

WTI Hit 5-month High above \$85 as Tensions Grew over Iran

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On April 1, an airstrike hit the Iranian embassy compound in Syria. Iranian media said Israel carried out the attack, killing seven Iranian Revolutionary Guard officers and six civilians. The airstrike has worsened the situation surrounding Iran and Israel, sparking regional tensions. Under these circumstances, crude oil prices showed a sharp rise.

According to Iranian media reports, an Israeli missile attack on the Iranian embassy compound in the Syrian capital of Damascus destroyed a building adjacent to the embassy, resulting in the deaths of 13 people, including Iranian Revolutionary Guard officers and civilians. The Revolutionary Guards said the seven casualties included senior officers such as a senior commander in the elite Quds Force.

It is unusual for embassies and consulates-general protected under international law to become subject to direct military attacks. The Iranian side strongly reacted against the military attack. On April 2, Iranian President Ebrahim Raisi hinted at retaliation against Israel. Although the Israeli side has not officially commented on its involvement in the incident, the military attack has led to a sudden increase in tensions between Iran and Israel.

Amid the escalation of the Gaza crisis that began last October, tensions between Iran and Israel had basically been growing. Since the very beginning of the crisis, Israel has sometimes suggested that Iran might have been behind Hamas's surprise attack on Israel. As Israeli military operations in Gaza have intensified since then, human casualties in Gaza have increased significantly. While humanitarian crises in Gaza have become unprecedentedly serious, conflicts have not been limited to Gaza but have continued to spread throughout the Middle East.

Hezbollah and Israel have had military clashes in border areas. While the Houthis in Yemen have attacked Israeli-flagged tankers in the Red Sea and other areas, the United States and Britain have conducted military attacks on the Houthis. As known well, Hamas, Hezbollah, and the Houthis have ties to Iran. It is believed that Israel has sensed Iran's presence behind the expansion of these conflicts. In Iraq and Syria, various destabilizing actions by pro-Iranian forces have been observed. The feud and tensions between Iran and Israel have remained at a high level amid the Gaza crisis.

However, the level of tension has changed significantly due to the recent airstrike on the Iranian embassy complex. In the future, the focus will be on the response by the Iranian side. There are concerns that the situation in the Middle East may suddenly be destabilized over Iran and Israel. Although Iran has hinted at retaliation, there is a view that Iran is actually exercising self-restraint to avoid direct confrontation that could cause a major blow to itself. The international community as a whole, while condemning the airstrike on the embassy compound, has called for maximum restraint

to prevent the tensions from escalating.

Even if there is no direct confrontation or large-scale war between Israel and Iran, however, it is quite possible that pro-Iranian forces will attack or retaliate against Israel. When the situation becomes tense and escalates military tensions significantly, there may be the possibility that the conflict will escalate in an unexpected or undesirable way due to misunderstanding or an unforeseen contingency.

That is why upward pressure has been exerted on oil prices in response to this incident. On April 2, the closing price of the front-month futures contract for the benchmark Brent crude oil increased by \$1.50 per barrel from the previous day to \$88.92/bbl, approaching close to \$90/bbl. Similarly, the key futures contract for the benchmark West Texas Intermediate crude oil rose by \$1.44/bbl to \$85.15/bbl. The Brent and WTI prices hit their respective highest levels in nearly five months since late last October.

Crude oil prices bottomed out around the beginning of January this year and rose moderately before staying in an extremely narrow range from February. They have resumed an upward trend since mid-March. Behind the recent upward trend has been the gradual retreat of pessimism about the global economy and signs of recovery in China, which are expected to bring about an increase in oil demand. Amid the oil demand increase, market participants have grown aware that the international oil supply-demand balance may tighten under the current coordinated production reduction arrangement for the OPEC-plus group of oil-producing countries even if U.S. shale and other non-OPEC oil production increases, contributing to the current upward trend.

Other important factors behind the upward trend of oil prices include geopolitical risks and their impacts on oil supply. Apart from the Middle East, Ukraine and Russia have stepped up attacks on each other's energy infrastructure as their war has remained at a stalemate. Particularly, Ukrainian attacks on Russian oil refineries have affected oil supply, contributing to oil prices' upward trend. Under a dominant market view that the oil supply-demand balance will tighten, geopolitical risks' impacts on oil supply have exerted influence on oil prices.

It is not surprising from the perspective of market logic that the military attack on the Iranian embassy compound strains Iran-Israel relations and further boosts oil prices. In the past, geopolitical risks frequently accelerated crude oil price hikes when prices were rising due to the tightening supply-demand balance.

The problem would be future developments. The current increase in crude oil prices is a reaction to the tense situation in Iran and the resulting geopolitical risks in the Middle East, as well as market expectations that geopolitical risks will affect oil supply from the Middle East. This was exactly what was observed in October last year, when the Gaza crisis broke out. When the Gaza crisis escalated due to Israel's response to surprise attacks by Hamas, oil prices soared temporarily on expectations that the conflict would affect Middle Eastern oil supply. It is still fresh in my memory that the most serious scenario related to the expectations was that Iran would be involved in the conflict and seriously affect Middle Eastern oil supply.

Indeed, the latest situation is close to the beginning of the most serious scenario. It is only natural that the world and oil market stakeholders will be of great interest in relevant future developments. Another point to note is that crude oil prices are on an upward trend as market players are aware of the possibility of a tighter supply-demand balance in the future. This is different from the

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situation in which the Gaza crisis started amid oil prices' downward trend that began in the second half of September last year. We must pay attention to the future course of the international oil market including supply and demand, geopolitical risks, and potential turbulence.

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