

Oil rallies on Middle East tension

Oil has unsurprisingly opened higher this morning after Hamas launched a large attack on Israel over the weekend to which Israel has retaliated. The market has started to price in a war risk premium given the uncertainty over how the situation evolves



Source: Shutterstock

Oil market moves higher

Following Hamas' devastating attacks on Israel over the weekend and the retaliatory actions taken by Israel in Gaza, it is no surprise that the oil market opened stronger this morning. ICE Brent has rallied more than 4% in early morning trading in Asia today with markets concerned about how the situation evolves. Up until now, the move in the market is purely reflecting an increased risk premium, rather than any change in fundamentals.

Israel is a very marginal oil producer, and so recent developments will have little direct impact on oil supply. However, given the rising tension in the region and the risk that the conflict could spread, market participants will remain nervous until there is a clear de-escalation.

Looking at the medium to longer term, there has been a growing trend in recent years for a normalisation of relations with Israel for a number of Arab nations. However, clearly, the attack over the weekend could make the continuation of this trend more difficult, particularly if we see

further escalation.

Does this change fundamentals?

While oil fundamentals have not changed since these attacks, it does not mean they won't. There are reports that Iran helped Hamas plan the attacks and gave them the "green light". If this is proven to be true, we could see the US, an ally of Israel, taking a tougher stance against Iran, which could ultimately lead to a reduction in oil supply.

The US administration has taken a much softer approach to Iran in recent months when it comes to sanctions. While US oil sanctions against Iran remain in place, they have not been strongly enforced. This is evident by the growth in Iranian oil supply over the course of this year. Output has grown from around 2.5MMbbls/d at the start of the year to around 3MMbbls/d currently. The softer approach from the US is likely due to concern over rising energy prices. However, it would be difficult to see the US maintaining this stance if Iran is connected to these attacks, whether directly or indirectly. Enforcing these sanctions more strictly would mean the potential loss of at least 500MMbbls/d.

The implication of losing this supply would be that the global oil balance would be tighter throughout 2024. At the moment, we are assuming Iranian supply remains in the region of 3MMbbls/d through next year, but clearly, there is downside risk to this given recent developments.

If this loss materialises, the surplus we currently forecast in 1Q24 would largely disappear, leaving the market roughly in balance early next year. For the remainder of 2024, we would see deeper deficits, particularly over 2H24. Under this scenario, there would be some upside risk to our current Brent forecast of US\$90/bbl for next year.

No change in OPEC+ policy expected

We do not expect OPEC+ to adjust their output policy as a result of recent developments. However, if we were to see significant strength in prices, i.e. Brent trading above \$100/bbl, there is a possibility that Saudi Arabia would start to unwind their additional voluntary supply cut of 1MMbbls/d. These are levels where the Saudis would start to become increasingly concerned over the potential for demand destruction.

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