

Letter n°153

The United States has made a political concession to an economically weakened Islamic Republic.

What does this mean for the outlook for oil prices?

“It is far easier to make war than peace.” Clemenceau.

This famous maxim by Georges Clemenceau is likely to be fully illustrated throughout the negotiations, which are expected to continue until 21 August. In an ironic twist of history, the Islamic Republic of Iran, which has been in a state of economic failure since 1979, and the United States, which has experienced military setbacks over the past three months, both have an interest in reaching an agreement that would increase Iranian crude oil production. Such is the demand of the Iranians, who have an urgent need for foreign currency reserves to rebuild their economy. It is also a key objective of Donald Trump, who is keen to see oil prices decline ahead of the November elections.

Iran’s economic underperformance is striking:

In 1979, Iran’s GDP stood at approximately US\$90 billion. 46 years later, it has reached around US\$400 billion. Over the same period, the GDP of its long-standing rival, Israel, increased from roughly US\$20 billion to US\$600 billion. On a per capita basis, Iran’s GDP was about US\$2,500 in 1979 and stands at approximately US\$4,200 today. In contrast, Israel’s GDP per capita rose from around US\$6,000 to US\$60,000 over the same period. The figures speak for themselves. According to Iranian statistics, economic growth between March 2025 and March 2026 did not exceed 0.2%.

The American military setback in this conflict is difficult to dispute:

The objectives were the fall of the regime, the permanent destruction of Iran’s military nuclear capabilities, and an end to the supply of discounted Iranian oil to China. Yet none of these objectives has been achieved. Moreover, the disruption of the Strait of Hormuz and its consequences for inflation and global growth have illustrated what many describe as the “butterfly effect.”

How could a country with a military budget exceeding US\$900 billion, roughly half of global defence spending, and supported by what is widely regarded as the world’s most capable military ally, Israel, become bogged down in a conflict against Iran, whose military budget is estimated to be below US\$20 billion per year? What had been expected to result in regime change has instead left the Islamic Revolutionary Guard Corps appearing more entrenched than before, consolidating its hold over a population facing even greater repression.

The outline of a potentially bearish deal for oil prices:

Unexpectedly from the Iranian perspective, the United States has reportedly accepted the resumption of Iranian oil exports, estimated at approximately US\$5 billion per month, even before the conclusion of a nuclear agreement. This represents a significant and surprising concession. As Thomas Friedman has observed, President Trump appears willing to distance himself from traditional allies, including Israel and the Gulf monarchies, in an effort to strengthen Republican electoral prospects in key swing states such as Michigan, Pennsylvania, and Georgia.

In this Letter 153, we examine the implications of this fragile “deal” for the expected evolution of global oil supply, prices, and demand.

Observed and expected developments in oil supply:

- *A temporary contraction in supply:*

On the eve of the conflict, oil prices were relatively low, as the world had approximately 3 Mb/d of spare production capacity. For many years, the Persian Gulf has accounted for around 30% of global oil production and one-quarter of global LNG output. Production levels among Gulf producers stood at approximately 10.3 Mb/d in Saudi Arabia, 4.3 Mb/d in Iraq, 3.6 Mb/d in the United Arab Emirates, 3.45 Mb/d in Iran, and 2.57 Mb/d in Kuwait.

In May, Saudi production is estimated to have declined by 25–35%. In the UAE, output reportedly fell to 2 Mb/d, in Iraq to 1.5 Mb/d, and in Kuwait to less than 0.5 Mb/d. According to the IEA, OPEC production declined by approximately 9.4 Mb/d.

The UAE was reportedly affected more severely than Saudi Arabia, partly because it had recognised Israel. While the country can utilise a pipeline to the Gulf of Oman, this route covers only around 50% of its production capacity. Kuwait reduced output during the conflict because its storage facilities became saturated and the Strait of Hormuz remained its only export route. Iraq cut production by roughly half due to insufficient storage capacity.

At the time the ceasefire was agreed, an estimated 170 million barrels of oil and approximately 185 tankers were stranded in the Strait of Hormuz. In recent days, around 50 vessels have been transiting the Strait daily, equivalent to roughly 40% of pre-war traffic, although estimates vary. A return to pre-conflict shipping volumes is likely to take time, particularly as many large tankers remain positioned off the US coastline.

- *Potentially abundant future supply:*

According to the IEA, global oil production could increase by approximately 8 Mb/d next year. As a result, the supply surplus relative to demand could exceed 5 Mb/d, compared with around 3 Mb/d before the conflict.

Since 2010, US oil production has increased by approximately 8 Mb/d, exceeding the combined increase of 6.7 Mb/d recorded across all Middle Eastern producers. Growth, however, is now moderating. US production stood at 13.4 Mb/d in 2025 and is expected to reach 13.7 Mb/d this year. According to the IEA, production could rise to a record 14.2 Mb/d by 2027.

In April and May, US oil exports increased from approximately 4 Mb/d to 5 Mb/d, helping to ease upward pressure on crude prices.

Outside OPEC, several countries have significantly expanded production since 2010 and are expected to continue doing so, including Canada (+2.8 Mb/d), Brazil (+2 Mb/d), and Guyana (+1 Mb/d).

In Venezuela, following the removal of Maduro, oil exports reportedly increased by more than 40% compared with the corresponding period in 2025. Oil revenues could reach US\$34 billion in 2026, up from US\$18 billion in 2025. The liberalisation of policies in favour of foreign investment, particularly in the energy sector, has been welcomed, although the country continues to face shortages of skilled labour and ongoing security concerns.

Middle Eastern producers are also expected to increase output in order to offset revenue losses incurred during 2026. The UAE, OPEC's third-largest producer after Saudi Arabia and Iraq, believes it has the capacity to raise production to 5 Mb/d and has therefore withdrawn from the OPEC cartel in pursuit of greater flexibility.

- *Reduced dependence on the Strait of Hormuz:*

In 2023, exports through the Strait of Hormuz amounted to approximately 6.2 Mb/d for Saudi Arabia, including 5 Mb/d destined for China. Iraq exported around 3.2 Mb/d through the Strait, with roughly half going to South Korea and the remainder to other Asian markets. The UAE shipped approximately 2 Mb/d, almost exclusively to India. Kuwait exported 1.5 Mb/d to Asia, Iran 1.3 Mb/d, and Qatar 0.6 Mb/d to Europe.

Before the conflict, approximately 20 Mb/d passed through Hormuz each day. During the conflict, volumes fell by roughly half. The shortfall was partially offset through alternative measures: Saudi Arabia's use of the Yanbu terminal on the Red Sea for 5Mb/d, compared with 0.7Mb/d at the beginning of the year; use of the Emirati pipeline for 0.7Mb/d; Iraqi exports via Ceyhan for 0.7Mb/d; the release of 3.9Mb/d of sanctioned oil; an increase of more than 1Mb/d in production by the other OPEC members; and the release of 3.3Mb/d from IEA strategic stocks. Even after all these measures, 4.6Mb/d remained unreplaced.

To avoid similar disruptions in the future, Gulf countries are seeking to develop pipeline infrastructure that bypasses the Strait of Hormuz.

Saudi Arabia could increase the capacity of the Yanbu terminal from 5 Mb/d to 7 Mb/d. Abu Dhabi has launched a US\$150 billion investment programme to double the capacity of its pipeline to the port of Fujairah and reduce dependence on Hormuz. Iraq is constructing a new pipeline that would provide an export route through Jordan.

Over the longer term, it is anticipated that only around 15 Mb/d, rather than 20 Mb/d, will transit the Strait of Hormuz. Greater use is also expected to be made of the Bab el-Mandeb Strait, through which more than 9 Mb/d of oil and petroleum products passed prior to the conflict.

Cyclical and structural trends in oil demand:

- *A significant decline in demand during the second quarter:*

According to the IEA, global oil demand declined by approximately 5% during the second quarter, equivalent to around 5 Mb/d. Demand is expected to decrease by 1.1 Mb/d over the year before recovering by approximately 2 Mb/d in 2027.

Europe and the United States are now only moderately dependent on Gulf oil producers. The countries most affected by the disruption have been in Asia. China sources approximately 42% of its oil imports from the Gulf, compared with around 95% for the Philippines, 88% for Vietnam, 70% for South Korea, and 60% for Thailand.

In May, China is estimated to have imported only 7.8 Mb/d of oil, compared with nearly 11 Mb/d before the conflict. The scale of this decline surprised markets and remains difficult to explain fully, although several factors may have contributed. According to the US administration, China had accumulated significantly larger precautionary oil reserves than most other countries, estimated at between 1 and 1.4 billion barrels, compared with approximately 350 million barrels in the United States, a level not seen since 1983 and a source of concern among industry participants, and around 260 million barrels in Japan. In addition, Chinese consumers appear to have reduced gasoline consumption and increased their use of rail transport. China has also relied more heavily on coal and expanded the use of renewable energy sources. This reduction in Chinese demand played a critical role in preventing oil prices from surging to US\$150–200 per barrel.

As a result, markets are now closely focused on the outlook for Chinese demand and attempting to assess how much of the recent decline reflects a structural rather than cyclical shift.

- *Structural trends in demand:*

The sensitivity of the global economy to oil has declined substantially since 1974. According to economist Paul Krugman, energy intensity in the United States has fallen by approximately 70% since the first oil shock. In France, energy intensity is estimated to have declined by a factor of four to five over the same period. At that time, oil accounted for around 56% of the world's energy mix. Today, it represents less than 30%, while natural gas accounts for approximately 17%, and nuclear power together with renewable energy sources represent around 40%. These long-term structural changes suggest that the global economy has become considerably less dependent on oil than it was during previous energy crises, reducing the impact of supply disruptions on economic activity and inflation relative to earlier decades.

Price developments:

- *Crude oil prices remained relatively moderate:*

Between 2011 and 2014, the average price of oil exceeded US\$100 per barrel. In June 2022, following Russia's invasion of Ukraine, prices reached US\$120 per barrel. In June 2025, after the Israeli attack, oil prices rose by approximately 20% to US\$79 per barrel.

At the outset of the war with Iran, some observers feared a far more dramatic escalation, with prices potentially reaching US\$150 or even US\$200 per barrel. The IEA estimated a supply shortfall of 10 Mb/d and described the situation as "the largest energy crisis in history."

However, such an outcome did not materialise. Markets demonstrated considerable flexibility, while demand adjusted downward rapidly. During the three months of conflict, the average oil price was approximately US\$105 per barrel, with a peak of US\$125 per barrel. The principal beneficiaries of higher prices were, temporarily, major exporting nations such as Russia, Canada, and Norway.

The IEA released approximately one-third of its strategic inventories, equivalent to around 400 million barrels. This was sufficient to cover roughly 40 days of disruption, while additional reserves remained available if required. According to Kpler, inventories held in so-called "shadow fleet" cargoes were also exceptionally high, reaching 58 million barrels in January compared with only 6 million barrels in 2025, consisting primarily of Iranian and Russian crude.

In recent days, Brent crude has fallen rapidly to approximately US\$72 per barrel, returning to pre-conflict levels. By 2027, the global supply surplus could reach 5 Mb/d, although lower prices are likely to stimulate renewed consumption.

Assuming sufficient time is available for OECD countries and China to rebuild strategic inventories, and assuming that emerging economies affected by fuel shortages during the conflict decide to establish larger precautionary reserves, oil prices could remain relatively low in 2027, potentially below the levels seen at the beginning of 2026.

The outlook for refined petroleum products is less certain, as the extent of damage to refining capacity and the time required for restoration remain difficult to assess.

Jet fuel has been among the most volatile products, given that nearly 30% of global aviation fuel production originates in the Middle East. The price of jet fuel exceeded €1,500 per tonne at one stage, compared with approximately €650 per tonne before the conflict. Fuel represents the largest operating expense for airlines, accounting for nearly 30% of total costs. Fortunately for the aviation sector, prices have fallen by around 50% in recent days, although they remain roughly 15% above pre-war levels.

- *Fertilisers:*

Another sector significantly affected by the conflict has been fertilisers. A distinction must be made between nitrogen-based and phosphate-based fertilisers. Prices of nitrogen fertilisers have fallen by approximately 50% in recent weeks after initially rising by 80–100% at the start of the conflict. The decline appears to reflect weaker demand rather than a meaningful recovery in supply, raising concerns about agricultural yields in future harvests.

Phosphate fertilisers, however, have not experienced a similar correction. These products require sulphur as a key input, and approximately 40% of global sulphur production transits through the Strait of Hormuz.

The risk of agricultural inflation resulting from lower crop yields has not yet materialised, largely because inventories remain elevated and recent harvests have been favourable. At around €196 per tonne, wheat prices remain far below the levels seen at the start of the Ukraine war, when prices approached €400 per tonne.

- ***Coal:***

Coal prices at Rotterdam rose to approximately US\$152 per tonne following the outbreak of the war with Iran. However, this remained well below the US\$400 per tonne levels recorded during the 2022 invasion of Ukraine.

Asian economies affected by disruptions in the Strait of Hormuz increased their reliance on coal. China, which consumes approximately half of global coal production and produces around 80% of its domestic requirements, led this shift. India, the world's second-largest coal consumer, also increased usage. India produces roughly three-quarters of its own coal needs and imports most of the balance from Indonesia.

- ***Liquefied Natural Gas, a growing market:***

Liquefied natural gas (LNG) accounts for only around 8% of global gas production, yet it remains strategically important. Prior to the conflict, the global LNG market was characterised by excess capacity. Today, these surpluses offset two-thirds of the Qatari gas supply that would otherwise be lost due to destruction or a blockade of the Strait of Hormuz – Qatar's sole export route. The largest importers of Qatari LNG are China and India, the latter relying on Qatar for roughly half of its LNG needs, followed by Taiwan, Pakistan, and South Korea.

In 2022, gas prices delivered to Rotterdam reached as high as €340/MWh. This year, despite an increase of approximately 80% and despite Qatar's expectation that normal export operations may take weeks or even months to restore, prices have remained below €56/MWh. Markets appear to be anticipating substantial new LNG export capacity from the United States.

In Europe, gas prices remain five to six times higher than those in the United States, whereas in 2020 the two markets were broadly aligned. Germany and Italy remain among the European economies most dependent on natural gas for industrial production.

Conclusion: “The biter is bit” Jean de La Fontaine, The Rat and the Oyster

- ***What lies ahead for Iran?***

The United States sought to use the closure of the Strait of Hormuz as a means of depriving Iran of approximately US\$400 million in daily oil revenues and compelling further concessions. However, Iran appears to have anticipated such a scenario by building a floating stockpile of more than 160 million barrels outside the Gulf, enabling it to continue supplying China through June. In 2025, China purchased approximately 90% of Iranian oil exports, although these volumes represented only around 13% of China's total oil imports.

Despite some 25,000 strikes over a period of 40 days, Iran remained resilient, even though reconstruction costs are estimated in the hundreds of billions of dollars, food-price inflation has reportedly exceeded 110% since the start of the conflict, and electricity rationing has been implemented.

Iran generated slightly less than US\$50 billion in export revenues in 2024. These revenues could increase significantly following the conclusion of an agreement with the United States, given that Iran possesses approximately 9% of global oil reserves and 15% of global natural gas reserves.

The nuclear issue remains unresolved. Nevertheless, Iran has achieved what may be viewed as a symbolic victory, reflected in the survival of the regime, its international recognition, the preservation of its ballistic missile capabilities, the easing of sanctions on oil exports (after production had previously fallen from 3 Mb/d to 1.7 Mb/d), the immediate release of US\$12 billion in frozen assets, the prospect of a further US\$12 billion becoming available within 60 days, the possible establishment of a US\$300 billion reconstruction fund, a greater role in the management of the Strait of Hormuz, and the inclusion of Lebanon within the ceasefire framework.

- *What lies ahead for the Strait of Hormuz?*

Never before, not even during the oil crises of 1974 or 1979, has the world experienced a disruption affecting such a significant volume of energy flows. The Strait of Hormuz is the transit point for around 40% of global sulphur shipments, 25–30% of liquefied natural gas (LNG) trade, 20% of refined petroleum products, 10% of global aluminium trade, one-third of global fertiliser shipments, 20% of global oil exports, and around 10% of total global maritime trade. Most of these flows are destined for Asia. At its narrowest point, the strait is just over 50km wide, but in practice the navigable passage is only around 10km because the surrounding waters are often too shallow.

By targeting Iran, the United States sought to restrict China's access to discounted Iranian crude. In practice, however, many of the vessels granted passage through the Strait have been tankers bound for China.

At the beginning of the conflict, it was often suggested that the ultimate victor would be the party controlling the Strait of Hormuz. Today, according to this interpretation, it is the Islamic Revolutionary Guard Corps that effectively determines the pace of traffic and grants passage permissions. Drawing parallels with the current transit fee of approximately US\$6.70 per tonne charged in the Dardanelles under the 1936 international convention governing the Turkish straits, Iran has reportedly expressed interest in imposing a transit charge through Hormuz that could generate as much as US\$40 billion annually. Legally, however, such a measure could not be implemented unilaterally. It would require broad international agreement and would likely face substantial opposition, as it would conflict with established principles governing freedom of navigation through international waterways.

Of the approximately 20 Mb/d of oil exported through Hormuz, roughly half could eventually be redirected via pipelines. This is not currently possible for natural gas exports, however, due to the absence of sufficient pipeline infrastructure. Kuwait, in particular, remains heavily dependent on the Strait, with no practical alternative export route.

Should the United States effectively allow Iran to exert influence over 20% of global oil flows, while its strategic partner Russia accounts for another 11% of global production, it would strengthen the geopolitical influence of the China–Russia–Iran bloc and potentially support the growing international role of the Chinese yuan at the expense of the West.

- *What lies ahead for the Gulf states?*

Economic growth projections for the Gulf states have been revised downward from 4.4% to 2.6% this year. Nevertheless, these countries remain exceptionally wealthy due to the scale of their sovereign wealth funds. The UAE holds approximately US\$2.7 trillion, Saudi Arabia US\$1.3 trillion, Kuwait US\$1.0 trillion, and Qatar US\$590 billion.

Over the past decade, the UAE has invested approximately US\$625 billion abroad, primarily in the United States and Europe. Qatar invested around US\$170 billion, while Saudi Arabia invested approximately US\$85 billion internationally. Despite this wealth, a slowdown is likely as priority will be given to domestic investment for reconstruction and the expansion of pipelines.

- *What lies ahead for energy equities?*

The medium-term direction of oil prices appears to be downward, reflecting the prospect of abundant supply and President Trump's preference for lower energy prices as a means of containing inflation. In the near term, however, peace negotiations remain fragile and could easily encounter setbacks. As a result, oil prices are likely to remain volatile.

For this reason, while exposure to energy stocks has been reduced following their strong performance, a partial allocation has been retained within portfolios. In the United States, the combined market capitalisation of the entire energy sector remains relatively modest, less than half the market value of NVIDIA alone.

Bruno Desgardins

Bruno Desgardins
CIO
Switzerland



SingAlliance Pte Ltd

16 Raffles Quay, #12-01 Hong Leong Building,
Singapore 048581
T: +65 6303 5050
E: info@singalliance.com

SingAlliance (Switzerland) SA | Genève

Rue du Mont-de-Sion 6,
1206 Genève, Switzerland
T: +41 22 518 85 85
E: info.switzerland@singalliance.com



SingAlliance (Hong Kong) Ltd

Unit 904-907, 9/F Dah Sing Financial Centre,
248 Queen's Road East, Wanchai, Hong Kong
T: +852 2639 3659
E: info.hongkong@singalliance.com

SingAlliance (Switzerland) SA | Zürich

Bahnhofstrasse 37,
8001 Zürich, Switzerland
T: +41 76 628 12 36
E: info.switzerland@singalliance.com

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