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Flash

Oil price spikes on Israel-Iran military conflict
Short-term upward risk if the conflict escalates further, but fundamental supply/demand prospects remain bearish

Israel strikes on Iran

Oil prices surged 9% after Israel struck military and nuclear targets in Iran earlier today. Some senior atomic scientists and military commanders have been killed.

Israel's objective is to remove the threat of Iran being able to make nuclear weapons. Israel's Prime Minister Netanyahu said that these operations "*will continue for as many days as it takes to remove this threat*". Iran declared that Israel should expect a "*severe response*" and already launched drones on Israel. Trump said that the US was not involved and hadn't even wanted Israel to attack. The White House remains committed to a diplomatic resolution to the Iran nuclear issue and hopes to return to the negotiating table soon.

No effect on oil supply yet, and even a complete blockade of Iranian oil exports could be compensated by OPEC+ spare capacity.

These strikes have no direct effect on oil supply, as currently no oil installations have been hit. But in the event of further escalations (and US involvement), export sanctions on Iranian oil could further be tightened and/or Iranian oil facilities could be targeted. Iranian oil exports already declined to 1.6 million barrels per day (less than half of its capacity) due to existing sanctions, which have been recently more enforced by additional US sanctions on Chinese importers and vessels. If these 1.6 mbd are completely taken off the market, they could be compensated by OPEC+ unwinding the 2.2 mbd of voluntary production cuts (0.4 mbd in monthly production hikes, to reach 2.2 mbd by October). On top of that, OPEC+ has another 3.6 mbd of spare capacity that it wishes to bring back to the market one day (not scheduled yet).

But what if the Strait of Hormuz is blocked?

Far more concerning for global oil & gas markets would be the impact of any possible Iranian response to limit oil and LNG flows through the Strait of Hormuz, accounting for 20% of global oil supply and 17% of LNG flows. And unlike the Red Sea blockade by the Yemen Houthis, where tankers could still navigate around Africa, there would be no alternative for the traffic from the Persian Gulf. But we still think this "worst-case" scenario is rather unlikely, as Iran has not much to win with this action and the US could military could intervene to re-open the Strait.

The current oil price spike is only psychological and temporary, while fundamental supply/demand prospects remain bearish.

We don't know how long the military conflict can last. But Iranian military options are probably limited. And we are not excluding a resumption in US-Iran nuclear negotiations. So, it is likely that tensions will ultimately fade, like they did following previous strikes.

Besides this short-term psychological effect (fear of supply blockades), the fundamentals for oil price remain quite bearish. Demand growth has slowed down and supply will further increase over the coming months as OPEC+ gradually unwinds its production cuts, and new projects in non-OPEC countries (e.g. Brazil, Guyana) come on stream Compared to current global production of 102 mbd, we expect 1.5 mbd in production increases by non-OPEC countries and about 2 mbd in production hikes by OPEC+ (unwinding of voluntary cuts, partly offset by overproduction compensation by some countries, and possibly lower Iranian exports). **Hence, we maintain our Negative view on the Brent price, but with a slightly higher target range of USD 60-70.** We see no reason to change our other asset class recommendations at this stage, but we will monitor the situation closely.

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MAP WITH MAIN FACILITIES AND INFRASTRUCTURE POINTS IN IRAN

Source : BNP Paribas Exane

BRENT PRICE

Source: Trading Economics

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