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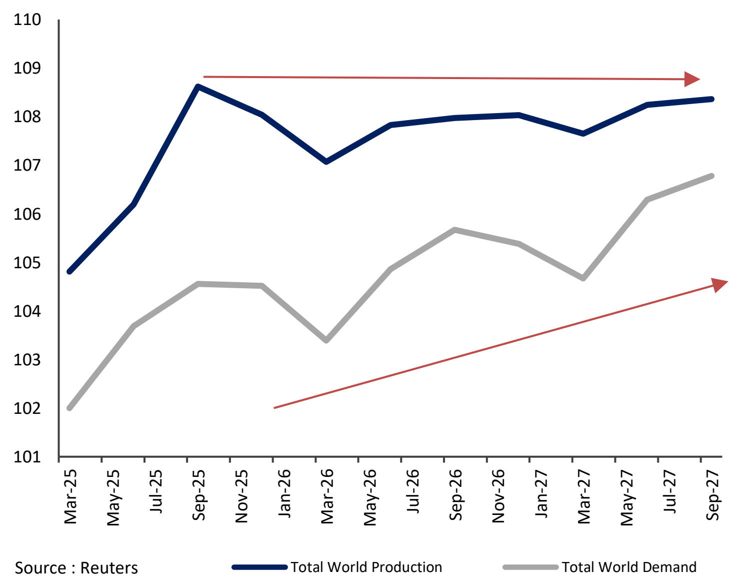
Crude Oil: Geopolitical Shock vs Supply Reality

January 16, 2026

Supplies expected to steady while Demand continues to egde higher going ahead



Source : Reuters

Crude prices ended 2025 with negative returns of about 15% as supply growth consistently surprised to the upside. OPEC aggressively unwinding cuts, resilient U.S. output, steady non-OPEC production growth, and the continued flow of sanctioned barrels from Russia, Iran, and Venezuela kept the supply running.

Demand growth, meanwhile, remained insufficient to absorb over-supplied market amid slowing global economic activity and trade-related uncertainty. While geopolitical events including Middle East flare-ups and Russia–Ukraine attacks on energy infrastructure injected episodic volatility, failing to to produce a sustained directional move in prices.

2026 Begins With a Geopolitical Stress Test…

Crude prices showed some signs of revival in the opening week of 2026, amidst global tensions escalating following the U.S. capture of Venezuela's president, initially reviving fears of supply disruption from a country holding the world's largest proven oil reserves. Early expectations leaned toward a sharp upside reaction in crude, driven by geopolitical risk, sanctions uncertainty, and headline shock.

Venezuela's diminished role in global supply helps explain the muted price action. Years of underinvestment, sanctions, and operational decay have reduced Venezuelan output to below 1% of global supply. Moreover, most Venezuelan crude exports had been flowing to China at steep discounts, largely used for strategic stockpiling rather than end-user demand. As a result, no immediate demand dislocation occurred, limiting the market impact.

Instead of tightening balances, crude prices softened after reports of a U.S.–Venezuela arrangement that could redirect 30–50 million barrels of sanctioned crude toward the U.S. Gulf Coast. Volumes previously destined for China were expected to shift westward, a move reinforced by China's late-2025 decision to diversify away from Venezuelan crude by increasing imports from Canada. Together, these developments eased near-term supply concerns and triggered some selling pressure.

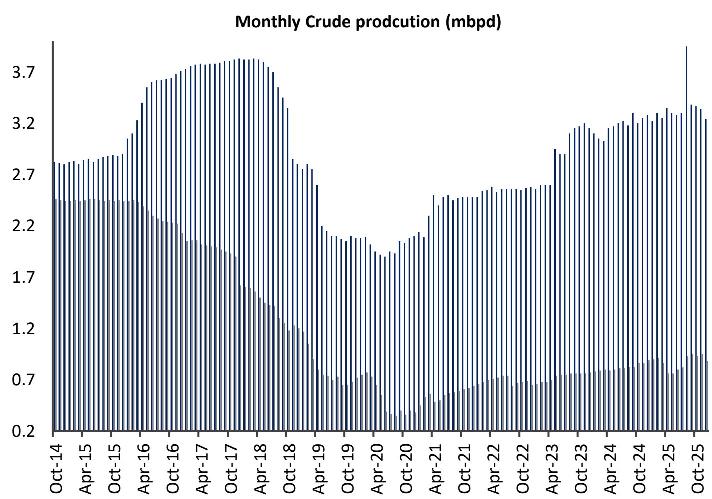
However, sentiments swiftly changed as geopolitical shocks, like the US - Venezuela situation, often disrupts operations, logistics, and shipping flows before policy clarity emerges. As a result, delayed market reactions began to surface, reflecting concerns around Venezuelan operational continuity and sustainability.

Even under improved political conditions, Venezuela's oil sector remains severely capital-constrained, with significant investment required merely to sustain current output levels and only limited volumes recoverable in the short term. Any meaningful return toward historical production levels would require sustained, large-scale capital inflows over many years. In addition, Venezuela was selling its oil at steep discount, but under US, Oil is going to be sold at higher base prices, which is also adding some support.

However, as per latest updates, U.S. Senate has attempted to curb unilateral military action by Presidetn Trump in Vnenzuela which is likely to ease geopolitical tensions and reduce risk premiums.

Iran: Elevated Risk Premium, But No Immediate Supply Loss

Iran unrest raises supply risk from a major producing nations



Source : Reuters

While Venezuela eased supply fears, Iran emerged as the more relevant geopolitical variable in early 2026. Ongoing economic stress in Iran led to widespread protests, increasing pressure on the government and raising doubts about maintaining stability.

As authorities struggled to contain the unrest, explicit U.S. warnings of potential intervention further heightened uncertainty, adding to the global geopolitical risk premium in oil prices.

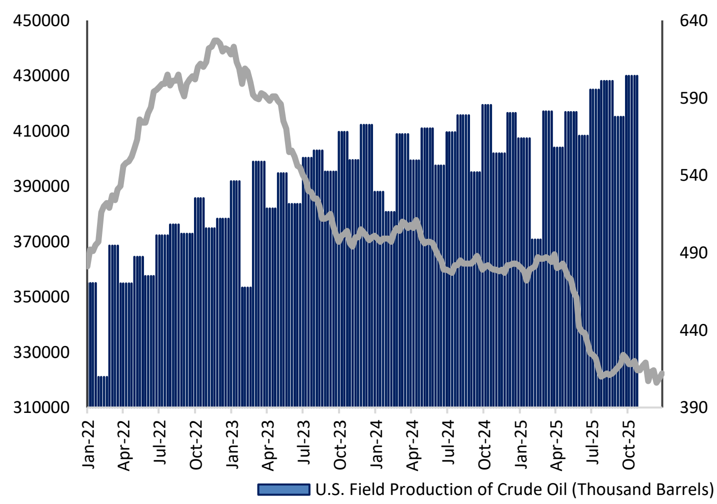
Iran currently holds a record 166 million barrels of crude and condensate on water, equivalent to roughly 50 days of production, as per market reports.

This build reflects slowing Chinese purchases in late 2025 as well as Iran's efforts to shield barrels from potential U.S. strikes by moving them away from the Gulf. The barrels exist, but their flow remains constrained by sanctions enforcement, trade policy risks, and China is purchasing behaviour. On top of this, U.S. sanctions targeting Iran's trading partners have intensified uncertainty, reinforcing concerns over an unresolved and widening geopolitical rift.

However, Crude prices saw a sharp pullback this week after the U.S. adopted a softer tone toward Iran. Signals of a delay and possible de-escalation in U.S. military action triggered a rapid unwinding of the geopolitical risk premium, as fears of immediate escalation faded and attention shifted back to fundamentals. With global supply remaining ample and the market structurally oversupplied, prices corrected sharply as traders reassessed the balance.

Geopolitics continues to support short-lived price spikes, but not sustained rallies, in a surplus market.

Falling US crude rig counts further highlights US supply issues



Source : Reuters

The EIA outlook reinforces a softer U.S. supply trajectory in 2026 as lower prices begin to bite. Weaker prices are prompting drillers to slow activity, resulting in a projected ~1% decline in U.S. oil output from 2025's record levels.

While the shift from growth to stabilisation reduces U.S. supply elasticity, it is insufficient on its own to offset broader global oversupply amid a fragile demand scenario.

The recent resumption of Venezuelan exports under limited U.S. sanction relief has allowed PDVSA to restart shipments and gradually reopen shut-in wells after storage constraints forced sharp production cuts late last year. While the recovery is expected to be incremental rather than disruptive, even a partial return of supply to an already well-balanced market, reinforces further downside risks.

The EIA's base forecast assumes sanctions on Venezuela remain in place through 2027. But if sanctions are eased and Venezuelan output rises more than expected, this would add to global supply and put additional downward pressure on prices.

A sustained upside move would require either a genuine supply disruption or a positive demand surprise, neither of which is evident at this stage. The recent rally was largely driven by geopolitical risk premium, which unwound swiftly after President Trump signaled a less aggressive stance toward Iran. This rapid reversal highlights how stretched prices had become on headline risk rather than fundamentals. While geopolitical escalation cannot be fully ruled out, there are no immediate indicators of supply impairment at this stage.

Until then, crude prices are likely to remain range-bound, reacting mainly to headlines and shifting risk premiums rather than a material change in global oil fundamentals.We expect WTI crude to trade in a broad $55–$63 per barrel range over the coming months.

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