OCTOBER 16, 2023

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Impact of war in Israel

On October 7, Islamic militant group Hamas carried a coordinated attack that surprised Israel and resulted in over 1,000 casualties. US President Joe Biden called it the deadliest day for Jews since the Holocaust. Israeli Prime Minister Benjamin Netanhayu declared that his country is at war. Israel retaliated with air strikes on the Hamas-controlled Gaza strip. As of this writing, there was huge troop deployment in preparation for a massive ground attack. In this article, we explain the relevance of the war between Israel and Hamas and its impact on financial markets.

1. What is Hamas?

Hamas or the Islamic resistance movement is a political and militant group that was formed in the late 1980s. Since 2007, Hamas has been in control of the Gaza strip, one of the two regions in Israel occupied by Palestinians. Hamas has routinely carried attacks against Israel and is thus considered a terrorist organization by Israel and the West. Hamas has close relations with Hezbollah, a Lebanese militant group. Both Hamas and Hezbollah are backed by Iran and are enemies of Israel. The goal of Hamas is to drag Israel into a protracted ground war that would derail peace talks between Israel, the Palestinians, and other Middle Eastern countries. Hamas aims to spark a full-blown war in the Middle East hoping that it would unite Muslim Arab countries, eradicate Israel, and establish a Palestinian state in its stead.

2. How was Hamas able to get through Israel's vaunted defense system?

Hamas fired thousands of missiles towards Israel, and most of these were intercepted by the latter's advanced missile defense system. However, the missile barrage provided the distraction for an orchestrated incursion through air, land, and sea. Hamas gunmen entered Israel through paragliders and landed in a music festival that was full of attendees. They used drones to bombard and disable Israel's defense towers. Hamas tore through Israel's border fences and entered by land using pickups and trucks. They also arrived by boats in various coastal locations.

3. What are the implications of a war in Israel?

Many fear that a war in Israel may escalate into a bigger regional battle with the involvement of Lebanon, Syria, Iran, and Iraq. A war against Muslim Middle Eastern nations may scuttle Israel's Abraham accords with the United Arab Emirates (UAE) and Bahrain. It may also kill any hope of a US-backed peace deal between Israel and Saudi Arabia. A war would counter efforts by Middle Eastern Muslim countries to normalize relations with Israel which is the only non-Muslim nation in the Middle East. A full-blown war in the Middle East is actually what Hamas is aiming for.

A regional escalation would directly affect the employment of millions of Filipinos in the Middle East and consequently dampen OFW remittances. As an oil-importing country, the Philippines would be more vulnerable to spikes in oil prices that may be caused by a war.

4. How do wars affect oil prices?

During Iraq's invasion of Kuwait in 1990, oil surged to $39 per barrel from a range of $18-20. When Russia attacked Ukraine in February 2022, oil jumped from $85 to $125. Based on this, a full-blown war may cause oil prices to spike by 50-100%. Below, we show a table of the top ten oil producers and exporters in 2022.

Rank	Country	Production	Rank	Country	Exports
1	United States	11.911	1	Saudi Arabia	7.364
2	Saudi Arabia	10.938	2	Russia	4.780
3	Russia	9.751	3	Iraq	3.712
4	Iraq	4.504	4	United States	3.604
5	China	4.037	5	Canada	3.350
6	United Arab Emirates	3.639	6	United Arab Emirates	2.717
7	Canada	3.373	7	Kuwait	1.879
8	Iran	3.301	8	Norway	1.558
9	Brazil	3.014	9	Nigeria	1.388
10	Kuwait	2.814	10	Brazil	1.346

In million barrels per day
Source: International Energy Agency

The top ten oil producers account for 72% of global production. Based on the data above, six out of the top ten producers are OPEC+ members (Saudi Arabia, Russia, Iraq, United Arab Emirates, Iran, Kuwait) and they account for 44% of total global production. This highlights the delicate situation in the Middle East and how an escalation of the war resulting in supply or export curtailment would cause prices to surge.

5. Why are markets relatively stable despite the war between Israel and Hamas?

Despite the ongoing Russia-Ukraine war and output cuts by OPEC+, oil prices declined in the first week of October due to demand concerns. There was talk of weaker demand for fuel products brought about by higher borrowing rates and a 3Q23 spike in oil prices. There was also concern about China's slowing economy and how it can dampen overall oil demand. Another reason behind the pullback in oil was anticipation regarding the US-brokered peace agreement between Saudi Arabia and Israel.

If the war in Israel escalates and involves other nations, then the conflict will have far-reaching consequences. However, the war has remained a domestic conflict and still has no direct impact on oil prices. If Iran and other Arab countries do not get involved, or if the Strait of Hormuz is not closed, then the war between Israel and Hamas should have limited impact to markets. Macroeconomic factors such as inflation, interest rates, and economic growth would have a bigger influence on the direction of financial markets.