

Twisted oil prices

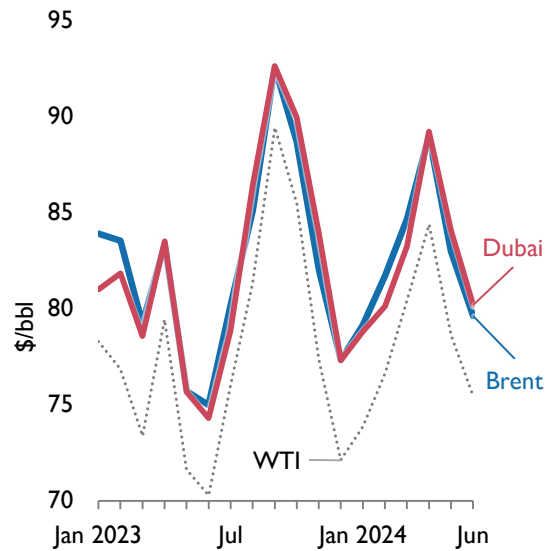
YANAGISAWA Akira | The Energy Data and Modelling Center, The Institute of Energy Economics, Japan

Dubai higher than Brent

Dubai crude oil prices are above Brent—Dubai averaged \$84.1/bbl and Brent \$83.0/bbl in May 2024. Based on the quality and properties of the marker crude oils, the light West Texas Intermediate (WTI) is usually rated high, followed by Brent and the heavy Dubai, which is usually rated low. Whilst WTI became cheaper after the shale revolution due to the easing of oil supply and demand in the United States (Cushing), the natural relationship that Brent being higher than Dubai was largely maintained. Since 2023, however, Dubai has been traded higher than Brent on average in more months ever. Reversals, which were previously one month or not per year, occurred five months in 2023 and two months by May in 2024. In August, October and November 2023, the reversal width was more than \$1/bbl, which had previously been around \pm 10/bbl. These high Dubai disappeared in early 2024, but reappeared in April, and in May the reversal width widened to \$1.1/bbl.

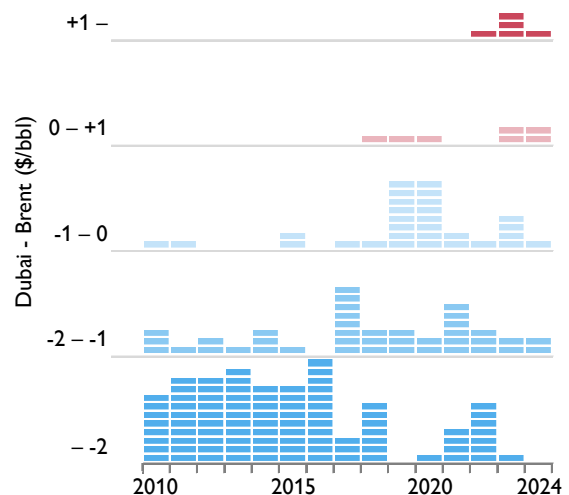
Although it is difficult to quantitatively analyse the structure of the Dubai's high, we can point to the following as factors in 2023: curbs in the supply of crude oil by the Organization of the Petroleum Exporting Countries (OPEC) plus, especially Middle Eastern crude oil by Saudi Arabia, which takes the initiative in voluntary production cuts; unexpectedly strong oil demand from China; the situation in the Middle East worsened due to Hamas' large-scale attack on Israel; and the increase in light crude oil production by the United States, etc. In 2024, the Chinese economy is slowing—although the extreme pessimism has eased—and oil demand growth is expected to be much smaller than in the previous year. But other factors persist. In addition, it is estimated that demand in Europe, which is closely linked to Brent, is softer than in China. For the time being, the Dubai's high may not be unusual.

Figure 1 | Major oil prices



Note: Monthly average. June 2024 is the average for the beginning of the month
 Sources: The Institute of Energy Economics, Japan (IEEJ) "EDMC Energy Trend", Intercontinental Exchange (ICE), Chicago Mercantile Exchange

Figure 2 | Distribution of price differences between Dubai and Brent



Notes: Until June 2024. Monthly average. June 2024 is the average for the beginning of the month
 Source: Compiled from IEEJ "EDMC Energy Trend" and ICE

Spot well below the front-month futures

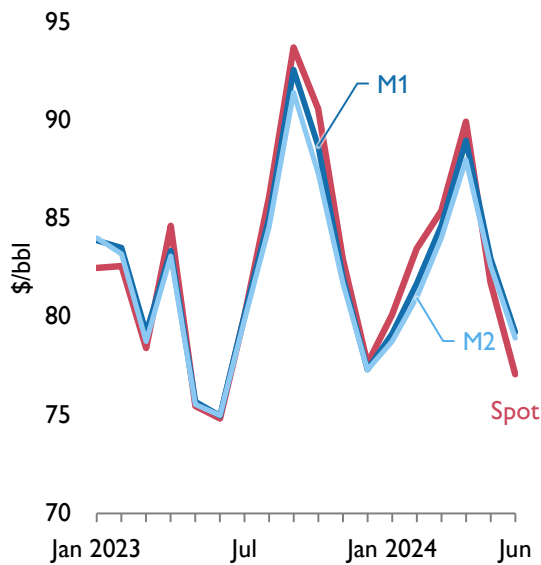
Brent is cheaper than Dubai, and its cheapness is also noticeable in another aspect.

There are various interpretations of the forward curve shape of oil prices. However, near-term futures prices are often higher than those of the periods ahead, i.e., backwardation, except during or immediately after a sharp decline in oil prices. The forward curve of Brent futures is now also a backwardation state.

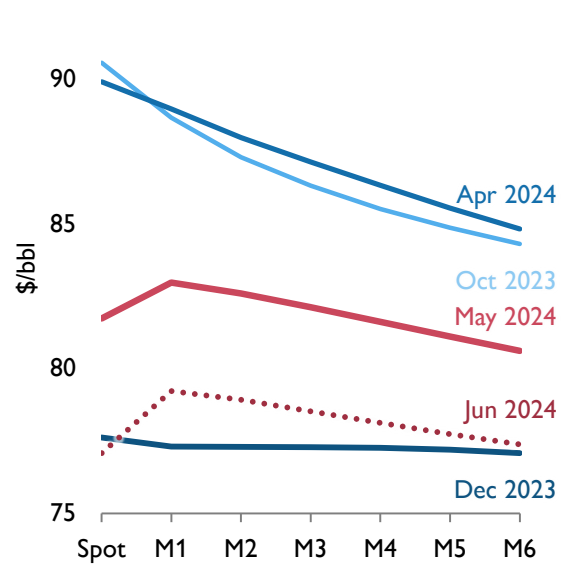
However, if spot price is added to the curve, it will form a chevron. It has been a long time (10 months), but it is not a rare phenomenon that the spot price is lower than that of the front-month futures. It, however, is a different story to say that whilst the price of the front-month futures is more than \$2/bbl higher than the futures price of period ahead (the sixth month), the price of spot, which is even closer to delivery, is conversely more than \$1/bbl lower than that of the front month. This is the first time in about 11 years except in April 2022 when oil prices fluctuated wildly after Russia's invasion of Ukraine. At present, the supply and demand of physical oil is much looser than that of paper oil.

The backwardation of the futures is more gradual than it was in April. Therefore, it is possible that such a pricing structure, which is not seen in WTI, will gradually settle into a smoother shape, accompanied by a downward shift in the overall curve—namely, a decline in oil prices. The unusual forward curve, however, may be an indication of a sudden adjustment.

Figure 3 | Brent prices
Spot and futures



Forward curve



Note: Monthly average. June 2024 is the average for the beginning of the month
Sources: U.S. Energy Information Administration, ICE

Whilst Brent drops below Dubai, the forward curve bends. Is this coexistence simply a sign of weaker oil demand than expected, the market being overly pessimistic about the current situation, or a signal of structural change? And what are market participants going to make of this? Even more than usual, we need to keep an eye on oil prices.

Contact: report@tky.ieej.or.jp