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COMMODITIES, FOOD & AGRI ENERGY

Middle East escalation leaves significant upside for oil and gas markets

Oil markets are set to open significantly higher following US and Israeli attacks on Iran. How sustained any spikes are depends on how long attacks persist. Global LNG markets are also facing significant supply risks due to this weekend's action

US strikes come sooner than expected, while Iran responds aggressively

While action taken by the US and Israel against Iran this weekend may not be a complete surprise, the timing is, given that the US and Iran were due for another round of nuclear talks. Therefore, there was still a glimmer of hope that a diplomatic solution could be found. This is clearly not the case.

The attacks on Iran have also made it clear what US ambitions are. It is not purely about ensuring that Iran doesn't have the ability to produce nuclear weapons, but also to push for regime change. This was clear in President Trump's speech urging Iranians to take over their government and that it will be theirs to take. Meanwhile, the successful targeting of Iran's Supreme Leader Ali Khamenei only reinforces this view.

However, actual regime change is easier said than done, particularly when the US and Israel have no ground presence. This makes any shift in power more difficult, while also meaning that any potential transition could be very messy if led by Iranian civilians, as President Trump has called for.

While it is still very early days and the situation is developing at a fast pace, it does not appear that this military action will be quick and short-lived, like seen in June 2025. Israel has said that action will take as long as needed.

There has also been a strong response from Iran, targeting Israel, US bases across the region and civilian infrastructure in some neighbouring Gulf states. The strong response from Iran highlights that the regime is essentially fighting for survival, while attacks on neighbouring countries could be an attempt by Iran to get these Gulf countries to put pressure on the US to end its strikes.

Energy markets face significant supply risks

It appears that we are moving towards our third potential scenario that we published last week, where we see prolonged military action and an aggressive response from Iran.

For energy markets, we expect an aggressive price response when markets open. ICE Brent could trade into the region of $80-90/bbl immediately, with risks for further strength towards $100/bbl and ultimately $140/bbl (worst-case scenario), if we are to see significant and extended oil supply disruptions.

Meanwhile, European gas and Asian LNG prices could potentially see relatively more aggressive moves, given the risks to Qatari LNG flows and the market being relatively tighter. If LNG/gas markets start to price in an extended period of losses to Qatari LNG supply, TTF could potentially spike to EUR 80-100/MWh ($28-35/MMBtu).

In terms of potential impact, there have already been unconfirmed reports of strikes on Iran's Kharg Island, where basically all of Iran's oil is exported from. This would be in the region of 1.5m b/d of oil, which goes predominantly to China.

Meanwhile, for gas markets, as a precaution, Israel has temporarily shut its Leviathan and Karish gas fields, which produce roughly 17bcm per year.

But most importantly, Iran has also reportedly announced the closure of the Strait of Hormuz. This is a key choke point for global energy markets, with 20m b/d of oil and more than a 100bcm of LNG per year moving through it, which is around 20% of global LNG trade. However, it would be difficult to enforce a closure and any attempts to do so would likely see a strong response from the US.

Vessels are becoming increasingly reluctant to navigate the strait given the risks and the longer this reluctance persists, the more of an impact it will have on oil and gas markets.

If needed, there is the potential to divert some oil flows via pipeline, which would reduce the oil supply at risk to around 15m b/d (9m b/d of crude oil and 6m b/d of refined product). Saudi Arabia is able to pipe some oil to its west coast and ship from the Red Sea. However, this

supply could still face disruptions if the Houthis in Yemen, who are backed by Iran, start to attack tankers moving southbound through the Red Sea.

The move would not be isolated to crude oil prices, as refined product cracks could also see strength. In the region of 6m b/d of refined products flows through the strait, which would be at risk, while disruptions to crude oil flows would also have an impact on refinery runs elsewhere, particularly in Asia, where the bulk of energy flows.

Any blockade will see plenty of pressure from other governments, particularly in Asia, to allow shipments through the choke point. Asia has a significant exposure to energy supplies from the Persian Gulf. 84% of oil and 83% of LNG that passes through the Strait of Hormuz ends up in Asia, with China the key market.

How could energy markets deal with any supply disruptions?

If the market sees significant oil supply disruptions, the quickest action we are likely to see from governments is a coordinated release of oil from strategic petroleum reserves (SPR). There will be plenty of focus on the US SPR, which is about 35% smaller than what it was at the start of 2021, given it was used heavily following Russia's invasion of Ukraine in 2022. However, at roughly 415m barrels, there is room for further emergency releases to take some pressure off the market. Clearly, releases from reserves can only offer temporary relief.

OPEC+ could also potentially help through supply increases. The group agreed on a larger-than-expected supply increase of 206k b/d for April at its meeting on 1 March, more than the 137k b/d expected. However, if we do see sizeable supply disruptions due to this conflict, this supply is not going to move the needle much. In addition, a key issue is that the bulk of OPEC spare capacity sits in the Persian Gulf. Therefore, if there are blockades in the Strait of Hormuz, this additional supply will be of less help to the market.

Higher prices will also see a supply response. And given its shorter lead time, the market will be focused on any supply response from the US shale industry. However, this will not be immediate, with it taking 6-12 months to bring additional supply onto the market.

For the global LNG market, it would also be difficult to deal with disruptions. The market is coming out of a period of tightness and while there is plenty of US LNG export capacity which is scheduled to start up in the coming years, including some capacity this year, it will be too little and too late to offset the volumes at risk from Qatar and the UAE. Instead, higher prices will need to persist in an attempt to try to balance the market through demand destruction.

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