

OCTOBER 13, 2023

# Israel: Shock And Aftershocks

The key to oil price movements will be how broad the conflict becomes.



One of the major themes cited in our [Economic Outlook for 2023](#) was “Tail Trouble.” As we described last November:

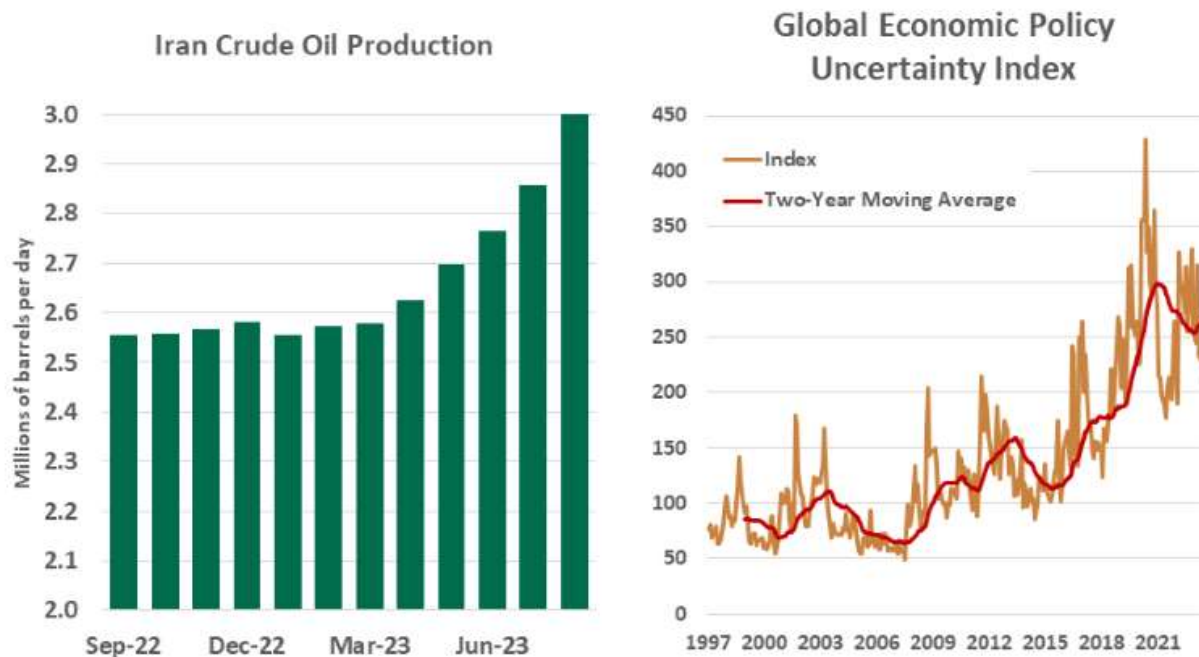
*“International dogma during the past thirty years has stressed deeper commercial ties as a means of keeping the peace. But the threat of sanctions and economic loss have not been enough to prevent heightened aggression.*

*The mere threat of geopolitical strife hinders economic and market progress. Should it manifest, the foundations of economies and markets will be severely shaken.”*

Sadly, geopolitical strife has dominated the headlines over the past week. The attacks in Israel were abhorrent; our thoughts and prayers go out to the country’s citizens. In the face of such carnage, it is difficult to look at events through an economic lens. But let me make the attempt.

The Middle East has long been a nexus of political and economic volatility. In 1973, U.S. support of Israel during the Yom Kippur war led to the first Arab oil embargo. The players are the same this time around, and oil markets remain a central concern. The price of crude jumped by almost \$5 per barrel in the wake of the attacks, but settled during the balance of the week.

The key to future price movements is how broad the conflict becomes. If Iran is confirmed as a major actor in the attacks, the United States and its allies would be expected to enforce sanctions against Tehran's oil sales more rigidly. Iran's output has increased to more than 3 million barrels per day; removal or reduction in this supply would have an important impact on crude prices.



Sources: Trading Economics, Economic Policy Uncertainty

Some analysts have doubts about the depth of Tehran's involvement. While Iran is openly hostile towards Israel, they are benefitting from the additional revenue derived from oil sales. Iran's nuclear enrichment program has progressed in the absence of international monitoring; in the past, Israel and the United States have collaborated on cyber-attacks that destroyed critical equipment used in the effort. So there are economic and strategic reasons why Iran might be better off keeping its distance. Russia is a sponsor of Iran, but relations between Moscow and Tel Aviv have been productive in recent years. While Moscow is always on the lookout for opportunities to hinder the United States, many think that Israel would be an unlikely fulcrum for leverage. Russia is therefore unlikely to become a major party to the conflict. Should tensions and attacks escalate and expand, Tehran could impede the transport of oil through the Strait of Hormuz. Somewhere between 20% and 30% of global crude production passes through this channel daily. A blockade could send oil prices skyrocketing; one report I read suggested a price of \$150 per barrel in a worst-case

scenario. As we described in our recent column on the [American energy industry](#), U.S. supply would not be able to respond in time, and a global recession would become inevitable.

The United States has been a staunch supporter of Israel, and is expected to provide substantial military aid. The impasse in the House of Representatives may create problems with timing.

The impact of the attacks on broader global markets has been modest. Long-term yields in the United States and Europe fell by about 20 basis points in the days after the strikes, reversing some of the increase that has occurred since July. Major world equity indices performed well this week, and the value of the U.S. dollar hasn't changed much in the last five trading days. For now, the flight to safety does not seem to be that significant.

Sadly, the potential for volatility remains high. The near-term focus will remain on the Middle East, but the longer-term trend toward polarization within and across countries raises the risk of other tail events. The resilience of markets and economies may continue to be tested in the year ahead.

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