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Brent, Gasoil and Naphtha: Summer Update

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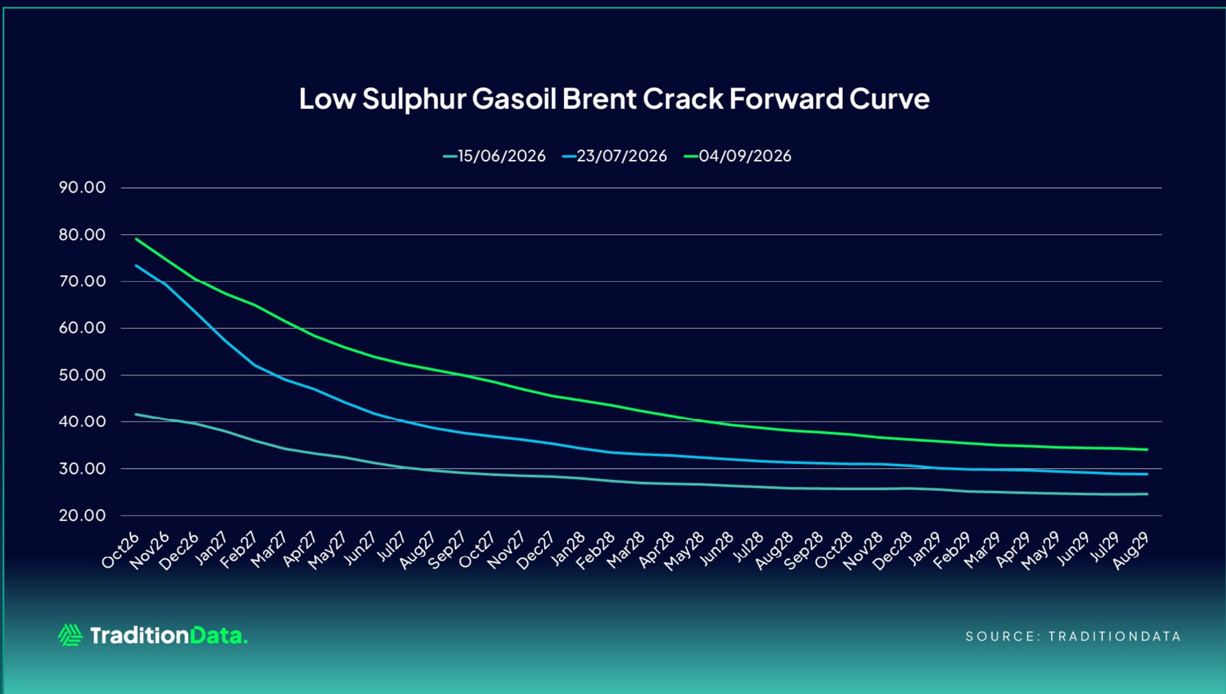
The summer has confirmed the divergence between crude and refined products that started to emerge during the early stages of the Iran conflict. While Brent has remained sensitive to developments in the Iran-US conflict, middle distillates have increasingly been supported by tighter physical balances. Naphtha has followed a different path, with weaker petrochemical demand limiting the impact of supply concerns.

By mid-June, Brent fell to below $72/Bbl, close to pre-war levels, as concerns over an immediate disruption to crude flows through the Strait of Hormuz eased. By contrast, Low Sulphur Gasoil/ Brent front-month crack remained well above $41/Bbl, still at a 50% mark-up. This suggested that some of the tightness in middle distillates was already becoming less dependent on the geopolitical premium in crude alone.

By the end of July, Brent recovered towards $90/Bbl, peaking above $100/Bbl on July 23, as tensions increased again. The gasoil crack strengthened further, reaching $74/Bbl on the same day, supported by restrictions on Russian diesel exports, refinery disruptions and lower availability of Middle Eastern products. The move in gasoil was therefore not only related to higher crude prices, but also to tighter middle-distillate balances.

The most recent attacks in the Middle East and concerns over shipping via the Strait of Hormuz have added further pressure, with Brent closing at $96/Bbl on Friday last week (September 4). At the same time, the gasoil crack surpassed $79/Bbl, it's highest level so far. The gasoil curve also moved into significant backwardation as shown by the chart below, indicating a higher value for prompt supply.



The fundamentals behind the move in middle distillates have also become more important. Russian refinery disruptions and export restrictions have reduced diesel availability, while disruptions to Middle Eastern refining and exports have limited alternative supply. European refiners also have limited spare capacity, making it more difficult to compensate for lost volumes.

Brent has been supported by the risk of further disruption to crude flows, but alternative supply and weaker demand have limited the persistence of the move.

However, the continuing decline in global inventories means that the market has less capacity to absorb another significant reduction in supply, making the response of Brent increasingly dependent on the duration of the disruption.

Naphtha behaviour differs from gasoil and diesel: supply concerns have supported prices, but petrochemical demand has been less supportive than demand for middle distillates. Higher feedstock costs have also put pressure on cracker margins, limiting the ability of naphtha to maintain the same level of support as gasoil.

The summer has therefore reinforced the different drivers of the three markets. Brent continues to reflect geopolitical risk and the potential impact on crude flows. Gasoil is increasingly influenced by physical availability and refinery supply. Naphtha remains more closely linked to petrochemical demand and feedstock economics.

The latest escalation has brought geopolitical risk back into focus, but the market is entering this phase with tighter product balances and lower inventories than at the beginning of the conflict. The relative performance of Brent and the gasoil crack will therefore remain an important indicator of whether the market is mainly pricing the risk of further disruption or an actual shortage of refined products.

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