Chairman's Corner

Iran: A Price Spike Before an Oversupplied Market? A Serious Risk of Renewed Military Conflict

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Highlights

- Renewed conflict is now the leading near-term risk: We assess a greater than 50% probability of US–Israeli military action between 7 November and 3 January, while the chance of an early agreement has fallen to 10% or less.
- Crude could spike towards $150/bbl—but the rally could reverse sharply if Hormuz flows remain near current levels and infrastructure damage is contained.
- Regional energy infrastructure is the critical vulnerability: Iranian retaliation against refineries, oil fields and facilities could prolong disruption across oil, products and LNG.
- Weak demand and rising supply point towards increasing oversupply in 2H 2027, conditional on a gradual normalisation of regional flows; another price surge would further suppress consumption.
- Refining margins should ease absent further damage, with regional refinery attacks, Chinese product exports and Ukrainian strikes on Russian refineries determining the pace.

The oil market faces two very different prospects: a renewed military confrontation that could send crude towards $150/bbl, and a recovery in supply that could leave the market oversupplied in as early as 4Q 2026 and increasingly so throughout 2027. Both could materialise in sequence. The immediate question is how the confrontation between Iran, the US and Israel evolves—and whether another round of fighting materially reduces the barrels reaching consumers.

Our assessment has shifted towards a greater likelihood of military action and a diminishing chance of an early agreement. Yet a price surge would occur against weak underlying fundamentals. Demand is already under pressure, additional Atlantic Basin supply is coming, and higher prices would compound demand destruction. The duration of any rally will therefore depend heavily on physical disruption.

Four Paths Ahead

The first scenario is a continuation of the business as usual. Under this scenario, the US maintains its blockade of Iran's seaborne exports and imports while increasing pressure on land and rail connections. The objective remains to squeeze the economy sufficiently to force concessions or precipitate political change. This could persist for some time, with considerable hardship inside Iran but no decisive diplomatic or military outcome.

The second scenario is a negotiated agreement. We previously attached greater weight to a deal building on the earlier MoU. That expectation has weakened substantially. We now put the probability of a near-term agreement at less than 10%, with the remaining opportunity concentrated between now and mid-to-late December. If that window closes, an agreement is more likely to become a question for next year.

The third scenario is renewed US–Israeli military action. We assess the likelihood at more than 50% between 7 November 2026 and 3 January 2027. Our political working assumption is that the Republicans will lose the House of Representatives, with roughly a 75% chance of also losing the Senate. These are forecasts ahead of the

elections. In our assessment, the period before the new Congress takes office could consequently be viewed by the administration as an opportunity to act.

The objective would be to weaken Iran's leadership sufficiently to compel an agreement or bring about a change in government. There could be extensive Israeli strikes against senior leadership and heavy bombardment. Limited operations against selected islands are also conceivable, although a major land invasion is outside our central expectation. Congressional timing is one consideration in this assessment; it does not itself determine whether military action occurs.

The fourth scenario develops out of prolonged economic pressure without an early agreement or renewed strike. By the middle of 2027, Iran could undergo an internal political adjustment, negotiated transition or more disorderly change. A leadership willing to compromise on nuclear activities, missiles and regional proxies could open a route towards accommodation with Washington.

The disorderly alternative could involve renewed protests and armed opposition, potentially supported by the US or Israel, including groups operating from the west and south. These remain highly uncertain possibilities. Political change would not automatically deliver stability or an immediate restoration of exports.

The Critical Risk Is Regional Infrastructure

Across these scenarios, our near-term working assumption remains that Strait of Hormuz flows continue broadly around current levels. Renewed military action would, however, put that assumption under severe strain.

Iran could intensify attacks on vessels or deploy mines along routes near Oman. Flows might continue despite the fighting, but a reduction towards half current volumes is a credible downside scenario. Such disruption could recreate the acute market stress experienced in March and April.

Equally serious is the possibility of Iranian retaliation against neighbouring countries' energy and essential infrastructure. Refineries, oil fields, power stations and desalination plants would all be exposed.

The prospect of attacks on Iran's own electricity and refining infrastructure is deeply troubling. In our judgment, such targeting would be a major mistake, increasing civilian hardship while creating further incentives for regional retaliation. The market consequences would depend on both the assets damaged and the time required to restore them.

A Rally Can Reverse Quickly

In an escalation, crude could surge towards $150/bbl, accompanied by another sharp increase in product prices. But the market would then have to reconcile its initial reaction with actual flows.

Our underlying balance assumes negative oil-demand growth alongside additional crude supply from Guyana, Brazil, the US and Canada. Higher prices would suppress consumption further. If Hormuz traffic continues close to present levels and producing infrastructure escapes prolonged damage, a sharp rally could therefore be followed by a substantial reversal.

Looking through the immediate confrontation, our central outlook assumes progressive normalisation of flows and recovery of supply during 2027 as some form of resolution emerges. Combined with weak demand and new production, that points towards oversupply emerging and increasing throughout the next year. This remains conditional on a resolution that permits supply to return; military action or political change alone would not guarantee that outcome.

Refining requires a separate judgment. Product balances depend heavily on whether further refineries are attacked. Continued Hormuz flows would allow available regional product supplies to reach export markets, while Chinese exports remain a key determinant of how quickly shortages ease. The intensity and effectiveness of Ukrainian attacks on Russian refineries are another major variable.

Absent substantial new refinery damage, we judge the present configuration to be close to the most bullish point for refining margins and expect some easing. Further attacks could overturn that expectation, sustaining product tightness even as the crude balance weakens.

The coming months could therefore bring a violent price spike followed by a much weaker market. Our central expectation remains a gradual recovery in supply and an oversupplied 2H 2027. The principal threat to that outlook is lasting damage to regional energy infrastructure or a sustained reduction in SoH flows. Those physical outcomes will determine how long the next geopolitical rally can endure.

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