

What Israel's potential response could mean for the oil market

The oil market is on tenterhooks waiting to see how Israel responds to Iran's recent missile attack. There are growing fears that Iranian oil infrastructure could potentially be targeted, pushing oil prices higher. However, the move in prices is fairly modest when considering the amount of supply at risk



Oil prices firm amid growing supply risks

ICE Brent is trading more than 8% higher than it was before Iran's missile attack on Israel. However, the bulk of this move occurred on Thursday after President Biden, when asked if he would support an Israeli strike on Iranian oil infrastructure, responded, "We're discussing that."

Depending on the scale of such a response, it could potentially be significant for oil markets. Not only due to the immediate impact of losing Iranian barrels but also due to the fact that this scenario risks spilling over into something more extreme, which could potentially lead to a disruption in Persian Gulf oil and LNG flows through the Strait of Hormuz.

How much oil supply is at risk?

Even if Israel decides to strike Iranian oil infrastructure, there is still plenty of uncertainty over how impactful this would be for oil supply.

While an attack on downstream oil assets would be significant for the Iranian domestic market, fundamentally, it would be less so for the world market with Iran still able to export. In fact, depending on the nature of the strike, such a move could potentially lead to even stronger crude oil exports. If domestic refining capacity is affected, it would leave more crude oil available to export. Iran might struggle to find willing buyers because of US sanctions. However, this would still likely be bullish for oil prices as it is a step closer to impacting global oil supplies and escalating tensions.

The bigger concern for the global oil market would be strikes that target midstream and upstream assets, as this would impact Iran's ability to export crude. Under such a scenario, we could see as much as 1.7m b/d of oil supply lost.

The loss of 1.7m b/d of crude oil supply would be enough to push the global market back into a sizeable deficit from 4Q24 through 2025, even when considering that OPEC+ will gradually unwind 2.2m b/d of additional voluntary cuts as currently planned. Such a scenario could see Brent averaging a little over \$90/bbl in 2025.

The Strait of Hormuz risk

However, such a move would likely not be the end of it. It will likely lead to further escalation and the key concern, while still extreme, would be that these disruptions spill over to the Strait of Hormuz, affecting Persian Gulf oil flows. Almost a third of global seaborne oil trade moves through the Strait of Hormuz and while some pipeline infrastructure means that a portion of oil flows could be diverted to avoid the Strait, it still leaves in the region of 14m b/d of oil supply at risk. A significant disruption to these flows would be enough to push oil prices to new record highs, surpassing the record high of close to \$150/bbl in 2008.

It is also important to remember that the Middle East has become more important as a refined products supplier in recent years with new refining capacity. This also suggests that any disruptions in oil flows would not only be bullish for crude oil but would also lead to increased volatility in refined product cracks. This is important for Europe, which relies more on middle distillate supply from the region following the EU ban on Russian oil and refined products.

Disruptions would not be isolated to the oil market. It could also potentially lead to disruptions in LNG flows from Qatar, which makes up more than 20% of global LNG trade. This would be a shock to global gas markets, particularly as we move into the northern hemisphere winter, where we see stronger gas demand for heating purposes. While we are seeing a ramp-up in new LNG export capacity, this still falls well short of Qatari export volumes. Qatar exports a little over 100bcm of LNG annually, while in 2025, roughly 30bcm of new LNG export capacity is expected to start. In addition, a lot of this capacity is slated to start up later in 2025, too late to help with any shortfalls over the 2024/25 winter.

How could potential supply losses be offset?

The first action we would likely see is governments around the world tapping into their strategic reserves, particularly the US as it heads towards elections. While the US Strategic Petroleum Reserve was drawn down significantly in 2022, it still stands at more than 380m barrels.

The hope would be that emergency releases would give OPEC+ members time to ramp up supply. While we believe the group would go ahead with unwinding its 2.2m b/d of additional voluntary

supply cuts (possibly bringing this supply back quicker than currently planned), there is no guarantee that the group will be quick to respond with increasing supplies beyond this. Saudi Arabia has a fiscal breakeven oil price of above \$90/bbl and so would be happy to see prices trading up to these levels. We would likely only see the group start to bring further supply back online if prices move above \$100/bbl.

The other issue is that the bulk of spare OPEC production capacity sits within the Persian Gulf. Therefore, in an event where there is a blockade of the Strait of Hormuz or at least a significant disruption to flows via the strait, this spare capacity may be of little help.

Author

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

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