October 16, 2023

The geopolitical and market risks of a prolonged Israeli-Hamas conflict

By Angelo Katsoras

The longer the Israeli-Hamas conflict continues and escalates into a protracted ground war, and the more it spills over into other countries such as Lebanon, the greater the risk of some form of confrontation between Iran and Israel. While this is likely to fall short of direct war, it could include actions ranging from targeted assassinations to the destruction of key facilities.

In particular, the brewing tensions could further strain an already tight oil market. Iran has a history of harassing and seizing oil tankers in the Persian Gulf (through which 20% of the world's oil exports transit) and targeting key oil facilities. It is widely believed that Iran was behind the drone and missile attacks on key Saudi oil facilities in 2019, which temporarily disrupted Saudi oil production.

Another risk to the oil markets is that the U.S. could tighten or increase sanctions on Iran's oil exports if it concludes that Iran helped Hamas plan the terrorist attacks against Israel and/or is actively participating in the war.

In the months leading up to the conflict, the United States had reportedly eased its enforcement of sanctions against Iran in order to facilitate the renegotiation of a new nuclear deal and to increase global oil supplies in an effort to keep a lid on prices. This is all the more critical now that U.S. strategic oil reserves are at a 40-year low. S&P Global Commodity Insights data show that Iranian oil production rose from 2.6 million barrels per day (bpd) last March to 3.1 million bpd in September, with exports at just under 2 million bpd.

Were oil prices to rise significantly, Saudi Arabia, the world's largest oil exporter, would face a dilemma. On the one hand, increasing production to lower prices could lead to accusations of siding with Israel and anger a large portion of the Arab public. On the other hand, Saudi Arabia fears that a spike in oil prices could increase the odds of a global economic slowdown. This would then cause prices to collapse, which would hurt its finances significantly.

The Israeli-Hamas conflict has probably already derailed efforts to normalize relations between Israel and Saudi Arabia. Analysts who suspect Iranian involvement in the planning of the attacks point to one possible motive in particular: disrupt efforts by the United States to get Israel and Saudi Arabia to form an alliance under its security umbrella that would essentially target Iran.

A protracted war would also divert more U.S. military equipment needed by Ukraine (not to mention Taiwan) to Israel. This includes weapons such as Patriot missiles and 155-millimetre artillery shells, which are already in short supply. The recent spike in oil prices due to fears that oil exports could be disrupted also means more money flowing into Russia's coffers.

Bottom line: The longer the conflict goes on, the greater the potential for oil market disruptions. In addition to the conflict spilling over into other regions such as Lebanon, there is also the risk of greater instability in neighbouring countries such as Egypt and Jordan.

Finally, this conflict adds a layer of geopolitical tension to a world already struggling with other challenges, including the ongoing war in Ukraine, great power rivalries, and escalating tensions over Taiwan. It also comes at a time when many Western leaders face growing political challenges at home, near-record debt levels and interest rates at two-decade highs.

Economics and Strategy

Montreal Office
514-879-2529

Stéfane Marion
Chief Economist and Strategist
stefane.marion@nbc.ca

Matthieu Arseneau
Deputy Chief Economist
matthieu.arseneau@nbc.ca

Kyle Dahms
Economist
kyle.dahms@nbc.ca

Daren King, CFA
Economist
daren.king@nbc.ca

Jocelyn Paquet
Economist
jocelyn.paquet@nbc.ca

Alexandra Ducharme
Economist
alexandra.ducharme@nbc.ca

Angelo Katsoras
Geopolitical Analyst
angelo.katsoras@nbc.ca

Toronto Office
416-869-8598

Warren Lovely
Chief Rates and Public Sector Strategist
warren.lovely@nbc.ca

Taylor Schleich
Rates Strategist
taylor.Schleich@nbc.ca

NATIONAL BANK OF CANADA
FINANCIAL MARKETS

UK Residents

This Report is a marketing document. This Report has not been prepared in accordance with EU legal requirements designed to promote the independence of investment research and it is not subject to any prohibition on dealing ahead of the dissemination of investment research. In respect of the distribution of this Report to UK residents, NBF has approved the contents (including, where necessary, for the purposes of Section 21(1) of the Financial Services and Markets Act 2000). This Report is for information purposes only and does not constitute a personal recommendation, or investment, legal or tax advice. NBF and/or its parent and/or any companies within or affiliates of the National Bank of Canada group and/or any of their directors, officers and employees may have or may have had interests or long or short positions in, and may at any time make purchases and/or sales as principal or agent, or may act or may have acted as market maker in the relevant investments or related investments discussed in this Report, or may act or have acted as investment and/or commercial banker with respect hereto. The value of investments, and the income derived from them, can go down as well as up and you may not get back the amount invested. Past performance is not a guide to future performance. If an investment is denominated in a foreign currency, rates of exchange may have an adverse effect on the value of the investment. Investments which are illiquid may be difficult to sell or realise; it may also be difficult to obtain reliable information about their value or the extent of the risks to which they are exposed. Certain transactions, including those involving futures, swaps, and other derivatives, give rise to substantial risk and are not suitable for all investors. The investments contained in this Report are not available to retail customers and this Report is not for distribution to retail clients (within the meaning of the rules of the Financial Conduct Authority). Persons who are retail clients should not act or rely upon the information in this Report. This Report does not constitute or form part of any offer for sale or subscription of or solicitation of any offer to buy or subscribe for the securities described herein nor shall it or any part of it form the basis of or be relied on in connection with any contract or commitment whatsoever.

This information is only for distribution to Eligible Counterparties and Professional Clients in the United Kingdom within the meaning of the rules of the Financial Conduct Authority. NBF is authorised and regulated by the Financial Conduct Authority and has its registered office at 70 St. Mary Axe, London, EC3A 8BE.

NBF is not authorised by the Prudential Regulation Authority and the Financial Conduct Authority to accept deposits in the United Kingdom.

U.S. Residents

With respect to the distribution of this report in the United States of America, National Bank of Canada Financial Inc. (“NBCFI”) which is regulated by the Financial Industry Regulatory Authority (FINRA) and a member of the Securities Investor Protection Corporation (SIPC), an affiliate of NBF, accepts responsibility for its contents, subject to any terms set out above. To make further inquiry related to this report, or to effect any transaction, United States residents should contact their NBCFI registered representative.

This report is not a research report and is intended for Major U.S. Institutional Investors only.

This report is not subject to U.S. independence and disclosure standards applicable to research reports.

HK Residents

With respect to the distribution of this report in Hong Kong by NBC Financial Markets Asia Limited (“NBCFMA”)which is licensed by the Securities and Futures Commission (“SFC”) to conduct Type 1 (dealing in securities) and Type 3 (leveraged foreign exchange trading) regulated activities, the contents of this report are solely for informational purposes. It has not been approved by, reviewed by, verified by or filed with any regulator in Hong Kong. Nothing herein is a recommendation, advice, offer or solicitation to buy or sell a product or service, nor an official confirmation of any transaction. None of the products issuers, NBCFMA or its affiliates or other persons or entities named herein are obliged to notify you of changes to any information and none of the foregoing assume any loss suffered by you in reliance of such information.

The content of this report may contain information about investment products which are not authorized by SFC for offering to the public in Hong Kong and such information will only be available to, those persons who are Professional Investors (as defined in the Securities and Futures Ordinance of Hong Kong (“SFO”)). If you are in any doubt as to your status you should consult a financial adviser or contact us. This material is not meant to be marketing materials and is not intended for public distribution. Please note that neither this material nor the product referred to is authorized for sale by SFC. Please refer to product prospectus for full details.

There may be conflicts of interest relating to NBCFMA or its affiliates’ businesses. These activities and interests include potential multiple advisory, transactional and financial and other interests in securities and instruments that may be purchased or sold by NBCFMA or its affiliates, or in other investment vehicles which are managed by NBCFMA or its affiliates that may purchase or sell such securities and instruments.

No other entity within the National Bank of Canada group, including National Bank of Canada and National Bank Financial Inc, is licensed or registered with the SFC. Accordingly, such entities and their employees are not permitted and do not intend to: (i) carry on a business in any regulated activity in Hong Kong; (ii) hold themselves out as carrying on a business in any regulated activity in Hong Kong; or (iii) actively market their services to the Hong Kong public.