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Energy

Diesel once again on the front line of supply disruptions and price volatility

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Crude oil | Gasoil | Jet fuel | Middle distillates

Key messages:

The US-Israel war with Iran is causing crude oil prices to rise and oil product prices to follow. The key driver of this is the effective closure of the Strait of Hormuz, through which some 15 million barrels/day of crude oil and 5.5 million b/d of refined products typically pass. Our base case assumes a 1-2 week blockage, but a more prolonged one could cause major disruption to oil markets and to the global economy.

Around 750,000 b/d of diesel/gasoil and 400,000 b/d of jet fuel transit through the strait, with these two products making up the majority of the 600,000 b/d of oil products that head to Europe through the strait. The approximately 250,000 b/d of diesel represent about 6% of Europe's road diesel demand, a significant volume to lose, particularly when increasingly strict sanctions on Russian oil have restricted supplies into Europe and made the Middle East a key supplier.

While the US Gulf Coast (USGC) can certainly increase exports, Europe is not the only diesel-importing region that will be looking to replace Hormuz supplies — Latin America and Africa will also be seeking imports, although the regions are likely to lose out to Europe's high premiums.

Since losing Russian supplies in 2022–23, Europe's diesel prices have had an added premium that is driven by the perception of risk to supplies rather than market fundamentals, which have been bearish overall, with demand on a structural decline. This latest disruption has spiked diesel crack spreads to over $40/barrel in the first week of the conflict, and we are forecasting a month-average diesel crack for March of $42/b (Northwest Europe [NWE] CIF).

The Trump administration is unlikely to want to prolong the disruption and cause sustained high oil prices; however, the war could spill over into the wider Middle East region and become difficult to contain. This would result in ongoing oil price volatility and cause the risk premium on diesel prices to be sustained for much longer.

Our alternative "oil shock" scenario explores the impact of a prolonged Hormuz disruption alongside damage to oil infrastructure, causing Brent crude prices to remain over $100/b for the next year. While middle distillate crack spreads would spike for longer, such high prices would ultimately result in demand destruction.

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