

# COMMODITIES INSIGHT



## Oil Markets Brace for Impact

7<sup>th</sup> October 2024

Oil prices have risen, posting its biggest weekly gain in more than a year, as trader's fear Israel could strike Iran's crude facilities in retaliation for Tehran's ballistic missile attack. The risk of an escalating regional war in the Middle East remains significant, with the potential to trigger a severe surge in oil prices that could impact the global economy and potentially influence the U.S. presidential election.

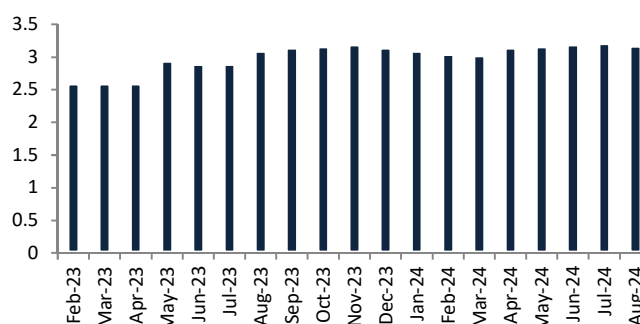
However, crude oil appears to be trading without significant reaction. Market participants, previously burned by geopolitical tensions that ultimately fizzled out, seem desensitized to the ongoing crisis between Iran and Israel. This time, they are waiting for concrete evidence of supply disruptions before pushing up crude oil prices.

The muted response can largely be attributed to concerns over lingering supply surpluses, economic slowdown in China, and internal tensions within OPEC+ members competing for greater market share amid prices that are too low for many producers to sustain their economies. For instance, oil prices surged to \$130 per barrel in March 2022 following Russia's invasion of Ukraine, but the expected supply disruptions never fully materialized, and prices subsequently returned to more moderate levels.

The key question for oil investors remains whether an Israeli attack on Iran would disrupt oil flows from the region. Oil prices would spike by \$10 to \$20 per barrel if an Israeli strike knocks out 1 million barrels per day of Iranian production over a sustained period. Just how high prices would go depends on whether OPEC uses its spare oil capacity to plug the gap.

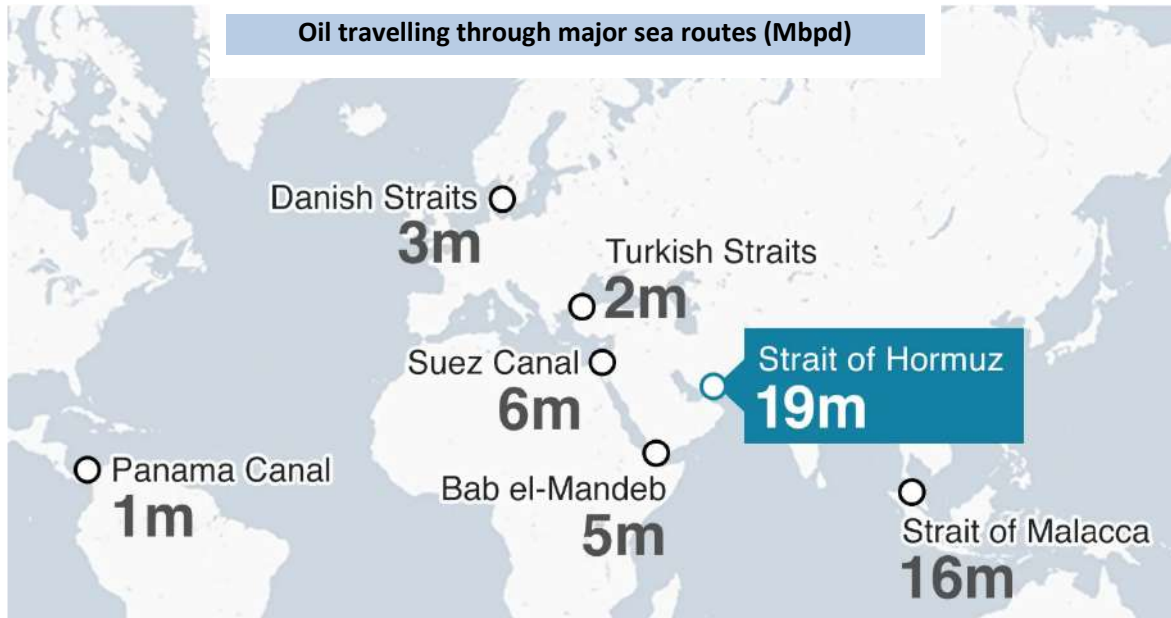
Although Iran remains under sanctions due to its nuclear program, it has continued to export oil, primarily to China. A particular risk is that Iran's primary export facility, Kharg Island, which accounts for 90% of its oil exports, could be targeted, leading to significant repercussions for global oil markets.

Iran Crude Oil Production (mbpd)



Source: RTRS

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## Strait of Hormuz

An even greater risk is that Iran might retaliate by disrupting the flow of oil through the Strait of Hormuz, the most vital oil chokepoint globally. This narrow channel, just 21 miles wide at its tightest point, serves as the only passage for transporting oil from the Persian Gulf to the world's oceans. Any disruption in the Strait of Hormuz could drive oil prices above \$100 per barrel, significantly impacting global energy markets. Producers, including OPEC members, could eventually compensate for the loss of oil supply, though it would require time. President Biden previously tapped into the SPR extensively after Russia's invasion of Ukraine, and it still remains the largest emergency oil reserve in the world.

If such a scenario were to unfold, global oil markets would find themselves in uncharted territory, likely experiencing a sharp spike in oil prices that could surpass previous record highs. However, such event remains unlikely, and any price surge would likely be temporary as the market adjusts. Nonetheless, an oil price spike could lead to soaring gasoline prices just weeks before the U.S. election, potentially unsettling consumers and businesses alike, raising concerns about the stability of the global economy.

**Outlook:** Oil market participants have largely ignored the escalating war in the Middle East until Iran launched nearly 200 ballistic missiles at Israel. Currently, the risk premium has been modest because there haven't been sustained supply disruptions over the past two years despite high geopolitical tensions. Any disruption of more than 6 Mbpd of spare capacity will push prices to \$92 and ₹7600 on MCX as currently as there is only 6 Mbpd of crude oil available in spare capacity on the side-lines that can come online and offset tightness from supply disruption scenarios.

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