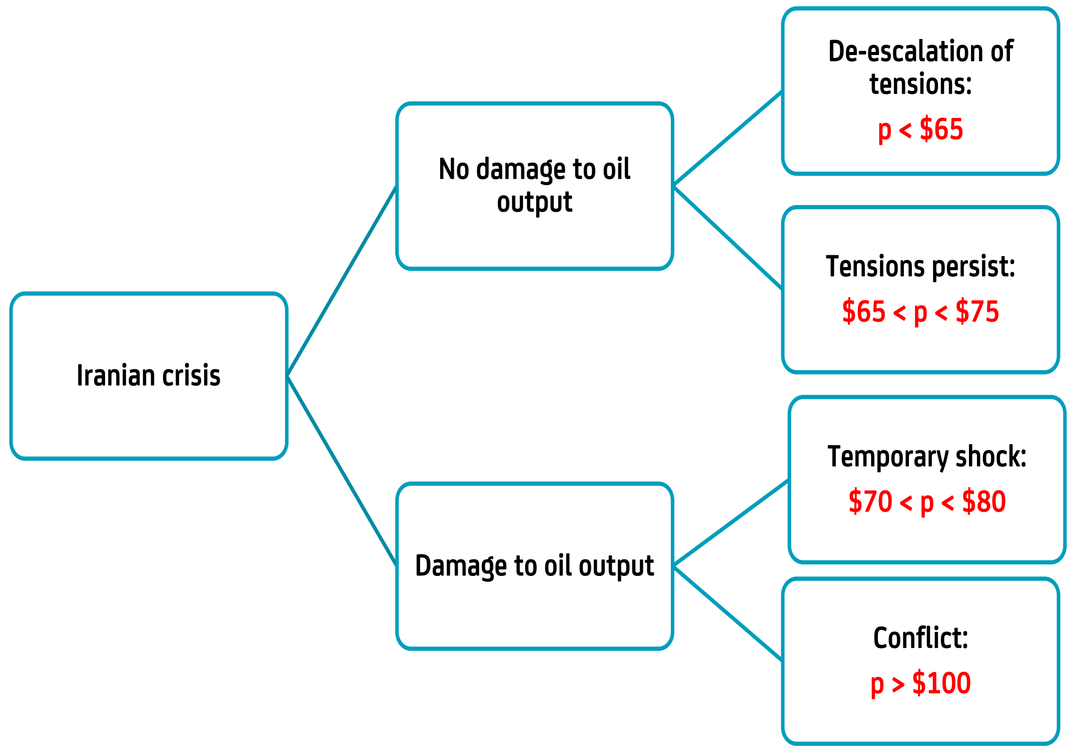
How high can US-Iran tensions push oil prices?

SHORT-TERM IMPACT OF IRANIAN CRISIS ON BRENT PRICE (PER BARREL)



Source: Bloomberg, UniCredit Research

- How high can oil prices go in the wake of the Iranian crisis? Although both parties now seem willing to back down from a further military escalation, the crisis is probably not over yet. Our *Chart of the Week* is a flowchart depicting our view on where oil prices could end up in the short-term, depending on whether or not oil production is disrupted and on how long the shock lasts.

- The first thing to acknowledge is that, as we have argued in the past, the crisis is taking place at a time of oil abundance. In recent months, the oil glut has overshadowed geopolitical risk and oil prices are no longer a reliable barometer of geopolitical risk in the Middle East. Therefore, if tensions between Teheran and Washington quickly de-escalate, without affecting global oil production in any meaningful way, we see market fundamentals kicking in again and pushing Brent towards USD 65/bbl or below. This is consistent with our baseline scenario of Brent at USD 63/bbl in 1Q20 that, in November, did not price in a geopolitical confrontation of this scale.

- Alternatively, if current uncertainty persists, as seems the most likely scenario, with the two countries trading threats or even carrying out minor military operations but, importantly, with no spillover to the physical oil market (like the Iranian attack on US bases in Iraq that took place last Tuesday), we expect Brent to trade within the USD 65-75/bbl range for a while. Once it becomes clear that tensions will not meaningfully affect oil supply, Brent would likely return to our baseline of USD 65/bbl and below. The initial price premium in this scenario, compared to the first one, would be due to the market fear that, at some point, oil facilities could become a target of the confrontation.

- However, it is possible that the hardliners within the Iranian regime might take over and weaponize oil to retaliate against the US, targeting oil facilities across the region or disrupting oil-shipping lanes. If these shocks only temporarily affect oil output, we expect Brent to approach USD 80/bbl before moving back to current levels once the situation normalizes. Since last summer, the provocations by Iran through its Shia proxies in the region, from the attacks on oil facilities in Saudi Arabia (that temporarily affected half of its 10m/bd production) to skirmishes in the Strait of Hormuz, all had a short-lived impact on oil prices. And the magnitude of the initial price jumps is similar to the one we are penciling in. Besides oversupply that weighs on oil prices, there are also many production cushions that could stabilize the market in the short-term, from OPEC spare capacity (around 3.1m/bd excluding Iranian oil, which is sanctioned) to commercial inventories and strategic reserves.

- If instead the Iranian crisis led to persistent and significant output losses, in particular in Saudi Arabia that remains the only country with the spare capacity (1.7 m/bd) and will to stabilize global production, then it is reasonable to expect Brent to break above USD 100/bbl. This is consistent with a scenario where major regional and global actors become involved in a deepening crisis, either directly or indirectly. This is a rather low-probability risk scenario at the moment.

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