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PHILEQUITY CORNER

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Oil War is Back

Recently, Filipinos were grappling with torrential rains and floods brought about by Typhoon Kristine. Then there are the Congressional and Senate hearings which have brought forth threatening rants and serious allegations involving clandestine online gambling, illegal detentions, escapes, drugs, bribery, money laundering, sex and murder - all ingredients of typical K-dramas and telenovelas that have kept many Filipinos glued on the screen. Meanwhile, the Americans are preoccupied with the upcoming elections which is just a week from now.

While all these dramas are unfolding, the specter of an oil war has returned to haunt crude markets as Israel attacks Iran over the weekend. While Israel has targeted military facilities in Iran, many fear that Iran's oil and nuclear facilities may also be attacked. This may now force Iran to attack oil facilities in Saudi Arabia and the UAE, which are allies of the US, potentially disrupting supplies from the world's key export region.

Bitter enemies

Israel and Iran have been bitter foes since the 1979 Islamic Revolution. Their decades-long animosity has typically played out through proxy conflicts and covert operations, but recently marked a dangerous shift to direct confrontation. Israel has long considered Iran to be its greatest threat, citing its leaders' calls for Israel's destruction, their support for militant groups like Hamas and Hezbollah and the country's nuclear program.

Diminishing risk premium?

Prior to Israel's weekend attack on Iran, oil markets appeared increasingly desensitized to Middle East tensions. A pattern had emerged: price spikes following geopolitical events - the Israeli airstrike on Iran's consular building in Damascus, Iran's unprecedented direct missile attack on Israel, the killing of key figures in Hamas, Hezbollah, and IRGC – became progressively less sustained with each peak lower than the last.

Subdued oil prices

This apparent softness in oil price was evident when Hezbollah leader Hassan Nasrallah was killed in an airstrike on September 27. This sent Brent crude climbing from $70 per barrel to $80. While Iran's subsequent missile attack on Israel on October 1 pushed prices sharply above $80 per barrel, the market has shown increasing weakness. Each price spike provided an opportunity for profit taking rather than the start of a sustained trend. In addition, despite OPEC+ cutbacks and the Western embargo of Russian oil, oil prices remain subdued.

Fundamental reasons keeping oil prices in check

Several fundamental changes help explain the muted response. The increase in US oil supply has kept oil prices in check, especially in a geopolitically charged world. The US accounts for 20.1% of global crude oil production, making it the biggest oil producer in the world. It has set a new production record of 13.5 million barrels per day, up from 13.2 million a year ago. This production increase is driven by technological breakthroughs in shale production. It has more than doubled US output since 2010, providing a crucial buffer against potential supply disruptions.

China's economic slowdown has also helped temper oil prices. The world's greatest oil importer has seen weaker-than-expected demand due to its persistent problems in its property sector and slower economic growth.

Meanwhile, the energy landscape continues to evolve. Renewables now account for 30% of global electricity production. Electric vehicle (EV) adoption is accelerating - electric cars accounted for 18% of global sales in 2023, up from just 2% in 2018. Even tech giants are reshaping energy markets, driving nuclear renaissance through investments in Small Modular Reactors for their power-hungry AI operations.

All-out war

However, the weekend's Israeli attack on Iran's military facilities could mark a turning point toward an allout war. While previous incidents were largely contained, the prospect of Iran targeting oil infrastructure in Saudi Arabia or the UAE represents a different order of magnitude. Iran has already warned Gulf states against allowing Israel to use their airspace for attacks, raising the stakes for the entire region.

Such escalation may send oil prices soaring despite abundant US oil production or growing renewable adoption. With oil facilities and shipping lanes potentially in the crosshairs, the oil war is entering a new and more dangerous phase.

"World War III has already begun" - Dimon

JP Morgan CEO Jamie Dimon recently cited geopolitics as his most important concern today. He points to the war in Ukraine and the Middle East, coupled with the growing cooperation among US adversaries Russia, China, North Korea, Iran and its Middle East allies. "They are clearly talking about dismantling the system set in place by the US and its allies after World War II," Dimon says.

While most Filipinos' attention is on the recent typhoon and Congressional hearings, the risk of a world war, though far from most people's minds, has been simmering. "The risk is extraordinary… World War III has already begun. You have battles on the ground being coordinated in multiple countries," Dimon warns. While we are hopeful that things do not get out of hand and that the oil war will be contained, we have to remain vigilant on the events that this geopolitical risk could bring about.