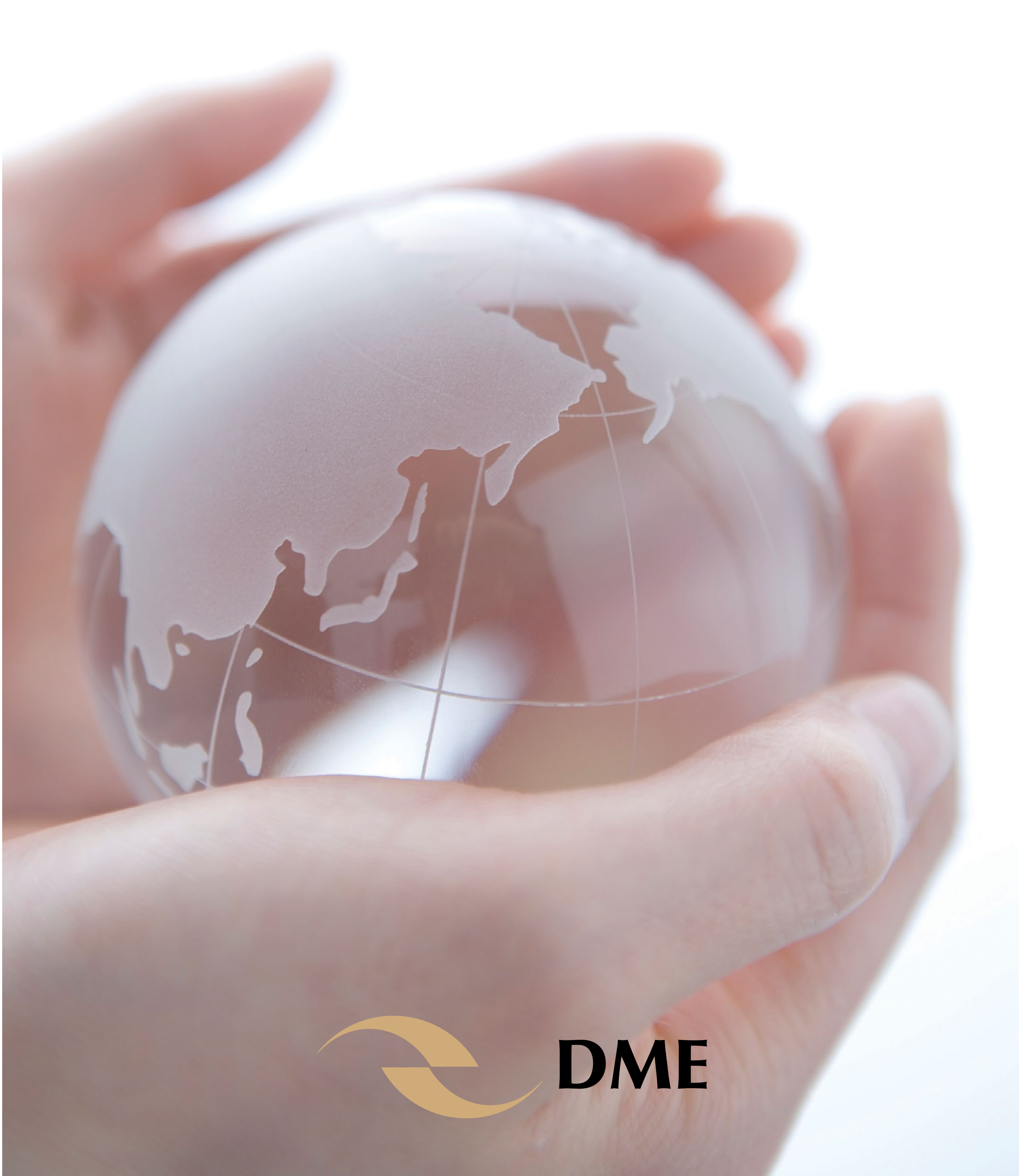


DME

# Oil price slump plunges markets into contango structure

Issue 12 - March 2020

DME

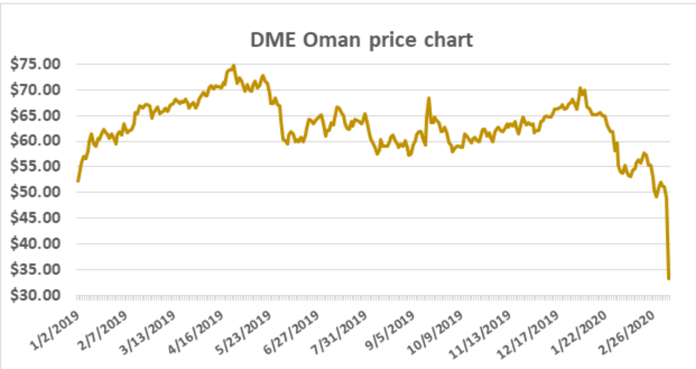
# Oil price slump plunges markets into contango structure

The disintegration of the OPEC+ producer group and subsequent price collapse has plunged the oil markets into a steep contango, as fears of a huge oversupply amid slumping demand led to the biggest one-day fall in Oman prices.

May-loading Oman crude trading on Dubai Mercantile Exchange was priced $33.30 per barrel at 1230pm Dubai time (0830GMT) Monday, which is referred to as the Marker Price and is used as a pricing reference for a number of Middle East oil producers.

Monday's value was $15.70/b down from Friday's corresponding Marker Price - or 32% - the largest ever price drop on the DME since the Oman contract was launched in June, 2007.

In terms of price trends Oman crude has now retreated more than 50% from the $70.45/b January high in the wake of the strike on Iran's General Soleimani and is the lowest price since March 2016.



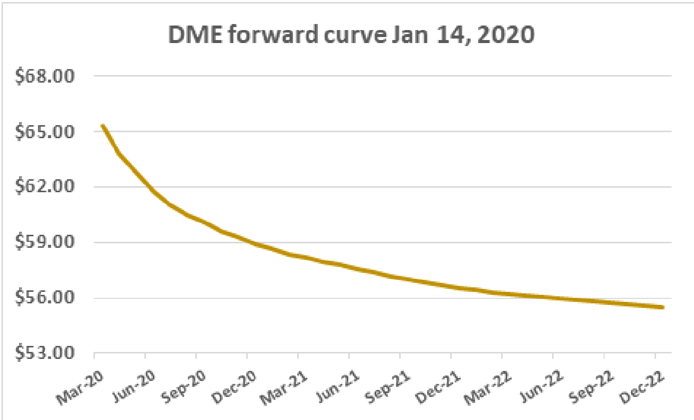

To find a bigger one-day price fall you need to go back almost three decades to the first Gulf War when prices collapsed.

Oil markets were already under intense downwards pressure prior to the OPEC+ meeting, with the coronavirus responsible for millions of barrels per days of demand destruction.

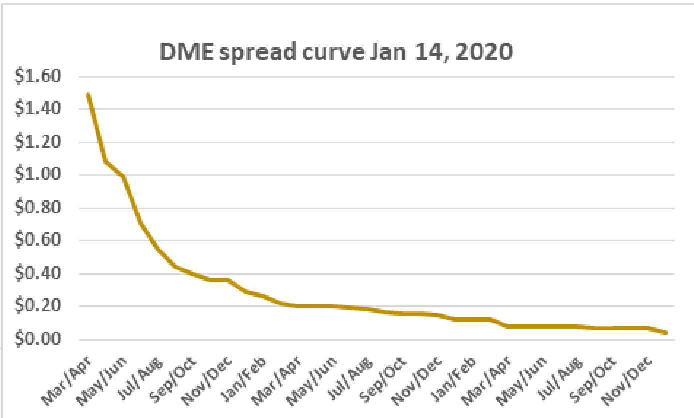
**Market structure**

Middle East crude markets have been largely backwardated since 2017, whereby prompt-loading barrels command a premium to those loading further forward. Healthy demand and disciplined production cuts from the OPEC+ group had lifted the front-month M1 vs M2 spread to $1.00-$1.50/b since last September 2019.

*The following graphic illustrates the strongly backwardated DME Oman market On Jan 14, 2019, with the front-month March contract almost $10/b above December 2022.*




*Intermonth spread value was highest at the front of the curve, with Mar/Apr around $1.50/b*




But in early February the M1 vs M2 spread (April vs May) started to retreat as initial fears over the coronavirus caused front-month prices to retreat faster than those further out.

The forward curve had largely flattened out by the end of February and OPEC+ bombshell this month led to the record price collapse – with prices at the front of the curve bearing the brunt of the rout.

In a sharp contrast to January, front-month May contract prices were around $8/b under December 2022 at Marker Price time, and expected to widen further.

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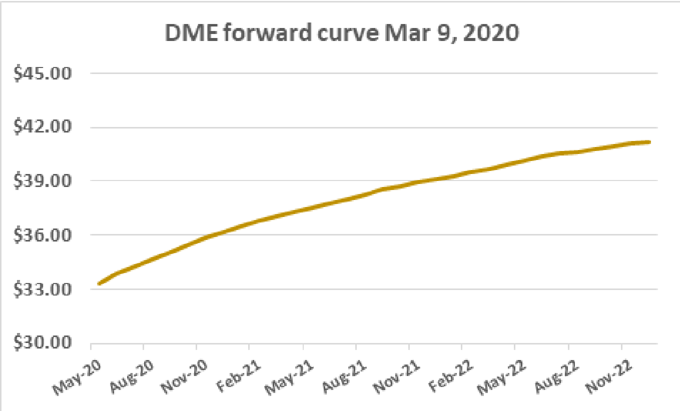
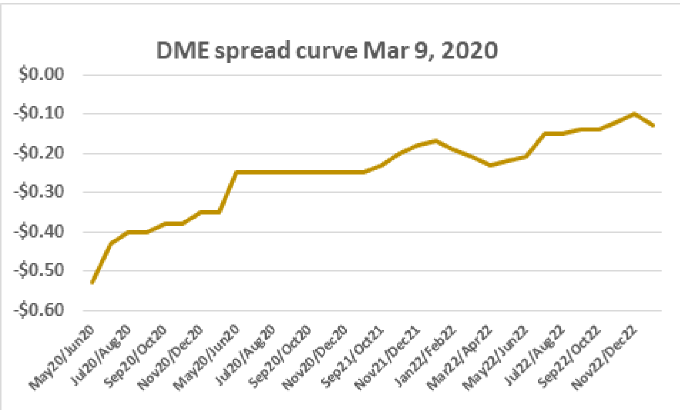



*The May/Jun spread collapsed to more than minus $0.50/b and has subsequently dropped to nearer minus $1.00/b*




Traders have factored in a sharp production increase from Saudi Arabia, which will likely lead to a major surplus, particularly in Asia which consumes the bulk of Middle East oil.

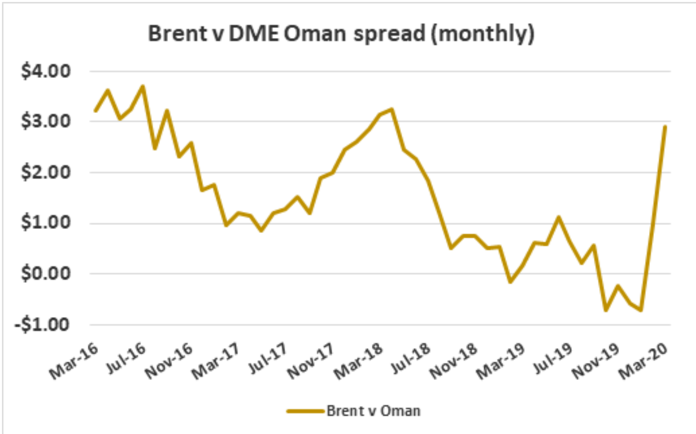
Reuters said April's production would be significantly higher than 10 mil b/d, and possibly closer to 11 mil b/d, citing Saudi sources. For the early part of 2020, Saudi Arabia has been producing around 9.7 mil b/d.

A number of Asian refiners have already indicated they will load up on crude at the new lower prices, but with demand expected to slump further and storage options limited, not all of the excess crude will immediately find homes.

Traders are already scouring the market for additional storage in order to take advantage of the steep contango, including floating storage options. In the price collapse of 2008, traders stored over 100 million barrels of oil on tankers to play the arbitrage, or wait for a price rebound.

**Brent/Oman reversal**

The other big change in market structure has been the huge swing in Brent/Oman spreads, as fears of the supply surplus sent Middle East prices tumbling fasters than those in Europe. The Brent/Oman spread was close to parity on Friday but has since widened to almost $3/b.




The overhang of light sweet crude and relative shortage of heavier barrels due to a combination OPEC+ cuts and sanctions on Iran, had been narrowing the spread between Oman and its North Sea Brent counterpart throughout 2019 and into 2020.

In the mid-2010s the Brent/Oman spread averaged around $3/b but the onslaught of shale into international markets had flipped the spread into negative territory by the fourth quarter of 2019.
But the coronavirus impact on demand and the impending oil price war has firmly established the Brent premium once again.