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Global Stock Market Crash and Iran Risk

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Two big risks that this report has reiterated in the recent past are shaking the world, particularly the global economy and international energy market. The first is the global economic risk symbolized by a global stock market crash. The second is the risk accompanying growing tensions involving Iran.

On October 10, the Dow Jones industrial average on the New York Stock Exchange suffered a heavy loss of 831 points or 3.1% from the previous day's close of 26,431 to 25,599. This was the third biggest single-day loss in history. The next day, the average lost 546 more points to 25,053. The two days' losses totaled 1,378 points amounting to 5.2%. Supported by robust corporate earnings, the U.S. stock market had been rewriting record highs in defiance of stagnation in other stock markets in the world, demonstrating the United States as "the sole winner". However, the two-day crash erased gains over the past nearly three months, pushing U.S. stock prices back to levels in mid-July.

The U.S. stock market crash induced substantial losses in other stock markets. On October 11, the 225-issue Nikkei average on the Tokyo Stock Exchange briefly widened its loss beyond 1,000 points and eventually closed 915 points or 3.9% lower at 22,591. In early October, the Nikkei average had risen above 24,200 to the highest level since the collapse of stock market bubbles before turning down. In response to the U.S. stock market plunge, it accelerated its decline. Other Asian stock markets followed suit. Particularly, the Shanghai stock market posted a substantial loss of 5.2% to the lowest level in about four years. The U.S. and Asian stock market plunges spilled over to Europe, leading to a global stock market crash. The British market posted a 1.3% loss and the German market a 2.2% decline. After the further Dow Jones loss on October 11, analysts were paying attention to whether Asian and European markets would decline further from October 12 and if they would further drop or bottom out next week.

Two major factors are cited behind the U.S. stock market crash. One is a rise in U.S. long-term interest rates. In a manner to end long monetary easing to address the Lehman Shock, the U.S. Federal Reserve has begun to raise interest rates to prevent economic overheating amid robust economic conditions. In such circumstance, U.S. long-term interest rates have been rising, including the benchmark 10-year Treasury yield that has increased beyond 3.2%. Interest rate hikes have been expected to affect corporate earnings and lead to economic deceleration, triggering the stock market crash. The other factor is the escalation of the U.S.-China trade war. As the trade war has escalated on the two countries' exchange of retaliatory tariffs, stock market participants have been concerned that the trade war could seriously hurt the global economy. Particularly, the trade war is seen as exerting a considerable negative impact on China, the second largest economy in the world. The Shanghai stock market decline and the Chinese yuan's depreciation are expected to lead China's real economy to deteriorate. The two factors have been combined to bring about the global stock market crash.

In response to the global stock market crash and the growing global economic risk, crude oil prices have declined substantially. On the New York Mercantile Exchange, the key West Texas Intermediate crude futures price lost $1.79 per barrel to $73.17/bbl on October 10. The next day, it declined by $2.20/bbl to $70.97. The two days' losses totaled $3.99/bbl amounting to 5.3%. The Brent crude futures lost $4.74/bbl or 5.6% in the two days to $80.26/bbl on October 11. As a matter of course, crude oil prices will continue to be influenced by stock market and global economic trends.

However, we cannot ignore another risk factor that has been shaking the global economy and international energy market. That is the United States' enhancement of economic sanctions on Iran, which is expected to result in a fall in Iranian crude oil exports and push up crude oil prices to eventually destabilize the oil market. As the United States has threatened to impose sanctions on countries that would fail to stop oil imports from Iran by November 4, Iranian oil exports have declined remarkably. Reuters and other reports say that Iran's oil exports in October could slip below 1 million barrels per day. Iranian oil exports before the United States' unilateral withdrawal from the Iran nuclear deal stood at about 2.5 million bpd and have declined faster than expected. As the United States has taken a hardline stance urging major importers of Iranian oil to stop imports, many countries have had no choice but to stop or substantially cut Iranian oil imports. In European countries that seek to maintain relations with Iran, it has become difficult for oil companies to continue trade with and investment in Iran. Even China and India, the most important Iranian oil importers, have no choice but to take a prudent attitude in the face of the tough U.S. posture.

If Iranian oil exports decline further and slip far below 1 million bpd, the supply-demand balance on the international oil market will tighten. Even if Saudi Arabia, Russia and some other oil producing countries expand oil production to make up for a decline in supply from Iran (or other oil producing countries), the balance may tighten depending on the magnitude of the decline. If Saudi Arabia increases production to cover a drop in Iranian oil supply, Saudi Arabia's surplus production capacity, which holds the key to international oil market stability, may be lost. This may be a grave problem for the market. Any sharp decline in Iranian oil exports is destined to add fuel to political and geopolitical tensions. It could be combined with some risk events (including unexpected events) to substantially push up crude oil prices.

Amid such speculation over Iranian oil supply, crude oil prices have risen since late September. The Brent futures price increased above $80/bbl for the first time since November 2014 on September 24 and hit a year-to-date high of $86.29/bbl on October 3. The WTI price also rose to $76.41/bbl on October 3. In response to such price hikes, media reports have stated that Saudi Arabia and Russia have been considering increasing production, symbolizing the Iranian situation as a key issue influencing future crude oil prices.

In the global economy and international oil market, two key risk factors that push up and down crude oil prices coexist. It is not easy to predict future developments regarding the global stock market crash, the global economic risk and the Iran risk. We will have to keep close watch on such developments toward late this year and next year.

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