Oil

Bullish oil outlook upends hedging universe

Iran sanctions spur buyers to lock-in prices while producers scale back contracts

The biggest fear among investors is the effect of US sanctions on Iran, which are expected to remove at least 1m barrels a day of crude from the market © Reuters

David Sheppard, Energy Editor SEPTEMBER 21, 2018

As Brent crude approaches $80 a barrel, trading close to its highest level in four years, energy companies and major industrial buyers of oil are sending a clear signal: they expect or fear even stronger prices in the future.

Small- and medium-sized oil producers, which generally sell forward or hedge a proportion of their output to lock-in prices, have scaled back their hedging this year in anticipation oil could rise further once US sanctions against Iran's oil sector kick in come November.

Big oil consumers such as airlines, on the other hand, have started aggressively hedging their fuel purchases one to two years in the future as they try to cap their exposure to the crude price.

That has had the effect of raising long-dated oil prices — for delivery next year or in 2020 — to their highest level in more than three years, with the Brent contract for December 2019 surpassing $75 a barrel. That contract has gained more than 30 per cent so far this year, compared to 20 per cent for the main front-month Brent contract, or spot price.

"The major story for oil right now is not $80 a barrel, but what's happening at the back end of the forward curve," said Thibaut Remoundos, a former Morgan Stanley oil trader who co-founded the London-based Commodities Trading Corporation (CTC), a consultancy.

"Hedging by oil producers in Brent-linked contracts is dropping off in expectation of higher prices in the future, while major consumers like airlines have

been rushing to buy for the same reason. You would need to go back to 2007 to see this level of hedging from consumers."

The next four weeks are probably going to present some of the best opportunities [for producers] to hedge this year

Mark MacLean, co-founder of Commodities Trading Corporation

A survey of Brent-linked producer hedging by CTC, compiled from company contacts and filings, showed that at the end of the second quarter this year producers were only 30 per cent hedged for the next 12 months in aggregate, compared to 38 per cent at the end of 2017.

For the same periods volumes for Brent contracts two years in the future were only 19 per cent hedged versus 25 per cent hedged previously, indicating that producers want to have more of their output exposed to the potential for further price gains.

Olivier Jakob at Petromatrix said the biggest fear in the market was the effect of US sanctions on Iran, which are expected to remove at least 1m barrels a day of crude from the market at a time when supplies are relatively tight.

"I can understand why producers might want to wait to see if Iran has a short-term price impact they could sell into," Mr Jakob said, although he warned that any gains from the Iranian sanctions could be shortlived.

"You see the resistance on the political side in the US but I also think rising prices will have a negative impact on demand. So it could be difficult to sustain a strong rally as a result."

Donald Trump, the US president, on Thursday tweeted at the Opec producer group, whose most powerful member is US ally Saudi Arabia, to "get prices down now" in his latest broadside against a cartel he has been leaning on since June to compensate for the loss of Iranian exports.

Mr Jakob's view was echoed by Mark MacLean, another former Morgan Stanley trader who co-founded CTC with Mr Remoundos two years ago. CTC advises and executes hedging programmes on behalf of clients but it is not paid related to the volume of the trades it carries out, working on a retainer basis.

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