



By: Tomorrow's Affairs Staff

Disruption of the oil market due to Israel's war against Hamas - could the 1970s crisis be repeated?



Oil prices on the global market dropped slightly at the beginning of the week, which could be a direct consequence of the delay of the ground operation of the Israel Defence Forces against the Hamas terrorists in Gaza.

Even though it might still be too early to draw such a conclusion, US political pressure on Israel to postpone military escalation and its ground troops' entry into Gaza has caused the oil market to stabilise.

The terrorist attacks by Hamas on Israel on October 7 have disrupted the market and caused prices to rise, which peaked last Friday (for now).

The beginning of this week brought a slight drop (Brent oil \$91 a barrel). This is partly the result of a relaxation of situation in Gaza, that is, humanitarian convoys entering the Palestinian enclave governed by Hamas.

However, the fear of a significant price increase still exists and is exclusively related to the scenario of the spill over of the conflict from Israel to the rest of the region, which includes the world's largest producers.

Iran as the principal threat

A crucial element in assessing this risk is Iran and its further attitude towards Israel's war against Hamas, that is, whether it will get involved through its proxy Hezbollah in Lebanon.

Given that Iran is one of the world's largest exporters, with a daily production of almost 3 billion barrels, a direct result of potential Iranian intervention in the conflict in Israel would undoubtedly cause a significant market destabilisation.

The market fears a potential blockade or disruption of transport in the Strait of Hormuz in the Persian Gulf, through which all Iranian oil and about 20% of the total global consumption passes.

A disruption in the Strait of Hormuz would

also affect the gas market, as a third of maritime gas deliveries pass through it. Europe would be the biggest victim, given that 16% of Qatar's total exports go there.

Since the oil market would be severely affected if the conflict in Israel were to escalate, it is in the interest of the world's biggest oil consumers, primarily the US, China, and Europe, to keep it within its current limits until it calms down.

Similarities and differences with 1973

The crisis in Israel inevitably brought back dark memories of 1973 and the October Israeli-Arab war, which triggered the global oil crisis and the largest disruption in the oil market.

Producers in the Middle East then reduced production and imposed sanctions on the US and its allies for their support of Israel, which caused a fourfold increase in prices.

However, as much as today's security crisis resembles that of 1973, many circumstances have changed since then, so the global oil earthquake of 50 years ago is not realistic today.

The US has significantly increased its own oil output in the meantime. Producers in the Middle East are reluctant to recall their blockade from the 1970s since it prolonged a toxic atmosphere with their major customers in the West.

After all, even if the current prices were to increase dramatically, due to the escalation of the conflict in the Middle East (estimated at even \$140-150 per barrel), there would be an adjustment on the consumer side and a drop in demand, which would lead to a decrease in prices.

Escalation suits Russia

For the US, any longer-term disturbance in the

market, accompanied by an increase in oil prices, would mean significant economic pressure, which would cause inflation. In the year leading up to the election, President Joe Biden's administration wants to avoid such a development, which would force it to use diplomatic efforts to prevent market disruption.

As a major exporter, Russia would benefit from a market disruption and price increase since it would allow it to fill its war budget and reduce the costs associated with the war in Ukraine.

Russia's revenue from oil sales continued to rise due to high prices. Last September, it reached close to \$19 billion, according to the International Energy Agency.

Regarding the escalation of conflict in the Middle East, Russian influence on its Iranian allies might be destructive.

Despite the fact that Iran exports to China at a significant discount due to pressure from international sanctions, the Chinese economy, which is the biggest importer of Iranian oil, would not appreciate a security escalation in the Middle East focused on Iran.

Given that most Chinese importers are private enterprises skilled at bypassing sanctions against Iran, the US and its allies have little influence over this sizeable portion of Iran's oil trade.

In this respect, the US has room to talk with the government in Beijing, with which it has a shared interest in securing stricter sanctions against Iran through reducing illegal practices in importing Iranian oil.

Saudi Arabia as a factor of stabilisation

Through the stricter application of sanctions and increased buyer caution, pressure on Iran, a crucial factor in a potential regional escalation, could lead to a drop in its exports.

In such circumstances, Saudi Arabia could abandon the unilateral production cut of 1 million barrels, which began last June (earlier than announced) and increase production. This would relax market conditions.

The Saudis have long-term reasons to avoid a security escalation in the region, regardless of the short-term benefits of higher prices.

A market disruption would have a negative impact on large Western markets. This would reduce growth and fuel inflation, which they had experienced about half a century ago and would probably like to avoid repeating.