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Contango Reverses With Crude Near $90: Energy Markets

By Asjylyn Loder and Mark Shenk - Dec 14, 2010

(Corrects attribution in second paragraph of story that ran yesterday.)

Oil producers increased sales for the first time in four weeks to lock in profits near $90 a barrel, reversing a two-year contango and raising speculation that stockpiles will decline.

Producers and merchants increased so-called net-short positions in crude futures and options by 13 percent in the week ended Dec. 7, the Commodity Futures Trading Commission's said in its Commitments of Traders report. Producers sell futures to secure prices for output from their wells. It was the second- largest set of sales in two years.

Hedging oil for future delivery pressured the longest- maturity contracts, erasing the contango, or premium paid for later shipments. Hedge funds exaggerated the move as oil for delivery in December 2011 began trading at a premium to December 2012 for the first time since the week Lehman Brothers Holdings Inc. declared bankruptcy in September 2008.

"Producers looked at prices at $90 and said they'll take some of that," said Adam Sieminski, Deutsche Bank AG's chief energy economist in Washington. "Hedge funds say, 'We're at $90, OPEC doesn't seem to care and the markets are getting tighter.'"

Oil for delivery in December 2011 settled at $90.14 a barrel on Dec. 3, 93 cents higher than the future for December 2012, which closed at $89.21 on the New York Mercantile Exchange. The premium widened to a record $1.50 on Dec. 6. January delivery crude advanced 82 cents, or 0.9 percent, to settle at $88.61 a barrel on the New York Mercantile Exchange.

Short Positions

Net-short positions held by producers and merchants reached a two-year low the week-ended Nov. 30 before the increased sales expanded their net-short position to 153,992 futures and options combined the week ended Dec. 7. It was the largest advance in net-short positions since the seven days ended Oct. 26, which was the biggest sell-off in two years.

"The increase in producer and merchant net-short positions confirms that producer hedging, selling forward, was a key driver in the flattening of the crude forward curves in the last week," said Michael Wittner, New York-based head of oil market research at Societe Generale SA.

Hedge funds and other large speculators increased bullish bets by the most in nine weeks, boosting so-called net-long positions, or wagers that prices will climb, by 26 percent, the CFTC report showed.

OPEC Meeting

The Organization of Petroleum Exporting Countries, which produces about 40 percent of the world's supplies, decided at a meeting Dec. 11 in Quito, Ecuador, to maintain current oil production quotas.

The group, which next meets in June, hasn't altered its formal limit since December 2008, when it announced record supply cuts and a quota of 24.845 million barrels a day. OPEC has breached its production quotas this year by an average of 1.934 million barrels a day, the most in six years.

The current price relationship, known as backwardation, provides an incentive for traders to liquidate stockpiles, said Andy Lipow, president of Lipow Oil Associates LLC in Houston. In a contango market, traders cover the cost of transportation, insurance and storage at the delivery point for New York futures in Cushing, Oklahoma, by selling crude for future delivery at a premium to today's price. As the curve reverses, that becomes impossible, he said.

"There's no offsetting contango for the leaseholders who have to pay monthly storage rates in Cushing," Lipow said. "As a result, you would expect that Cushing inventories starting in the new year will be liquidated."

Petroleum Inventories

U.S. inventories declined more than forecast last week, falling by 3.82 million barrels to 355.9 million. Supplies were forecast to decrease 1.4 million, according to the median estimate of 16 analysts surveyed by Bloomberg News.

Total U.S. petroleum stocks, including diesel, gasoline and crude, declined 43 million barrels to 1.101 billion since reaching a record high in the week ended Sept. 17, according to an Energy Department report on Dec. 8.

"The most bullish thing for oil is you look at the demand forecasts," Lipow said. Outlooks for U.S. and worldwide demand have increased, he said.

The International Energy Agency boosted its 2011 global demand forecast in its monthly Oil Market Report on Dec. 10. Crude use worldwide will average 88.8 million barrels a day next year, up 1.6 percent from this year and about 260,000 barrels more than it projected in November.

U.S. demand will climb 2 percent to 19.18 million barrels a day next year, according to the Paris -based adviser to oil- consuming countries.

Hedge Funds

Managed money, including hedge funds, commodity pools and commodity-trading advisers, increased net-long positions by 42,603 futures and options combined to 206,807 the week ended Dec. 7, according to the CFTC report.

In other markets, net-long positions in futures and options combined in four natural-gas contracts rose 28,920.8 futures equivalents, or 40 percent, to 100,567.8 in the week ended Dec. 7, the highest level since August, the CFTC report showed.

The measure of net longs includes an index of four contracts adjusted to futures equivalents: Nymex natural gas futures, Nymex Henry Hub Swaps, Nymex Henry Hub Penultimate Swaps and ICE Henry Hub Swaps. Henry Hub, in Erath, Louisiana, is the delivery point for Nymex futures, a benchmark price for the fuel.

Managed money's bullish, or long, bets on gasoline rose 4.6 percent, the fifth weekly increase, to 68,434 futures and options combined, the CFTC data showed. Net-long bets on heating oil rose 56 percent, or 15,249 futures and options combined, to 42,487.

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