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The geopolitical and market risks of a prolonged Israeli-Hamas conflict

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The longer the Israeli-Hamas conflict continues and escalates into a protracted ground war, and the more it spills over into other countries such as Lebanon, the greater the risk of some form of confrontation between Iran and Israel. While this is likely to fall short of direct war, it could include actions ranging from targeted assassinations to the destruction of key facilities.

In particular, the brewing tensions could further strain an already tight oil market. Iran has a history of harassing and seizing oil tankers in the Persian Gulf (through which 20% of the world's oil exports transit) and targeting key oil facilities. It is widely believed that Iran was behind the drone and missile attacks on key Saudi oil facilities in 2019, which temporarily disrupted Saudi oil production.

Another risk to the oil markets is that the U.S. could tighten or increase sanctions on Iran's oil exports if it concludes that Iran helped Hamas plan the terrorist attacks against Israel and/or is actively participating in the war.

In the months leading up to the conflict, the United States had reportedly eased its enforcement of sanctions against Iran in order to facilitate the renegotiation of a new nuclear deal and to increase global oil supplies in an effort to keep a lid on prices. This is all the more critical now that U.S. strategic oil reserves are at a 40-year low. S&P Global Commodity Insights data show that Iranian oil production rose from 2.6 million barrels per day (bpd) last March to 3.1 million bpd in September, with exports at just under 2 million bpd.

Were oil prices to rise significantly, Saudi Arabia, the world's largest oil exporter, would face a dilemma. On the one hand, increasing production to lower prices could lead to accusations of siding with Israel and anger a large portion of the Arab public. On the other hand, Saudi Arabia fears that a spike in oil prices could increase the odds of a global economic slowdown. This would then cause prices to collapse, which would hurt its finances significantly.

The Israeli-Hamas conflict has probably already derailed efforts to normalize relations between Israel and Saudi Arabia. Analysts who suspect Iranian involvement in the planning of the attacks point to one possible motive in particular: disrupt efforts by the United States to get Israel and Saudi Arabia to form an alliance under its security umbrella that would essentially target Iran.

A protracted war would also divert more U.S. military equipment needed by Ukraine (not to mention Taiwan) to Israel. This includes weapons such as Patriot missiles and 155-millimetre artillery shells, which are already in short supply. The recent spike in oil prices due to fears that oil exports could be disrupted also means more money flowing into Russia's coffers.

Bottom line: The longer the conflict goes on, the greater the potential for oil market disruptions. In addition to the conflict spilling over into other regions such as Lebanon, there is also the risk of greater instability in neighbouring countries such as Egypt and Jordan.

Finally, this conflict adds a layer of geopolitical tension to a world already struggling with other challenges, including the ongoing war in Ukraine, great power rivalries, and escalating tensions over Taiwan. It also comes at a time when many Western leaders face growing political challenges at home, near-record debt levels and interest rates at two-decade highs.



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