

# Oil: Risk Is Biased To The Upside



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**GRANITE POINT  
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## Oil & Gas

# Focus Report: Oil: Risk Is Biased To The Upside

### Bottom Line:

**Oil prices could hit US\$150 to \$200 per barrel depending on the duration of the war** and the damage to infrastructure in the Gulf region. We believe that oil prices have more room to run as the conflict drags on and uncertainty mounts.

### Key Points

**The closure of the Strait of Hormuz has taken 20% of the world's oil and LNG supply offline.** The strait which separates Iran from Oman is only 21 miles wide at its narrowest point and the actual shipping lanes are just two miles wide.

**There are few alternatives for Gulf producing countries than shipping via the Strait of Hormuz** to global markets.

**Top producing countries such as Kuwait, Saudi Arabia and Iraq have all cut production.**

**All the spare capacity of OPEC+ is in the Gulf region and that is effectively all offline removing about a fifth of the world's oil supply.**

**Many of the tankers needed to satisfy world demand are trapped in the Persian Gulf.**

**Damaged infrastructure and shut-in oil fields will take weeks if not months to bring back online once the hostilities end.**

**A risk premium for oil is likely to be baked into the market for years even if the war ends quickly.** The longer the conflict drags on, the larger the risk premium is likely to be as damage to vital infrastructure is more likely to occur and trust between Iran and its neighbours' frays further.

**Important Disclosures:** See pages 8-9



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### Inside This Issue

1. U.S./Israel war with Iran

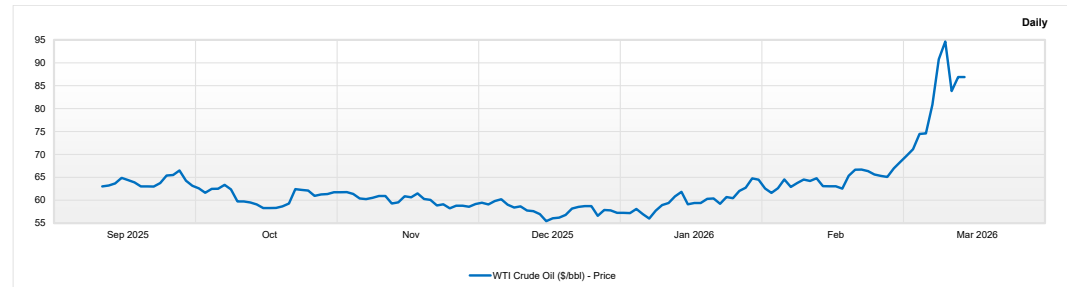
**“The war in the Middle East is creating the largest supply disruption in the history of the global oil market”, the International Energy Agency (IEA)**

## Oil: Risk Is Biased to the Upside

**Oil prices could hit US\$150 to \$200 per barrel depending on the duration of the war** and the damage to infrastructure in the Gulf region. We believe that oil prices have more room to run as the conflict drags on and uncertainty mounts. The U.S./Israel war with Iran has sent crude prices sharply higher with WTI prices briefly hitting \$119/barrel in intraday trading on March 2 before pulling back. Brent and the European natural gas benchmark contract (Dutch TTF) have risen sharply along with WTI.

**The majority of the initial move in futures prices has been concentrated in the first few delivery months** with the outer months only advancing ~3%. We believe that this suggests that at least in the early stages of the war there was still a considerable amount of complacency amongst oil traders as to the severity of the impact on the oil market.

**Exhibit 1: WTI Prices Have Moved Up Sharply of Late (US\$/bbl – daily closing prices)**



Source: FactSet, Granite Point Research

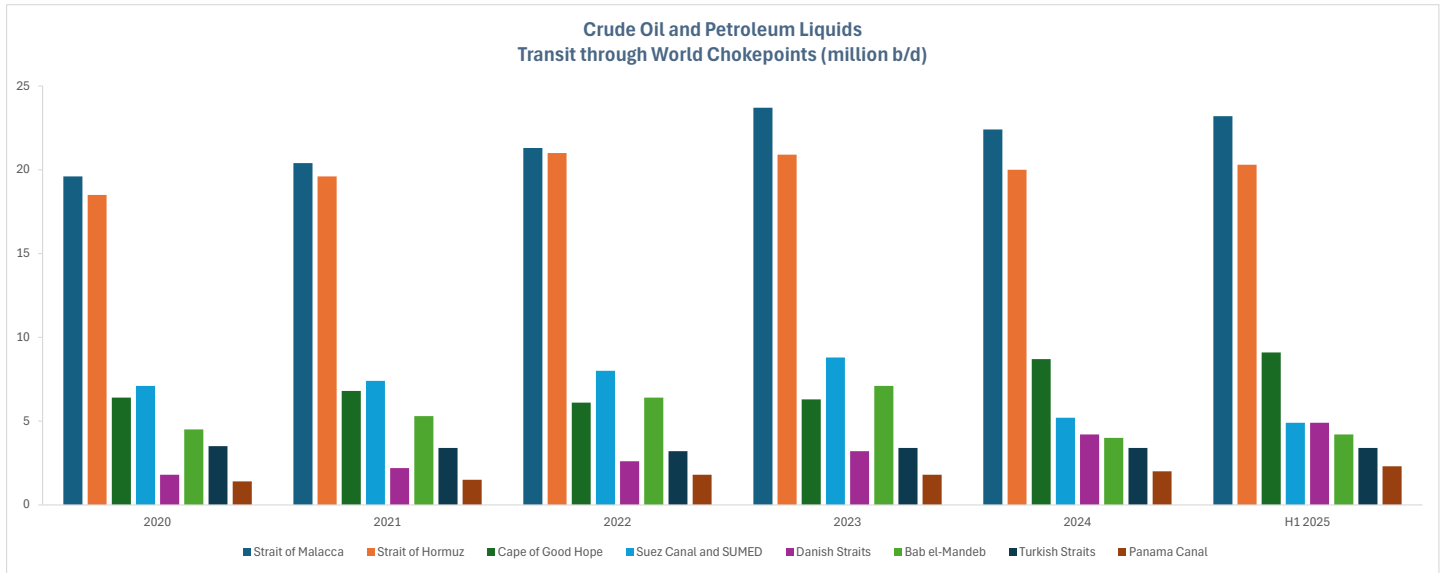
**Twenty percent of the world’s oil supply is now offline with no immediate prospect of a restart**

**The effective closure of the Strait of Hormuz has taken 20% of the global crude and NGL<sup>1</sup> supply offline.** The strait which separates Iran from Oman is only 21 miles wide at its narrowest point and the actual shipping lanes are just two miles wide. Insurance premiums for tankers have jumped and the approximately 80 daily transits of oil tankers have ground to a halt as shippers fear a drone strike or missile strike on their vessels. Only the Strait of Malaca sees greater volumes of oil, petroleum liquids and liquified natural gas than the Strait of Hormuz.

**There are few alternatives for Gulf producing countries than shipping via the Strait of Hormuz** to global markets. The UAE and Saudi Arabia can ship some of their production via pipeline to avoid these waters but most of the other countries in the region are not able to do that. The Saudi’s typically ship 6 million barrel/day of crude via Hormuz but now they are reliant on their East-West pipeline which terminates at Yanbu on the Red Sea for egress. The pipeline can take up to 5 million barrels per day but as a practical matter Yanbu has rarely been able to load more than 2.5 million bbl/d.

**Top producing countries such as Kuwait, Saudi Arabia and Iraq have all cut production** at their oilfields as they all must pump oil into storage if they can’t load it into tankers and storage is brimming after more than a dozen days of a shutdown at the Strait of Hormuz.

<sup>1</sup> Natural Gas Liquids

**Exhibit 2: Crude Oil and Petroleum Liquids – Transit Trough World’s Choke Points (million b/d)**


Source: U.S. Energy Information Administration (EIA), World Oil Transit Chokepoints analysis, based on Vortexa tanker tracking, Granite Point Research

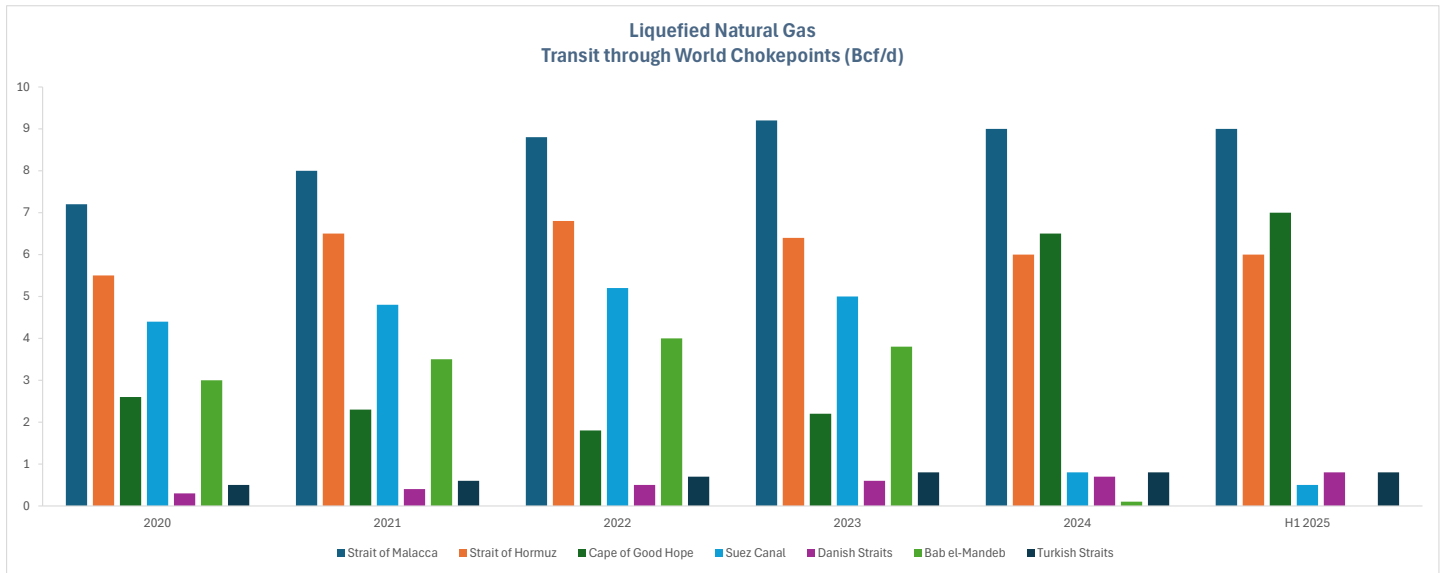
**Qatar Energy declared force majeure (March 4) on its LNG shipments with the onset of the war.** The force majeure<sup>2</sup> notice was delivered after a production halt at Ras Laffan and Mesaieed, triggered by security concerns and infrastructure damage after regional attacks. Qatar is the second largest LNG exporting country in the world (U.S. is number one) with all its LNG transiting the Strait of Hormuz.

**Disruptions in the Strait of Hormuz also impact fuel supplies.** Refineries in the Gulf region have for the most part been unable to deliver the fuel they produce. Kuwait’s giant Al Zour refinery (615,000 b/d), which is a major supplier of jet fuel for Europe and Africa, has been unable to ship fuel.

Other refiners in the region are also offline. Saudi Aramco has shut its largest refinery at Ras Tanura after a drone missile strike. Bahrain’s Bapco Energies Sitra refinery was hit early this week forcing it to declare force majeure and shut down.

<sup>2</sup> Force majeure applies to contracts and governing law and allows companies to abrogate on a temporary basis their contractual obligations for acts of god, war or other matters beyond their control. In essence, it prevents them from being sued for non-delivery provided it is a legitimate claim.

**Exhibit 3: Liquefied Natural Gas – Transit Through World Checkpoints (Bcf/d)**



Source: U.S. Energy Information Administration (EIA), World Oil Transit Chokepoints analysis, based on Vortexa tanker tracking, Granite Point Research

**All the spare capacity of OPEC+ in the world is in the Gulf region and that is now offline.**

**Offshore fields such as those in Guyana are not a solution in the near-term as it takes 5-10 years to develop meaningful production increases from offshore fields**

**The narrative on oil has changed dramatically.** Over the prior six months the narrative was all about the market being oversupplied with OPEC+ producers bringing on an additional 2.2 million barrel per day swinging the market into surplus. Today, the concern is over a supply shock that will likely drive oil price into triple digits. With about a fifth of the world’s oil supply removed from the global market there is no longer spare capacity but rather a very large supply/demand imbalance.

**Asia is the most vulnerable region of the world to the Hormuz disruption** as they rely more heavily on oil, fuel and natural gas from the Middle East than other parts of the world. Countries in Asia are scrambling to deal with the pending shortages with South Korea announcing price caps on fuel for the first time in 30 years while China has asked refiners to halt exports and Bangladesh has closed universities to conserve fuel and power.

**There is no global spare capacity but rather a gaping deficit.** The spare capacity that OPEC+ brought online in the past year that weakened crude prices only exists in the Gulf region. Now that production is effectively offline. Countries such as Guyana with their massive offshore oil fields will be unable to close the gap as meaningful production gains in offshore will take 5-10 years to bring online.

**War appears more likely to continue for some time than a quick cessation of hostilities.** Yesterday, Iran’s new supreme leader, Mojtaba Khamenei said that they will fight on and use the Strait of Hormuz as leverage against the United States and Israel. Shortly after the announcement Iran’s Revolutionary Guards said they would keep the strait closed in line with his orders. Yesterday, two tankers were ablaze in an Iraqi port hit by suspected explosives-laden boats.

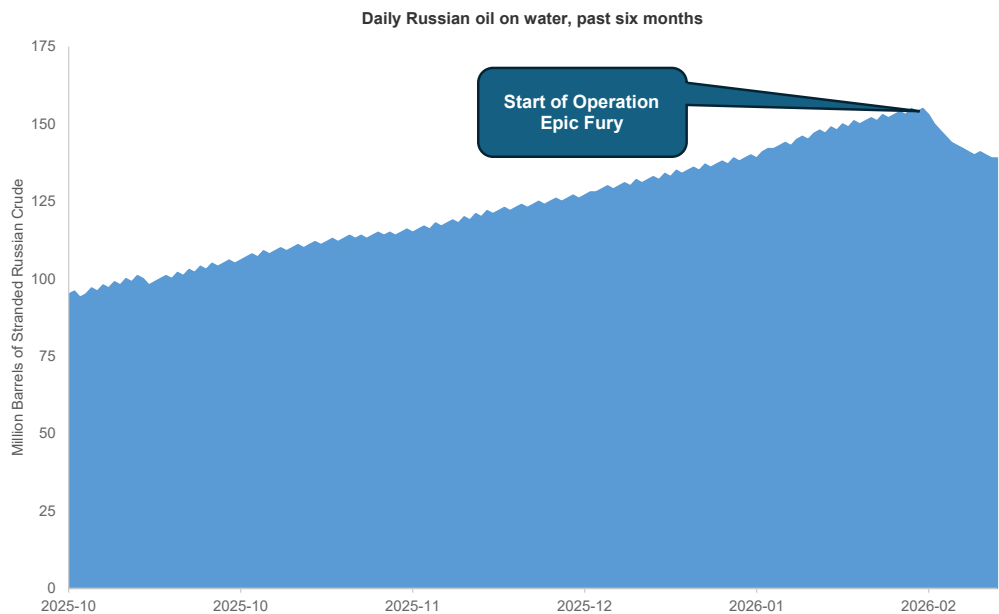
**IEA member countries sought to calm the market on Wednesday with the biggest-ever release of emergency oil reserves.** The 400 million barrel announced release of emergency stockpiles has done little to calm the market. There still isn’t any clarity on how this will be conducted, with some suggesting 3.3 million barrels per day would be released and that it would be dispersed slowly. Should that be the case it will do little to plug a 20 million barrel/day gap.

**Many of the tankers needed to satisfy global demand are trapped in the Persian Gulf**

**The release of oil from strategic stockpiles is unlikely to have a major impact on oil prices in the short or long term.** The IEA's announced release is equivalent to 4-5 days of normal global production which the market is likely to see through and drive oil prices higher. Furthermore, many of the tankers that are needed to transport oil to the market centers to satisfy global demand are trapped in the Persian Gulf.

**Waivers for stranded Russian crude illustrate how dire the situation is.** Before the war some 152 million barrels of stranded Russian crude were at sea looking for a home. Refiners in India and elsewhere now armed with a waiver from the U.S. government to purchase this once shunned product have been loading up with a recent 12% drop in the stranded barrels at sea. In the past, Russian oil used to trade at a discount to world prices but in some cases, it is now trading at a premium.

**Exhibit 4: Stranded Russian Barrels Are Now Selling Like Hotcakes**



Source: Vortexa, Granite Point Research

**Damaged infrastructure and shut-in oil fields will take weeks if not months to bring back online** extending the timeline for a recovery. Oil fields that have been shut in for some time can suffer a loss of pressure that can lead to a long-term reduction in output. Qatar's LNG plant, for example, can take several weeks or perhaps longer to bring back online and damage to regional pipelines could take months to bring volumes back to where they were before the start of the war.

**Even if the conflict ends quickly, it could still lead to elevated risks.** A quick resolution to the war could also be problematic as it would likely leave the existing Iranian regime in place which would potentially hand Tehran more control over a vital choke point for the world's oil and NGL supply.

**A risk premium for oil is likely going to be baked into the market for years** even with a quick resolution to the war. The longer the conflict drags on the larger the risk premium is likely to be as the potential damage to infrastructure increases and trust between Iran and its neighbors' frays

**Watch John's recent interview on BNN Bloomberg where he discusses the U.S./Israel war on Iran and it's implications for the oil market ([here](#))**

further. Shipping costs and the cost of insurance are likely to remain a fixture of the market even with the cessation of hostilities for the foreseeable future.

## Important Disclosures

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RATING	COVERED COMPANIES
BUY	3
HOLD	
SELL	

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