

OIL PRICE RISE MIGHT BE WRONG BUT IT IS NOT IRRATIONAL: EXPERT

CONTANGO NARROWS FROM \$9 TO UNDER \$6 PER BARREL

LONDON: The oil futures curve is flattening as a wave of bullishness washing across the market raises the price of near-dated contracts faster than that of contracts for deferred delivery. Brent for delivery in May 2016 has risen more than \$10 per barrel since early February, while prices for delivery in 2017 are up less than \$7 over the same period. The discount for Brent crude delivered in May 2016 compared with the average of 2017, a price structure known as contango, has narrowed from \$9 to well under \$6 per barrel since Feb 11

The shape of the futures curve is intimately connected with expectations about supply, demand, stocks and the availability of storage ("Brent contango is hard to square with missing barrels", Reuters, March 10). So the narrowing contango implies the market now expects less oversupply and a smaller build-up in stocks in the months ahead. But market bullishness is at odds with warnings from influential analysts forecasting supply will continue to outstrip demand and stocks rise ("Oil shrugs off Goldman warning about premature rally", Reuters, March 14).

MAYBE WRONG, BUT RATIONAL

It is sometimes said the futures curve is not "forward-looking". If that means the curve is not a simple forecast and is not good at predicting what will happen to spot prices in future, the statement is correct. But the futures market is actually very forward-looking and focused on how the balance between supply, demand, stocks and prices will evolve in the coming months and years. Via the futures curve and the mechanism of financing and storage, those expectations about medium-term supply, demand, stocks and prices

are ruthlessly discounted back to the present. Given many market participants believe oil supplies will fall sharply, demand will increase, and stocks will peak and begin to fall later this year, the recent rise in prices and narrowing of the contango are entirely rational.

Any other price response would be irrational because it would violate the requirement for inter-temporal consistency. The market could be wrong in its expectations for supply, demand, stocks and prices later in the year and in 2017, but it is being absolutely rational.

SPOT PRICES AND SPREADS

The price of oil for delivery on a future date (e.g. calendar average 2017) can be thought of as the sum of a spot price (May 2016) and a spread (the price difference between May 2016 and the calendar average of 2017). As a matter of convention, the spread is normally expressed as the spot price minus the futures price (it can just as easily be expressed the other way round).

If futures prices are above the spot price, the spread is negative and the market is said to be in contango. If futures prices are below the spot, the spread is positive and the market is trading in backwardation.

For example, if the future price is \$50 and the spot price is \$40, the future price can be analyzed as a spot price of \$40 plus a spread of \$10 contango. Many real trades are arranged this way, with the customer buying (selling) near-dated futures contracts and then adjusting their position by selling (buying) the spread between the near date and the forward one.

The advantage of executing trades as two transactions (spot and spread) rather

than just one is that it enables dealers and customers to make best use of the greater liquidity in spot contracts.

In principle, spot prices and spreads are determined independently and can move separately. In practice, there is normally a high degree of correlation between them. In most cases, rising spot prices will be accompanied by a narrowing of the contango (or a move from contango into backwardation). Conversely, falling spot prices will normally be accompanied by a widening of the contango (or a move from backwardation into contango). This is exactly what is happening at the moment: the market's newfound bullishness is resulting both in a rise in the spot price of Brent and a narrowing in the contango.

PRICES MOVE TOGETHER

As the market becomes more bullish, the price of contracts for short-term delivery rises faster than the price of contracts for later delivery. The result seems paradoxical since an improved outlook for supply-demand balance over the next few months and years has its biggest impact on the price of oil delivered now. In fact, this behaviour is typical for oil and other commodity markets. Over the period from 1992 to 2016, taken as a whole, there is no correlation between the level of oil prices and the degree of contango or backwardation in the futures curve.

High spot prices have coincided with backwardation (January 2008) and contango (May 2008). Low spot prices have coincided with contango (January 1999) and backwardation (April 1999). But the large shifts in the absolute level of prices since 1992 obscure the short-term relationship between spot prices and the shape of the futures curve. — Reuters

GUPTAS SLAM 'HATE SPEECH' AS S AFRICA SCANDAL BROILS

JOHANNESBURG: The Indian brothers who are accused of corrupting South African President Jacob Zuma lashed out yesterday at "xenophobic and hate speech" against them, and denied benefiting from links to the government. The Gupta family's power has allegedly extended to appointing ministers under Zuma, whose presidency has been engulfed in graft scandals and growing disillusion over the country's post-apartheid prospects.

"As the global economic slowdown began to bite, the family became the scapegoat for every calamity and misfortune that South Africa has faced," the Guptas said in a statement.

"We have been quiet until now but given the recent xenophobic and hate speech against us, now is the time to set the record straight." The statement was printed across a double-page spread in The New Age—the pro-government paper they own—under the headline "Gupta family: The Inconvenient Truth".

"Our interaction with the current president began in 2000, which was long before he became president," it said. "It is absurd to suggest that we benefit from government business when only less than one percent of the (family's) business is with the South African government." The statement listed the three Gupta brothers' interests in mining, engineering, technology, media and property, and said they employ 5,000 staff after starting in 1993 with a marketing company in a Johannesburg garage.

"Our position remains: happy to face the consequences for any wrongdoing, hard though to deal with 'whispering campaign,' it added. The statement comes after deputy finance minister Mcebisi Jonas said that they offered him the top job in the treasury last year. He said he rejected the offer, but several other ministerial appointments have been widely reported as being due to the Guptas. The ruling African National Congress (ANC), which led the struggle to end apartheid, began a three-day meeting of its national executive committee yesterday, where the Gupta controversy is likely to dominate. Jonas's revelations appeared to expose a major split in the party, pitting Zuma's extensive network of loyalists against reformers headed by Finance Minister Pravin Gordhan. — AFP

FRANCE'S LABOR RULES FINAL STRAW FOR CALAIS LACEMAKER

CALAIS, France: A Monet painting inspired the field of red poppies embroidered onto the delicate lace at Gerard Dezoteux's 126-year-old lace factory in Calais, northern France. The samples at Desseilles Laces, supplier to lingerie brands such as La Perla, Ralph Lauren and Victoria's Secret, may never make the shop floor as the company is on the brink of collapse. Competition from Asian rivals has squeezed the region's lace industry so Dezoteux cut jobs to save money. But a court overturned the decision, a costly blow that may force the company to shut and business groups say is another case of outdated labour laws making it hard to operate in France.

"This was my own masterpiece," Dezoteux said, holding up the red fabric on the factory floor where "tullists" still adjust threads by hand on clattering machines that are even older than the factory. "It could now end up in a museum. What a total waste."

There were over 300 lace factories in Calais at the turn of the 20th century, and the town has a museum celebrating the industry. There will only be two left if Desseilles closes as a result of the December court order to rehire five of the workers it laid off in 2013, pay two-and-a-half years of salary arrears, plus an amount of compensation that has yet to be set. Dezoteux estimated it could cost at least 750,000 euros (\$850,000) overall, more than the company's loss for the whole of 2015 and about 10 percent of its turnover.

"It's just absurd," Dezoteux, who took over the company in 2011 with two partners. "This is the final straw for us." The redundancy scheme had been approved by labour inspectors, the labour ministry and another tribunal so the decision highlighted the legal uncertainty created by unwieldy labour laws that the Socialist government is trying to slim down to make France a more business-friendly place.

In a rare move, the government's local administration has joined Desseilles in appealing the court's decision.

DEATH KNELL

This conflict played out on the national stage this week when Prime Minister Manuel Valls unveiled a labor reform bill but was forced to water it down amid a Socialist party revolt and protests from unions. One of the measures that was dropped - a cap on compensation packages labor courts can award unfairly dismissed workers - would have helped businesses in similar court cases to Desseilles Laces. Business leaders and many economists say the unpredictable cost of laying off workers puts companies off doing business in France. — Reuters



TOKYO: A man walks past an electronic stock board at a securities firm in Tokyo yesterday. Asian stocks mostly advanced yesterday as higher prices for commodities, including crude oil, pushed Wall Street stocks higher overnight. But shares in Tokyo fell as the yen's strength worried investors. — AP