

FUTURES INSIGHTS

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CONTRACT

Product margins underpin crude strength as refining crunch bites



Oil prices consolidating above \$100 per barrel crude since Russia's invasion of Ukraine has captured most the headlines in recent weeks, but to a large extent the underlying strength has come from refined products markets as the world continues to suffer from an acute shortage of refining capacity.

Not only have refining margins for key road transport fuels surged to post pandemic highs, cracks for gasoil and gasoline have posted all-time highs during May as end-user demand recovers after the pandemic, while availabilities have also tightened due to sanctions on Russia, reduced exports from China and the fall in refining capacity, particularly in Europe.

The crunch in refining capacity across the world led to Saudi Arabia's energy minister, Prince Abdulaziz bin Salman, issuing an unprecedented warning this month about the gap between the price of crude oil and fuels, along with the broader lack of investment in energy infrastructure.

Crude spreads

The surge in distillates and gasoline has impacted the dynamics of the crude oil markets with lighter barrels, that yield a higher cut of transport fuels, gaining against flagship Middle East crude grades such as Oman and Arab Light.

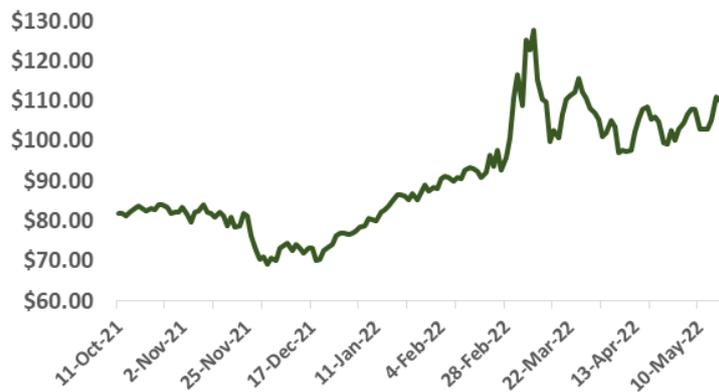
The key North Sea Brent futures price versus DME Oman futures has widened to \$3.50-\$4/b during May, from around \$2.50/b prior to Russia's invasion, while the US WTI benchmark has consolidated above Oman for the first time in many years.

The strength of WTI reflects soaring gasoline demand in the US, despite record retail prices, and the growing appeal of WTI as an export grade and global marker price. Next year, the WTI Midland export grade will become a component of the Dated Brent benchmark.

Key medium sour grades such as Oman, Upper Zakum and Al Shaheen had been trading at around parity for much of the year, but Oman and Al Shaheen pulled away slightly from Upper Zakum in May, reflecting the strength of the distillates market.

Both were trading at a premium of around \$0.30/b to Upper Zakum, which in turn is setting the Dubai assessment this month. DME Oman futures rebounded to around \$110/b heading into the final week of May.

DME Oman front-month

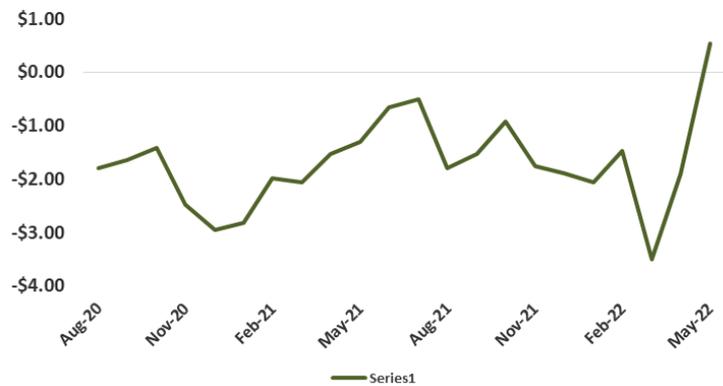


Brent vs DME Oman



Gasoline/distillate strength underpins Brent/Oman spread

WTI v Oman spread (monthly)



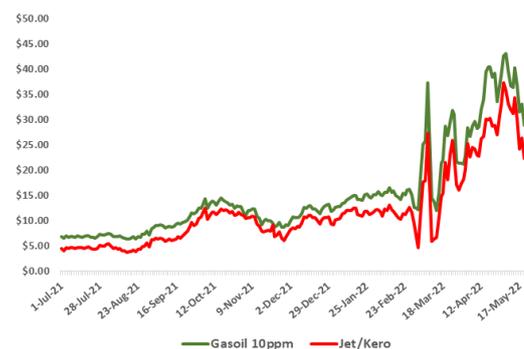
WTI benchmark rallies on gasoline price surge.

Distillates

The gasoil/diesel market, which makes up the largest share of oil demand in Asia, has rallied strongly since late February, hitting record highs in May along with record levels of volatility. Benchmark 10ppm Singapore gasoil/diesel reached a high of more than \$40/b above DME Oman (front-line DME Oman futures versus front-line 10ppm swap), around triple the level prior to Russia's invasion of Ukraine. Gasoil cracks have since retreated, but elevated levels of above \$30/b continue to underpin markets.

Jet/Kerosene cracks followed a similar pattern to gasoil, reaching a record margin over benchmark DME of around \$35/b, despite the airline industry still operating at levels well below the pre-Covid capacity.

Distillates vs DME Oman



Gasoline

Global gasoline cracks surged in late May following an explosion at the Ulsan refinery in South Korea adding to supply concerns and already tight market.

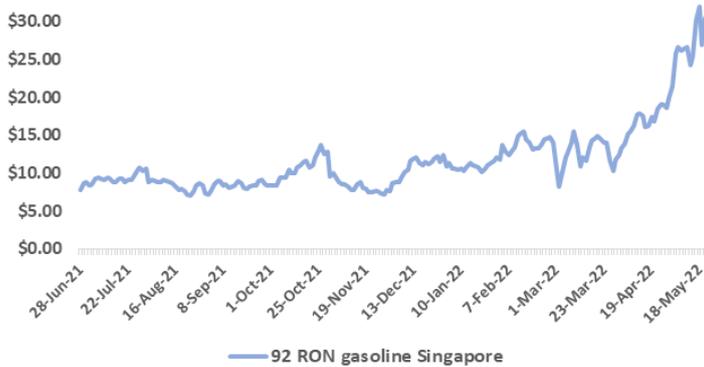
Supply fears have also been exacerbated as the US enters into what is termed as the summer 'driving season', while upcoming hurricane season has also focused attention on refining capacity after 2021's Hurricane Ida landed a direct hit on Louisiana, paralyzing the state's refining sector.

The physical 92 RON crack in Asia jumped to a record high of more than \$40/b against DME Oman after the explosion at the 580,000-bpd refinery left eight injured and one dead.

Asia had already been hit by a fire at key Indonesian refinery tightening supplies there.

Gasoline swaps cracks also rallied strongly, trading at more than \$30/b over Oman crude futures.

Gasoline vs DME Oman



Fuel Oil

Fuel oil margins, which are important for Middle East crude grades, have also been given a lift by the strength of the 0.5%-sulfur marine fuel grade, used primarily in the shipping market as bunker fuel.

Tight supplies across the Asia region and a shortage in distillates blend stock used to reduce the sulfur content has lifted cracks versus DME to the highest levels since the grade was first launched in 2020 with the implementation of IMO 2020 legislation, which mandated 0.5%-sulfur fuel.

Physical refining margins for marine fuel rocketed to more than \$15/b against DME Oman, while swaps were around +\$13/b. Short supplies of distillate export licenses from China has fed into that tightness, with Beijing having issued far fewer export permits this year compared to 2021.

Margins for the 380 CST HSFO grade, however, came under downwards pressure, impacted by the high cost of distillates needed to blend down the sulfur content.

Fuel oil vs DME Oman



Summary

Refining margins have played a huge role in current crude prices, while global refining is running at full capacity outside of scheduled and unscheduled maintenance.

The OPEC producer group has issued a number of warnings over the crunch in global refining, making the case that more crude in the market will not solve the problem.

Refined product prices in 2022 suggest that those warnings are now being realised across global oil markets.

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