DME

FUTURES INSIGHTS

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OSP

$60.85

TOTAL EXCHANGE VOLUME

92,703 CONTRACTS

Light Sweet/Medium Sour crude spread on the move as oil prices soar

The glut of light crudes in the global oil markets during recent years, combined with a tightening in supplies of medium and heavy crude oil, has led to a narrow **light sweet versus medium sour** spread since 2018.

This bucked the long-term trend of Brent trading at a healthy premium to Oman and other similar Middle East crudes, such as Dubai and Upper Zakum.

A shift in underlying fundamentals in the first quarter (Q1) of 2021 has in part restored the Brent premium over medium sour crudes loading primarily from the Middle East Gulf.

This article looks at some of the underlying drivers on the key Brent/Oman spread, and factors to watch moving forward.

Shale soars, light sweet loses its premium

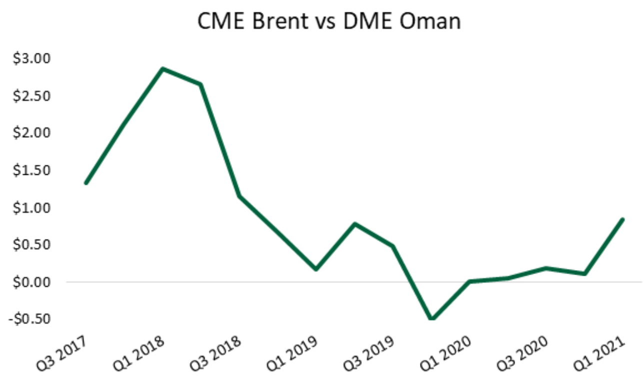
Up until 2018 North Sea Brent would regularly trade at a premium of $1.50-$3 per barrel over the Middle East sour crude benchmark, Oman, which is traded as a futures contract on the Dubai Mercantile Exchange.

However, over the last three years the Brent/Oman spread has been at historic lows as the Middle East, producing mostly heavier barrels, kept the market finely balanced through production discipline; whereas the light sweet crudes were abundant as the U.S. became a major exporter of shale crude.

Light sweet crudes with their higher yield of transport fuels such as gasoline, diesel and jet have historically commanded a premium over medium sour crudes. Heavier barrels have a higher cut of residual fuel, which require further expensive processing to yield the more sought-after refined products.

The Brent/Oman spread started to narrow during 2018 as U.S. exports of light crude and condensates dragged down global prices of naphtha and gasoline, in turn pulling down the entire complex for lighter crudes which includes North Sea Brent, Forties and Oseberg.

At the same time, sanctions against Iran and Venezuela kept significant volumes of heavier crude out of the market, which helped reshape the light/heavy price relationship and saw the premium for lighter crudes evaporate.



U.S. export boom

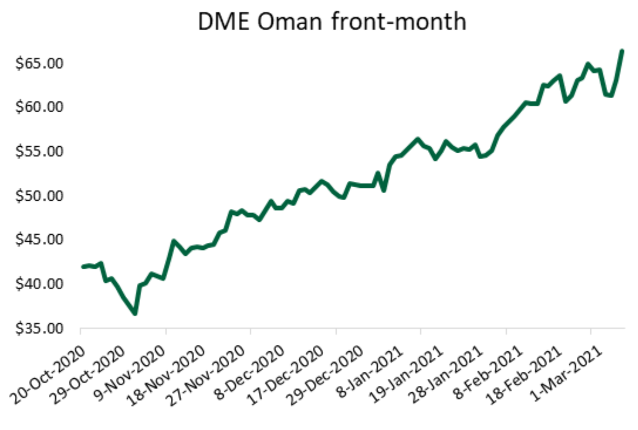
U.S. production hit a record of over 13 million b/d in early 2020, while U.S. exports for the whole of 2020 averaged 3.2 million b/d, according to data from the U.S. Energy Information Administration.

Exports have largely consolidated above 3 million b/d, although the hurricane season (peaking Aug/Sep) and February's big freeze across Texas reduced both figures.

Although Asian refiners have been taking larger volumes of lighter US crudes, plants configured to run heavier grades are unable to take full advantage of cheaper US exports.

China regularly topped the list of importers of U.S. crude in 2020, averaging over 700,000 b/d in the May-Oct period, while more recently India imported a record 560,00 b/d from the U.S. in December.

U.S. production had dropped to around 11 mil b/d by the end of 2020, as the price-sensitive shale output was reigned in, as the COVID-19 pandemic took its toll on prices and output, tightening the overall light sweet crude complex.



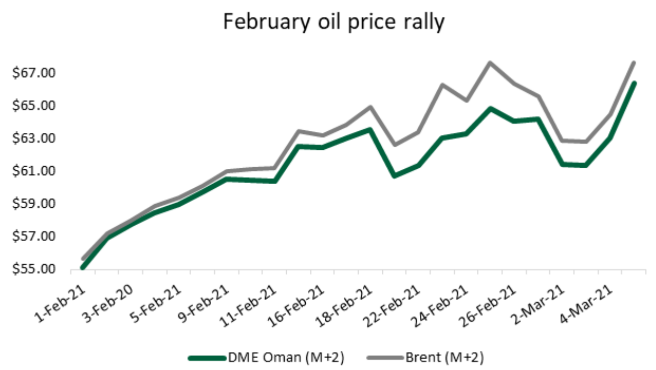
U.S. and Middle East key price drivers

Oil prices had already been in a firm uptrend since November but the extreme cold snap in February knocked out 3-4 million barrels of day of U.S. crude oil production, as the Permian Basin in Texas was particularly hard hit.

This further tightened light sweet crude, and at the same time lifted premiums for gasoil and heating oil/diesel.

CME Brent futures raced to a premium of more than \$3/b over DME Oman futures in late February – also on expectations that Middle East producers would agree to a production hike at the early March meeting, increasing the volume of heavier barrels available in the market.

However, the producer allies surprised many analysts by opting to maintain current output levels into the second quarter of 2021 and allow market fundamentals to rebalance.



The Brent/Oman spread has since eased to around \$1.50/b in early March, but still comfortably above the \$0.14/b average during the second half of 2020.

Elsewhere, Australian heavy sweet crudes are currently the most expensive in the world; supported by low-sulfur fuel oil which is used for bunker fuels and in parts of Asia power generation during periods of peak demand, such as the January cold snap across North Asia.

Vincent crude traded a record Brent +\$13/b in February, making it the costliest crude oil in the world.

Outlook

Brent/Oman is a crucial reference price used not only to track European/Asian crude values, but also a measure of grade quality in the crude complex, plus a valuable tool in tracking arbitrage economics.

As WTI export crude becomes an increasingly important factor on the global markets, the WTI/Oman spread will act a key price signal.

In the early part of 2021 Brent has clearly pulled away from its medium sour counterparts, however, it remains to be seen if light sweet crudes are set to re-establish the historical premium over heavier barrels.

On the light sweet crude side, much will depend on a rebound in shale production.

At above \$60/b shale should start to look attractive, but amid wavering investor appetite and environmental concerns over fracking some analysts believe shale reached its peak in 2019.

The OPEC+ group, led by Saudi Arabia and Russia and collectively is the guardian of medium and heavier barrels, have managed to keep tight controls over production and the producer group further extended this discipline in agreeing to maintain production levels into Q2.

However, the OPEC+ group have in the region of 7-8 mil b/d of spare capacity, so face a tricky balancing act in releasing these barrels to meet the expected demand recovery during 2021.

Implied Brent/Oman spreads can be traded on screen via Dubai Mercantile Exchange and cleared at CME Clearing House as a cost effective one-venue risk management solution.

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