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SEE ENERGY BRIEF

Monthly Analysis

The Latest Middle East Crisis and the Impact on Energy Markets

Introduction

For months, oil markets did not seem to be pricing in the prospect that Israel's multifront battle against Iran and its regional proxies might disrupt global supplies. As a matter of fact, the front-month Brent crude futures price has fallen about 20%, from roughly $90/bbl when Tehran and Tel Aviv last confronted one another directly in mid-April, to a little less than $72/bbl at the end of September. In early October, Iranian missile attacks—and muddled White House comments on potential Israeli strikes on Iranian oil infrastructure—produced the sharpest oil price rise in two years. More specifically, Brent surged approximately 10% or a little more than $7/bbl, and on October 7 it reached an intraday peak north of $81/bbl. Yet even in this febrile environment, the market is not panicking. Since then, international oil prices have retreated further, with Brent now trading at about $75/bbl. **(1)**

The escalating turmoil in the Middle East threatens to reshape global energy markets, yet oil prices remain curiously stable. The current Monthly Analysis will examine in detail the factors keeping oil prices in check, will discuss scenarios that could disrupt markets and will analyse how the widening conflict might impact global LNG supplies.

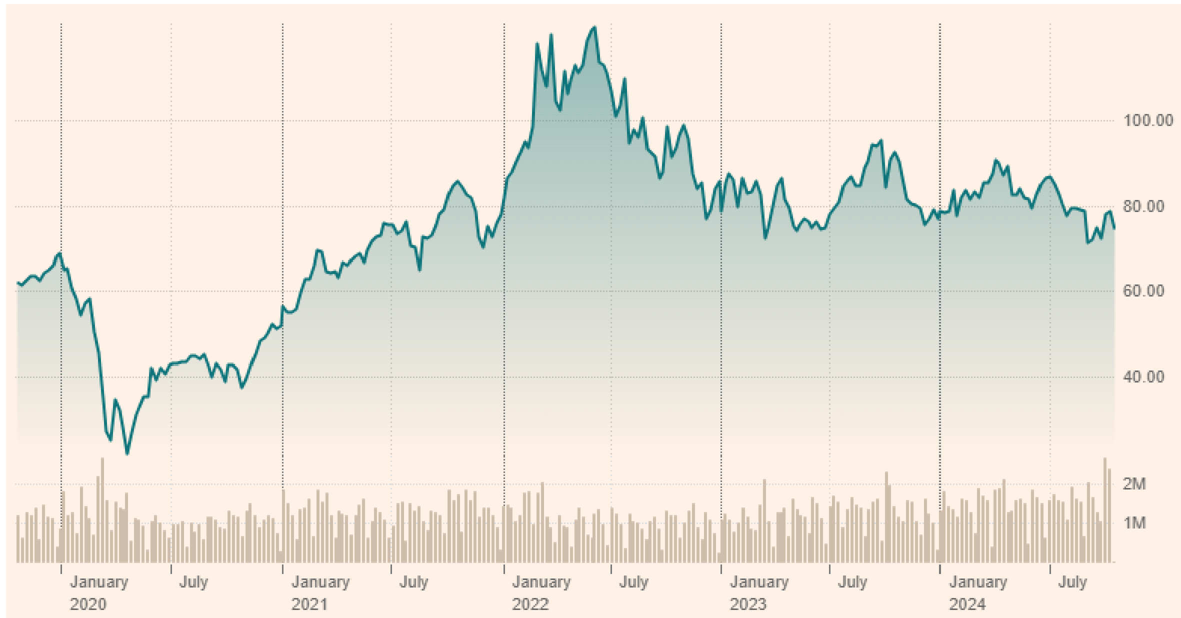
Why the Global Oil Market Is Still Not Panicking

As mentioned earlier, the global oil market is not panicking. Three factors help explain why. First, this is a well-supplied market with a big buffer. The Organization of the Petroleum Exporting Countries and allied producers (OPEC+) has made several group-wide and voluntary production cuts in the past two years. But the group has struggled to bring those barrels back onto the market, thanks to a combination of weaker oil demand, especially in China, and robust non-OPEC+ supply. OPEC+ recently delayed a planned output increase for October until at least December **(2)**, and 2025 does not look much better for market balances. As a result, the International Energy Agency estimates that OPEC+ has more than 5 million barrels per day of spare capacity. **(3)**

Second, the global oil market no longer overreacts to potential supply risks. Good information from IEA and OPEC on crude oil statistics and new intelligence tools, including satellite surveillance and tanker trackers, provide near-real-time data on loading, shipping, and inventory levels. In addition, there are specific data providers, such as Kpler and Rystad, which provide useful latest data and analyses. These new resources have tempered price responses to potential supply disruptions. The September 2019 attack on the Abqaiq oil-processing facility and Khurais field in Saudi Arabia marked a turning point. Oil prices spiked after the attack, but because satellite surveillance proved that Saudi Aramco had repaired the damage to its facilities and used inventories to sustain export levels, within two weeks Brent crude prices were back at pre-attack

levels **(4)**. Traders have spent the last five years discounting oil supply threats in the absence of real disruptions.

Figure 1: Brent Crude Oil Price Movements over the Last 5 Years



Sources: ICE, Financial Times

Third, the geopolitical climate in the Gulf area has changed. A China-brokered agreement between Iran and Saudi Arabia in 2023 showed a new desire to contain tensions. Trust between the parties is limited and Iran can still cause trouble in the region through proxy forces and acts of sabotage. But the Arab Gulf states are urging de-escalation, and it is now less likely that Iran would respond to an Israeli attack on its oil facilities by lashing out at its neighbors and wreaking havoc on oil exports. The often-mooted scenario of the closure of the Strait of Hormuz—home to about 30% of the world's seaborne oil and gas transit—is overblown. Naturally, the markets could be mistaken. A spectacular attack on Iran's refineries or oil terminals could shake off the market's complacency and send prices soaring. But if this doesn't happen, oil prices will likely decline as yet another bullish narrative fizzles out.

Iran Threatens to Hold Global Energy Hostage

Russian President Vladimir Putin announced Moscow's support of Iran's aggression against Israel at a meeting with the Islamic Republic's President Masoud Pezeshkian on October 11 in Ashgabat, Turkmenistan. Russia is boosting Iran's military-industrial complex by purchasing thousands of ballistic missiles and "suicide" drones for its war in Ukraine.

Putin's statement comes after Iran launched some 200 missiles targeting populated areas in Israel on October 1 and has been providing support to its proxies Hamas, Hezbollah, the Houthis as well as Palestinian Islamic Jihad. The Islamic Republic and its proxies pose a serious threat to the energy sector, including oil and gas in the Middle East. Ongoing tensions in the Persian Gulf, where the US and Iranian navies have repeatedly had risky encounters, and continuing Iranian attacks on Israel threaten to escalate into a more intense region-wide military confrontation. This could lead to a blockade of the Strait of Hormuz. Iran has repeatedly threatened to block the Strait, while Iranian proxies continue to mount further attacks in the region.

Specifically, repeated attacks by the Iranian-supplied Houthi terrorists on crude oil tankers may escalate to include all shipping from the Gulf. In the absence of effective countermeasures from the West, terrorist groups and Iranian forces are being emboldened to impede shipping around the entirety of the Arabian Peninsula, blocking vital trade routes. Growing concerns among Western allies about Iran's possible mining of the Strait of Hormuz and Houthi attacks require collective action, including an overwhelming military response, destruction of the Houthis' military potential, and readiness for quick and effective mine-clearing operations.

This is not the first time that Iran has used the strategy of targeting the raw material base of potential opponents to inflict maximum damage. For example, in 2019, Yemeni Houthis attacked two Saudi Arabian oil refineries, leading to a reduction of over half of the Kingdom's oil production and, as a result, an increase in oil prices. In 2022, oil facilities in the capital of the United Arab Emirates were attacked by a drone belonging to Iranian proxies. The UAE did not directly escalate with Teheran in response, and Iran demonstrated its ability to use force to threaten the destabilization of global energy markets unimpeded. Notably, in 2024, Iran and the UAE became members of BRICS. This is unlikely to protect the UAE from subsequent proxy attacks.

Iran has also expressed its intention to target sites beyond the Middle East. In April 2024, IRGC Telegram channels circulated information that Iran should attack targets in Tel Aviv and the so-called "centers of Israeli presence" in Baku, the capital of Azerbaijan **(5)**. Iran has threatened to strike Azerbaijan's oil refineries in retaliation for potential Israeli military action against Iranian oil. Both countries are part of the BRICS organization, but Azerbaijan continues to pursue an independent policy and enjoys strategic cooperation in the defense sector with Teheran's declared arch-enemy.

The Russian Federation, which is linked to Tehran by a recently signed comprehensive partnership agreement **(6)**, can be one of the primary beneficiaries of Iran's threats to oil fields and infrastructure. As Western sanctions force Russia to sell oil at below-market prices to customers, like China, disruptions causing the price of oil on Russian "grey" exports to increase will allow for greater profits to fuel the ongoing invasion

of Ukraine.

The American response to Iran's actions has been muted and inconsistent, likely motivated by an effort to avoid a spike in oil prices. In the wake of Tehran's second ballistic missile attack on Israel at the beginning of October, the Biden administration discouraged Jerusalem from striking Iranian oil fields, suggesting that it seek alternative targets. Fears of rising global oil prices, leading to higher gasoline prices, are understandable for the current administration ahead of the November elections. On the other hand, the White House and the Pentagon announced the deployment of the Terminal High Altitude Area Defense (THAAD) anti-missile batteries to Israel, perhaps to ensure that the Israeli civilian population is better protected from likely missile strikes by Iran that are intended to produce significant civilian casualties and could impel Jerusalem to respond more aggressively than Washington might prefer.

Meanwhile, another geopolitical rival of the United States, China, will be a net loser if heightened oil prices result from an escalation of the conflict in the Middle East, especially in the event of Iran escalating military presence in the Persian Gulf. This could cause world oil prices to spike at over a hundred dollars per barrel, putting a significant economic burden on China, which relies on imports for nearly three-quarters of its oil, including 15% from Iran and roughly 15% from Saudi Arabia. Beyond contending with a higher price tag for oil across the globe, China would have to seek other sources of oil if Israeli forces targeted the Iranian oil infrastructure.

Iran and its proxies have a history of threatening the global energy sector to gain leverage against powers that rely on affordable energy. In the 1980s tanker war, Iran attacked not only international but also American-flagged tankers, causing a global oil crisis. It is evident through the actions of the Houthis and threats coming out of Tehran that this is their intention again. If the West does not take decisive action to protect itself and its allies against Iran and its militant proxy groups, the security implications will be felt not only in the Middle East but across the world, where disruptions of the energy sector will affect virtually all economies and could trigger a global recession. **(7)**

Two Factors to Track for LNG

While Iran is the world's third-largest producer of gas and has one of the largest global reserves, its current exports are limited to a very small amount via pipeline to neighboring countries (Iraq, Armenia). Due to Western sanctions, Iran has not been able to develop LNG export facilities and thus military conflict or attacks on its infrastructure pose little threat to the global markets. But with tight global markets for LNG, in contrast to oil, the risks of supply disruption are still important. Two issues stand out.

First, the Hormuz Strait is a critical chokepoint for Middle Eastern exports of oil and gas to the global market.

Qatar exports roughly 20% of global LNG through the Hormuz Strait and onward to Asia and Europe. The actual risk of a blockade appears low, but individual cargoes or ships could be affected by increased tensions and a full blockade would have large implications for prices.

Second, eastern Mediterranean gas fields, such as Tamar, Leviathan, and Karish, produce just over 20 billion cubic meters per year, supplying Israel and neighboring countries such as Egypt. Last year, the Israeli government temporarily halted production from those offshore assets after the October 7 Hamas attack **(8)**. Risks from Hezbollah attacks seem low for now, but Iran has announced it could target Israel's offshore gas fields and energy infrastructure in an escalating conflict. A stoppage could mean an increased need for LNG for Egypt, adding to its planned winter cargo procurements, which could tighten the supply-demand balance going into the high-demand season. Even though European gas storage levels are at their highest level, a tight global market means this is a space to watch.

Market Undercurrents Steering Oil Prices Amid Middle East Conflict

There is no doubt that the prospect of an all-out war in the Middle East has increased after Iran launched a massive missile attack on Israel on October 1. Israel has threatened retaliation, fueling concerns of a disruption to the flow of oil and gas from the energy-rich region. Global oil prices have already soared 9% since Iran's attack, which came amid Israel's year long war in the Gaza Strip and its invasion of southern Lebanon later. A full-scale conflict between Israel and Iran could upend the global energy supply and send shock waves throughout the global economy, energy experts warn. A major disruption of regional oil and gas exports is likely to have a material impact on the global economy.

With Brent below $80/bbl over the last few weeks, the market is clearly not buying the worst-case scenario of a blockade of the Strait of Hormuz as a likely one. Other reasons for the relatively muted response to the geopolitical events are the prevailing fundamentals. Prior to the conflict, OPEC+ was struggling to prop up prices due to weak demand, especially from China, whose economic recovery has been slower than expected. Recent stimulus efforts in China seem aimed more at stabilizing the economy than boosting oil demand significantly.

Despite the cartel's efforts to paint a bullish picture, with forecasts for demand growth outpacing other industry estimates, its credibility has been weakened. Most likely, oil demand will continue to rise this decade, while non-OPEC+ supplies can easily satisfy any potential increase in demand. Electric vehicles and the use of compressed natural gas are exerting pressure on gas markets and in the long term could suppress oil prices. At the same time, the cartel has been cornered in its efforts to maximize short-term revenues as its

production cuts have only incentivized the high-cost producers to add more oil to the market. OPEC+ still has an estimated 5 million barrels per day of spare production capacity, which it is eager to deploy to defend its market share if prices rise too sharply in the wake of a supply disruption.

In addition, according to the latest IEA's Oil Market Report of October, OECD industry crude stocks accounted for more than half this multi-month crude decline, dropping 64.8 million barrels in total over the period, to 1,324 million barrels in August – the lowest in a year. While OECD total industry stocks remain below their five-year average in volume terms, in days of forward demand cover they are in line with their average since 2016, excluding 2020 and 2021. OECD government strategic reserves stand at 1.23 billion barrels, of which 916 million barrels are crude.

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