

## Near Term Outlook

### Focus: Conflict Highlights Complex Challenges for US Foreign Policy

Monday,  
Oct 23<sup>rd</sup>,  
2023

#### Connecting the dots...

October 18<sup>th</sup> was an illustrative date for US foreign policy, clearly demonstrating the difficult issues, maneuvering and diplomatic requirements that lie ahead for the Biden administration. The President met with the Israeli Prime Minister for a comprehensive and frank discussion on next steps. The President reiterated his steadfast support for Israel and reaffirmed U.S. determination to provide the Israeli government with what it needs to protect its citizens. The President also managed to secure a deal on humanitarian aid, as Egypt agreed to reopen its sealed border, allowing trucks carrying supplies to cross.

On the same day, the Organization of Islamic Cooperation (representing 57 Muslim countries) convened an emergency meeting in Saudi Arabia. During this meeting, Iran's foreign minister proposed an oil embargo against Israel, reminiscent of OPEC's embargo nearly 50 years ago. That proposal did not carry the day, but tensions are demonstrably high.

Iran's role in the conflict remains a key factor for both US policy and, de facto, global energy markets. Iran is officially under sanctions, but its oil exports have continued with minimal enforcement. In July, these exports surged to 1.6 million barrels per day. Additionally, in September, Iran was granted access to \$6 billion in previously frozen funds. That said, any *proven* direct involvement could easily see a huge risk premium enter the crude oil market as the use of military options would gain consideration, potentially jeopardizing a significant portion of Iran's current 3.4 MBD estimated output.

To further understand why members chose to meet calls for an embargo with polite silence is to further understand the fundamental tenet of the organization: OPEC will always choose market share over margin. Higher prices may sound initially attractive, but members have learned that runaway pricing will both lower consumption (as economies slow) and encourage greater supply (making US shale profitable).

On the domestic front, the current administration is faced with the inherent difficulties of being involved in two major foreign conflicts, on the cusp of a Presidential campaign season. While the various spokespeople have pointed toward the improving economic data on one side of the coin (in Jun-22 CPI stood at 9.1%, by Sep-23 it was 3.7%; unemployment is at 3.4% and advanced GDP is estimated at +4.9% for 23Q3), the other side continues to show ongoing declines, as consumer sentiment has fallen for the third month in a row to 63.0 for Oct-23, for example.

Additionally, a recent poll shows that 62.7% of likely voters said the country was on "the wrong track", with 62.2% of respondents saying they were "very concerned" about inflation. Any expansion of the current conflict that risks taking Iranian barrels off the markets, threatens a surge in global crude prices, and runs the risk of pushing US gasoline pump prices to the \$5:00 - \$6:00 range...all less than 12 months before an election. Given that the incumbent ticket's approval rating stands around 41%, with disapproval around 55%, a doubling of gasoline prices would probably not be considered a positive development, at this time.

For various humanitarian, economic, and political reasons, the administration would like to see significant progress in its diplomatic efforts toward a lasting cessation of hostilities happen soon.

#### Market Impact...

**E\*Comdty** believes that as long as the conflict stays within its current political/regional boundaries, both WTI and Brent are "Fair Value" priced at around \$80-\$85 & \$85-\$90, respectively. Should there be an escalation, where the physical supply/distribution of oil is impeded from "the free flow of oil at free market prices", then **E\*Comdty** believes a significant risk premium would enter the current strip of Brent pricing. Holding all other things equal, if the bulk of Iranian barrels were sanctioned off the market (as postulated above), we estimate the impact on short-term "fundamental value" would be around \$21.00, with a longer-term price impact of \$15.00. Under this scenario, the current market value of the Brent Dec23-Nov24 12-month strip would push above the \$100 mark, with an average "Fair Value" estimate of \$105-\$110 range.

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The Risk Tracker series is sent to ECRA clients to provide an integrated view of political, fundamental, market & environmental risks impacting the energy sector.



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### Political Risk Tracker

Region	Market Impact	Market Comments
United States	Bearish	On Oct 25 <sup>th</sup> , the Subcommittee on Energy and Mineral Resources held a legislative hearing on several bills that would support domestic energy production. Of import was the introduction of a bill that would address a significant bottleneck in the permitting process, requiring federal agencies to notify right-of-way applicants if their application is completed within 60 days. At present, there is no such timetable for responding to right-of-way applications on federal lands. <b>E*Comdty</b> sees this as a positive, market-based solution, shortening the time between approval and investment, especially for the growing inventory of currently sidelined “go to market” projects.
Europe	Neutral	Eurasia Group’s Director of Energy, Climate & Resources (my former job, btw), estimated that the 2022 energy crisis cost the EU a trillion dollars. He points out that the effects still linger, as prices are still rising at more than 3X faster than the Bank of England’s target rate. Last month the consumer price index held at 6.7 per cent, due to the stubborn high cost of fuel. Do not expect the EU to sit idly by while negotiations for a ceasefire go on, without a seat at the table. Their economy cannot take another year of the same. Macron’s 2 day trip was a careful balancing act aimed to push cessation now. We expect to see more of the same.
Asia	Neutral	China has kept up appearances, having phone calls with the foreign ministry heads of Israel, Egypt, Saudi Arabia, the United Arab Emirates and Norway, as well as representatives of the UN and EU. The Middle East special envoy expressed concerns about the conflict spreading in the region and called on the international community to be “highly vigilant” on how to bring an end to the conflict. But China’s neutrality is not without purpose. Publicly condemning the Oct-7 assault outright puts China at cross purposes in its relationship with both Russia and Iran. The ink isn’t dry yet on their deal restoring ties with the Saudis, so don’t expect too much support for Iran opening a second front via proxy. China sees the strategic merit of a stable region to do business in, not the block and tackle work of diplomacy, especially in the tinderbox that is Middle East politics. China’s role, at best, will be to set the groundwork, not negotiate the peace.
South America	Bearish	Venezuela reached an agreement with its opposition party last week, granting them increased participation in the upcoming election in exchange for a partial easing of U.S. sanctions. Prior to the 2019 sanctions, the U.S. was importing nearly 600,000 BPD from Venezuela, a figure that has since decreased to around 180,000 BPD. Nevertheless, the U.S. Energy Information Administration predicts that the country’s same underinvestment and mismanagement in its refinery and pipeline sectors will similarly impede production sector growth, as well. While sanctions relief may provide the country with better access to the necessary chemicals for diluting its crude, the limited 6-month relief window will pose challenges in securing the long-term investment commitments required to sustain improved oil output.
Africa	Neutral	The Nigerian Senate is urging a comprehensive investigation into the implementation of the Petroleum Industry Act (PIA) due to concerns over ExxonMobil’s potential exit from Nigeria. ExxonMobil’s departure could lead to job losses, revenue loss, and unsatisfied obligations. Despite NNPC’s right of first refusal on ExxonMobil’s assets, the company proceeded with their \$1.3B deal with an local independent oil and gas company. Lawmakers expressed concerns that the PIA lacks clear implementation plans for such situations and called for stakeholder involvement to ensure a smooth transition.
Russia / FSU	Bullish	Russian President Vladimir Putin visited China for a high-level meeting with Chinese leader Xi Jinping, marking his first visit since the invasion of Ukraine. The visit coincided with the Third Belt & Road Forum for International Cooperation. China, viewing Russia as a bulwark against US influence, refrained from criticizing Moscow’s actions in Ukraine. The visit underscored Putin’s defiance of Western isolation attempts and highlighted the alignment of Russian and Chinese stances on global issues. Amid Western sanctions over the Ukraine war, Russia has increasingly relied on China economically, underscoring Beijing’s crucial and growing dominant role in its relationship with Moscow.
<b>E*Comdty Aggregate View</b>	<b>Slightly Bullish</b>	Internal US policy to debottleneck existing programs and the easing of Venezuelan sanctions are viewed as bearish crude values, while the middle east conflict and growing Russian/China cooperation is viewed as bullish. All other regional activity is currently viewed as Neutral. In total, <b>E*Comdty’s</b> aggregate risk view remains Slightly Bullish.

**Bullish/Bearish:** This political risk factor will likely have some impact on the trajectory of the market over a three-month time horizon, relative to other factors.

**Strongly Bullish/Bearish:** This political risk factor is likely to have an impact of significant magnitude, either on volumes or perceptions of risk, and to become the dominant overriding factor in the market over a three-month time horizon.