

# Treasury Trends

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## Refining Risk: A Treasury Risk Management Approach For Oil Price Exposure

The recent spike in oil prices has once again reminded businesses – especially those reliant on energy, transport or petroleum-linked inputs – that volatility in crude is not just a market risk event; it's strategic risk. Whether an organisation consumes diesel to run cars or trucks, imports oil-based products or simply relies on global supply chains where freight and energy costs feed into the cost base, having clarity over the financial risk is essential.

Oil price movements rarely happen in isolation. They ripple through FX rates, freight charges and supplier pricing. An appropriate hedging policy should therefore look beyond “*the price per barrel*” and treat oil risk as a multi-dimensional exposure that affects margins, cashflow and competitiveness.

### Crude Awakening: Identifying Oil Price Exposure

The first step in treasury risk management is identifying the nature and extent of exposure. Oil exposure can arise in several ways:

- **Direct exposure:** Those purchasing crude oil or refined products (e.g., airlines buying jet fuel).
- **Indirect exposure:** Through supply chains, transportation costs, or energy-intensive inputs (e.g. plastic).
- **Macroeconomic exposure:** Oil price changes affecting inflation, interest rates, and foreign exchange.

Oil is a key transmitter of economic risk, influencing production costs and broader financial markets.

### Fuel for thought. Examples of oil/fuel exposure

**Diesel (Transport, Logistics, Mining).** Diesel exposure is common across road freight, shipping support services, construction, and mining. The treasury management challenge depends heavily on contractual structure:

- **Fixed-price contracts:** The supplier bears the full impact of oil price risk. If diesel prices spike, margins compress immediately.
- **Fuel Adjustment Factor (FAF) mechanisms:** Partial risk transfer to customers via periodic price resets.
- **Pass-through pricing:** Minimal exposure, as costs are directly passed to customers (though timing mismatches can still create short-term risk).

### Key Points

- Confirm the nature of the financial risk and impact
- Manage basis risk
- Balance cost vs protection
- Be prepared to adapt to rapidly changing conditions
- Work within a defined policy – and report against that

A logistics firm with fixed-price contracts is effectively “*short oil*” – rising diesel prices reduce profitability (conversely, falling diesel prices add to profitability). A pass-through model reduces structural exposure but still leaves timing and working capital risk, particularly when prices spike rapidly.

**Jet Fuel (Airlines).** Jet fuel is a refined product derived from crude oil but does not perfectly track crude benchmarks like Brent Crude or WTI Crude. This creates basis risk, the risk of refining costs/margins changing.

Airlines typically hedge:

- A percentage of forecast fuel consumption
- Over a rolling forward horizon
- Using swaps, options, or jet fuel-specific derivatives where available

A key lesson from past oil spikes is that over-hedging can be as dangerous as under-hedging. If demand falls (e.g., during economic downturns), airlines may be left with excess hedge positions, effectively speculating on fuel prices.

**Fertiliser (Agriculture and Chemicals).** Fertiliser production is highly energy-intensive and indirectly exposed to oil via natural gas and petrochemical feedstocks.

- Nitrogen fertilisers depend heavily on gas prices.
- Phosphate and potash involve energy-intensive mining and processing.

Even where oil is not the direct input, it influences fertiliser prices through:

- Transportation costs (diesel)
- Input substitution effects across energy markets



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For agricultural businesses, exposure is often second-order but still material. Treasury teams must therefore consider cross-commodity correlations, not just direct oil exposure.

*Indirect Costs (Broad Corporate Sector).* Many firms face oil exposure indirectly through:

- Freight, shipping and logistics costs
- Supplier pricing adjustments
- Inflationary pressures linked to energy

This type of exposure is harder to quantify and hedge. It often manifests as margin compression rather than explicit line-item cost increases.

For example, a retailer may not buy fuel directly but will face higher import costs when shipping prices rise due to diesel or bunker fuel increases.

## Slick Strategies: Managing the risk

Once an exposure is confirmed and considered material, it is critical that any hedging aligns with the actual economic exposure. Mismatches will introduce basis risk or speculative positions. Key alignment considerations will include:

- *Volume:* Hedge only the proportion of expected consumption or production.
- *Timing:* Match hedge maturities with forecast exposure periods.
- *Index:* Use instruments linked to the same benchmark (e.g. Brent vs WTI).

Failure to align can lead to ineffective hedges or unwanted gains/losses. For example, hedging jet fuel exposure with crude oil futures may introduce basis risk if price movements diverge. A variety of financial instruments are used to manage oil price risk:

*Futures Contracts.* Standardised contracts traded on exchanges to lock in future prices.

- Advantages: Liquidity, transparency.
- Disadvantages: Margin requirements, potential mismatch with exposure.

*Forward Contracts.* Customised OTC agreements.

- Advantages: Tailored to exact needs.
- Disadvantages: Counterparty risk.

*Options.* Provide the right, but not the obligation, to buy/sell oil at a specified price.

- Call options: Protect against price increases.
- Put options: Protect against price decreases.
- Allow participation in favourable price movements but involve premium costs.

*Swaps.* Fixed-for-floating price exchanges.

- Common in corporate hedging to stabilise cash flows.

The choice depends on cost, flexibility, and risk appetite.

## Oil Well That Ends Well

Identifying and, as appropriate, managing oil price risk is a complex but essential treasury function. Oil-related treasury risk is not a single, uniform exposure but a portfolio of distinct risks shaped by how energy costs enter the business. Diesel, jet fuel, fertiliser, and indirect costs each behave differently, and pricing structures such as fixed contracts, FAF mechanisms, and pass-through arrangements fundamentally alter the risk profile.

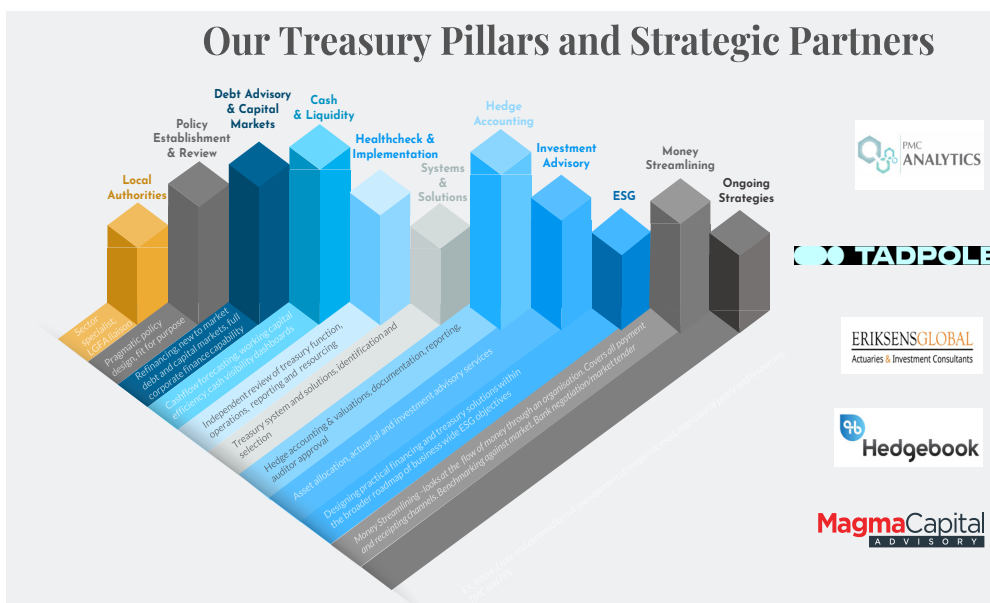
The recent spike in oil prices highlights the importance of proactive risk identification, robust measurement, and carefully aligned hedging strategies - if the impact is deemed material.

Risk managers in organisations must ensure that hedging instruments closely match underlying exposures to avoid unintended risks. At the same time, they must navigate rising hedging costs, increased volatility, and stringent reporting and accounting requirements.

Ultimately, effective treasury risk management is not about eliminating all risk, but about controlling it in a way that supports strategic and financial stability, even in highly volatile energy markets.

Please call us or speak with your advisor to work through how an oil or oil-related risk exposure healthcheck might be beneficial.

## WHAT WE DO



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