winter power crisis has spread unprecedented volatility through European and Asian natural gas pricing.

The potential energy crisis has already had a major impact on oil values, with benchmarks such as Middle East DME Oman and North Sea Brent hitting three-year highs in October, while the US WTI benchmark was trading at its highest level since 2014.

Although oil has been less attractive as a power generation fuel in recent years, analysts expect additional demand this winter for generation, lifting crude and refined products to new post-pandemic highs.

Natural gas volatility

Prices swings in European and Asian natural gas markets for the week ending October 8 experienced unprecedented volatility, far beyond anything experienced in oil markets, as prices in both regions surged to record highs.

On October 6, S&P Global Platts set its benchmark The Japan-Korea Marker (JKM) for November $16.655/mmBtu higher on the day at $56.326/MMBtu – an oil equivalent of over $300/b - before a sharp reversal the next day.

This was both the largest single-day price rise and the highest level since Platts started assessing the benchmark in 2009, said the Price Reporting Agency.

Prices for natural gas in Europe experienced even greater prices swings, as the benchmark Dutch Title Transfer facility (TTF) rallied by around 40% in a single day to reach a record €160 per Megawatt hour, before retreating to below €100/MWh the next day.

TTF prices have more than doubled in less than a month and approximately quadrupled since mid-June, when TTF prices initially reached all-time highs of around €30/MWh.

Record low seasonal natural gas storage levels in Europe, steep competition from Asia and uncertainty over much-needed Russian supplies via the Nord Stream 2 gas pipeline have all added to the European gas supply crunch.

Australian thermal coal futures for November reached fresh highs of around $280 per metric tonne, accelerating fears over a winter energy crunch as China's government reportedly instructed state-owned energy companies to step up energy imports in a bid to tackle widespread power shortages across the country.

Meanwhile, India was reportedly running perilously low on coal stocks, lifting demand for alternative energy sources.

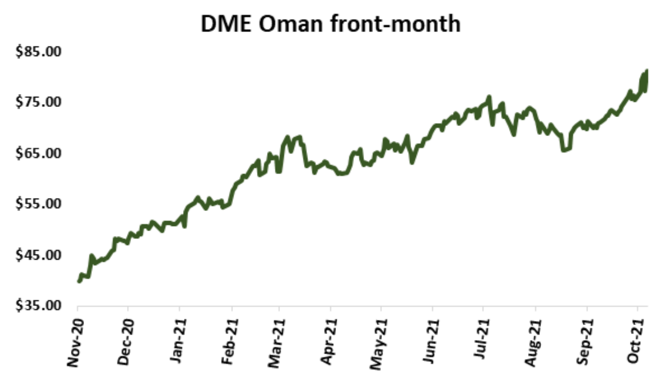
Oil impact

Oman crude futures trading on the Dubai Mercantile Exchange moved above $80/b for the first time since October 2018.

Middle East prices also strengthened at the start of the month after the OPEC+ group's decision to proceed with gradual production increases of 400,000 bpd per month, although most forecasts had been for no change to the existing policy.

US investment bank Goldman Sachs has raised its 2021 oil-price forecast for Brent to $90/b, which is trading around $2/b over Oman.

The bank said if temperatures were to drop by one standard deviation below seasonal norms this winter it could spark an additional 900,000 barrels per day of oil demand for power generation.



Refined products

Within the oil barrel, gasoil and fuel oil are most likely to drawn into the power generation pool.

The 180 CST HSFO grade is already a staple power generation feedstock in some parts of Asia, while the more expensive gasoil is used for powering diesel generators, which are often used in China on an industrial scale to alleviate power shortages.

As a medium sour crude, Oman yields relatively high cuts of both gasoil and fuel oil, which is likely to make the Middle East benchmark grade a popular choice for refiners over the winter months.

Based on cracking yields, Oman produces around 20% fuel oil and around 40% distillates, primarily gasoil.

Distillates

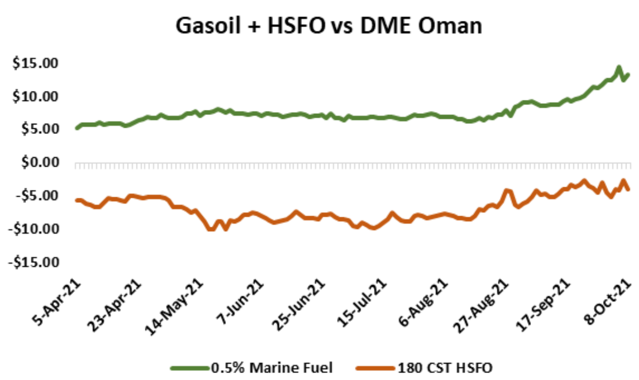
Benchmark 10ppm gasoil cracks versus DME Oman have largely returned to pre-pandemic levels, surging into double-digit premiums in September and pushing towards +$15/b above Oman in early October.

The squeeze on energy supplies has meant a sharp drop in exports of refined products from China, which is Asia's largest refiner, helping to lift Singapore gasoil/diesel price to $95/b on October 8.

Middle East and Asian refiners are also major suppliers of gasoil for the European market, so the shortfall in exports from Asia is having a wider impact.

Hurricane Ida had already tightened global distillate supplies after a number of US Gulf coast refiners were offline during September.

The jet/kerosene market in Asia has also largely tracked gasoil higher, with kerosene an important heating oil in North Asia during the winter months.



Fuel oil

HSFO 180 CST, which is used for power generation, has also been on the rise, having traded at DME Oman -$10/b in the summer months to around DME Oman -$3/b in the early part of October, based on Singapore product prices.

Asia is largely the global driver for high sulfur fuel oil markets and while heavy fuel in the power generation pool has declined sharply in recent years, it is still used for backup generation to meet demand at peak times.

Oil is also typically the more expensive option in power generation, but soaring natural gas and coal has made heavy fuel oil a competitive option for the winter months.

Conclusion

DME Oman has largely avoided the volatility seen in natural gas coal markets but with energy pricing set for a roller-coaster ride in the coming weeks and months, hedging strategies have rarely been so important.

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