

Letter n°157

The mystery of oil.

“The Stone Age did not end for lack of stones, and the Oil Age will not end for lack of oil” Sheikh Yamani.

Since 1974, the spectre of a disruption in oil supplies and a sharp rise in oil prices has haunted the world, and Sheikh Yamani was right to think that this would last.

At the beginning of the conflict with Iran and the closure of the Strait of Hormuz, many feared a barrel at \$150 or more, but this did not happen.

To shed light on the mystery of a Brent price below \$90/b, let us try to understand why the rise in prices has been so measured and consider who is benefiting from the increase, because while the barrel is not at \$150, the rise is nevertheless 50% since the beginning of the year.

Why has the rise in prices remained measured?

Answering this question requires analysing supply and then demand.

The evolution of supply:

In June, according to the IEA, global production stood at 98.8Mb/d, below the level recorded before the start of hostilities with Iran.

Before the conflict, 15Mb/d of crude passed through the Strait of Hormuz. This figure was as high as 21.6Mb/d in the last quarter of 2025 when refined products are included. In the second quarter of this year, the figures, which should be treated with caution, were below 5Mb/d through Hormuz. In recent days, according to Kpler, it appears that 6Mb/d are passing through the Strait of Hormuz along the Omani coast, often at night and without transponders, which is a risk factor. Many are taking this risk because the price is often heavily discounted, thereby absorbing the cost of freight and insurance, as indicated by the CEO of TotalEnergies. Around 17% are Iranian vessels. Of the remainder, many are Chinese, Emirati and Greek. This is a figure far below the 20Mb/d before the conflict, but much higher than the 300,000 to 3Mb/d seen during the first months after the conflict began.

Negotiations for an agreement between Iran and Oman without the United States are making little progress. In the absence of a toll, “service fees” are being considered to ensure transport security and cover the impact of government intervention. Middle Eastern countries appear to be resigning themselves to this and would prefer a toll to a resumption of the conflict. After all, \$1/b would amount to just a few cents per litre at the pump.

- *The confusion over Iran:*

Between Iran and the United States, the situation is confusing. Militarily, Trump has not achieved his objectives and has used a large part of his weapons stockpiles. He appears to have backed down on his demands: abandoning the nuclear programme, eliminating ballistic missiles and ending Iranian support for regional militias.

He therefore appears to want to use, together with Scott Bessent, the economic card of sanctions against all countries likely to trade with Iran – in other words, the card of a blockade.

As we know, the Iranian economy is experiencing serious difficulties. According to the IMF, GDP is expected to fall by 5.5% this year because oil sales, which accounted for 11% of GDP before the conflict, have dried up significantly. Official inflation stood at 88% in July, and in reality, it is much higher. According to a former economic adviser to President Rouhani, since 2018, the population living below the poverty line has increased by 18 million. Every year, 700,000 young people enter the labour market, while only 57,000 jobs are reportedly being created. The Iranian regime may be more fragile than we think and may be fighting for its survival. It is intensifying repression, and the number of executions has reached a record level. It remains to be seen whether Trump will implement these economic sanctions, as we know he often backs down.

But, as we have often noted in these Letters, since Napoleon's failed blockade of England, there are not really any examples of successful blockades. We can see this at present with Cuba, which continues to benefit from Chinese support. We saw it in Venezuela before Maduro's fall, and with Iran, it is difficult to see China yielding. There have already been American attempts to prohibit trade with Iran. China had avoided exposing its major companies to sanctions but had used small local refineries instead. And today, it is difficult to see Xi yielding. To avoid Hormuz, Iran can use the Caspian Sea and its borders with Turkey or Pakistan. It also uses a railway route to China through Turkmenistan and Kazakhstan and resorts to the Yuan to avoid exposure to the \$.

- ***Alternatives to Hormuz being implemented:***

In Saudi Arabia, thanks to the pipeline, 7Mb/d are now reaching the Yanbu terminal. 5Mb/d are exported (compared with 1Mb/d before the conflict) and 2Mb/d are refined. Ships therefore have the possibility of passing through the Suez Canal, but large tankers cannot pass at full capacity and must rely on the Houthis' willingness to allow them through.

In the UAE, 1.5Mb/d passes through the pipeline to Fujairah, compared with 1Mb/d before the conflict.

Iraq exports 0.2Mb/d through a pipeline to Turkey and 0.2Mb/d by truck via Syria. It remains heavily affected by the blockade of Hormuz, as it was only able to export 1.7Mb/d in July, compared with 3.4Mb/d before the conflict – a serious problem because oil accounted for 90% of the country's revenues before the conflict.

We must also take into account the development of supply outside the Middle East and thus, according to the IEA, global oil supply in 2026 is declining by 4.3Mb/d.

- ***What are the prospects for crude oil supply?***

In 2027, assuming a reopening of the Strait of Hormuz, oil supply could, according to the IEA, increase by 8.3Mb/d, including 5.8Mb/d from OPEC.

Admittedly, independently of the war, we are seeing a slow decline in Russian production. Extraction of 8.9Mb/d is expected this year, compared with 9.2Mb/d in 2024 and more than 10Mb/d in 2020. Rystad expects 8.6Mb/d in 2027 because Russia lacks the means to replace ageing wells.

But elsewhere, increases in production are expected. By the end of 2027, the UAE will have doubled its pipeline capacity to 3.8Mb/d. It has left OPEC so that it can exceed its quota of 3.4Mb/d and ultimately reach 5Mb/d. Iraq should increase its capacity by 1Mb/d within 1 year and, within 4 years, should build a new 1,600 km pipeline with a capacity of 1 to 2.5Mb/d to Aqaba in Jordan. Thus, in 2030, if Bab el-Mandeb remains open and Hormuz remains closed, there will still be a shortfall of 5Mb/d in the region.

Outside OPEC, in the United States, Baker Hughes is reporting an increase in the number of drilling rigs. Production in 2027 could reach, according to the IEA, 14.2Mb/d, compared with 13.4Mb/d in 2025. In Brazil, production has reached a record 5.6Mb/d and will continue to grow. Production is also increasing in Guyana and Canada.

- ***What are the prospects for refined product supply?***

5Mb/d of refined products passed through Hormuz last year, and today this supply has dried up. For the time being, there do not appear to be any alternatives, apart from a Saudi project for 2Mb/d, while Russia, having been hit by Ukraine, has lost significant refining capacity.

Building new refineries outside the Gulf will take time and will be costly.

The evolution of demand:

Global oil demand fell by 5%, or 5Mb/d, in the second quarter and the IEA has revised down its demand expectations for this year to -1.6Mb/d, an unprecedented decline that needs to be explained.

The main cause is the decline in Chinese consumption, down 1.6Mb/d in the second quarter. In 2025, China, the world's largest importer, was buying 11Mb/d. Half of this came from the Middle East. In the second quarter, this share fell to 30% and, overall, imports declined by nearly 5.8Mb/d, or 50%. An apparently surprising decline in a country undergoing industrialisation and supposedly growing. China has used part of its reserves, but nobody knows the volume of these reserves. Some estimate reserves at 1 to 1.4 billion barrels, compared with 350Mb in the United States and 260Mb in Japan. In addition to drawing on reserves, a combination of factors is at play: refineries have reduced their exports of jet fuel, diesel and gasoline and lowered their utilisation rate to 70%, coal consumption has increased, and air travel has fallen by 7%.

An important point to bear in mind is that, thanks to the effects of the energy transition and the desire for energy independence, the decline in Chinese demand appears to have an undeniably structural component. Rystad Energy estimates this decline at between 0.2Mb/d and 0.6Mb/d.

The beneficiaries of the current situation:

Non-OPEC producing countries: the example of Venezuela.

Exxon and Chevron, wary following previous nationalisations in the 1970s and early 2000s, are hesitant to invest, but a small Californian company, Pacific Coast Energy, is interested, while Trafigura and Vitol are handling the sale of the production. We can therefore expect an increase in the country's production. However, this will take time because the country has lost many engineers, its infrastructure is deteriorated and, even though the country has the world's largest reserves, this is heavy crude requiring specific processing. Nevertheless, US refiners in the southern states are well equipped.

Oil companies:

They are benefiting from the rise in oil prices. For example, the five largest global oil companies are expected to generate an additional \$75 billion in free cash flow this year. TotalEnergies thus recorded record profits of \$5.4 billion in the second quarter. Shell did as well. Exxon's profits more than doubled. Chevron, Marathon and Valero also reported record results. In Saudi Arabia, despite the war, Aramco generated \$33 billion in profits in the second quarter, with revenue up 22%.

Among oil companies, the big winners are refiners. Margins on refined products are currently very high, as the increase in product prices is far greater than that of crude. The "crack", that is, the margin, on kerosene has risen from \$25 at the beginning of the year to \$76 today. For diesel, the gap is even greater, from \$20 at the beginning of the year to \$77 today. For gasoline, the increase is smaller, from \$12 at the beginning of the year to \$35 today.

US refiners are operating at full capacity and exporting record quantities of diesel and jet fuel because 5Mb/d of capacity, out of global consumption of 65Mb/d of gasoline and jet fuel, is unavailable in the Middle East and Russia. As we know, Russia, weakened by destruction at its refineries, has halted its exports, and so has China because it wants to prioritise its domestic market.

Gas producers:

Gas prices remain high because the level of storage in Europe, at 61%, remains low compared with an average of 74% at this time of year. This is the second-lowest level since 2011. The same trend is evident in Asia, even though new LNG capacity is available.

Some countries, such as Belgium, continue to turn to Russia for their gas supplies, but the EU wants to put an end to this.

The energy transition:

Notwithstanding Trump's positions, the United States is installing record solar and wind capacity because there is demand for additional electricity generation, 40% by 2035 according to consultant ICF, and solar and wind are the fastest ways to develop electricity generation. In addition, as the removal of subsidies decided by Trump takes effect at the beginning of July, many projects were started at the beginning of the year.

In solar, China is the undisputed leader with 80% of the global market, but overcapacity is so significant, at twice global demand, that even Chinese companies are losing money. More than 40 Chinese companies have disappeared and workforce reductions have reached 30%. Longi, the global Chinese leader, lost \$280 million in the first quarter. Jinko Solar and Triana Solar, other major Chinese players, are also making losses.

Nuclear:

All major countries are engaged in development programmes. By 2050, according to the IEA, one-third of the increase in capacity will be in China. China plans to increase its nuclear capacity by more than 40% by 2030. China thus wants to achieve energy independence and reduce coal-fired power generation.

China has a major advantage in construction costs. Power plants are built by state-owned companies, financed 70% by debt at preferential rates below 1.4%, whereas in Western countries companies are often private and debt rarely exceeds 30% of financing needs, according to the IEA.

In the United States, the government is offering \$17 billion in subsidised loans to accelerate the development of 10 new reactors.

The producers of electric vehicles:

In China, more than half of new vehicles are electric, and globally the IEA anticipates a figure of 29% in 2026, compared with 25% in 2025.

China is benefiting from the Iranian conflict and is therefore the major winner from the development of electric vehicles. Already in 2025, three-quarters of the electric cars sold worldwide were Chinese. In the first half of the year, exports of electric vehicles increased by 120% compared with the first half of 2025. In emerging markets, China has a 60% market share of electric vehicles, compared with a 10% market share for traditional vehicles. Producing an electric car costs 35% less in China than in Europe because labour is cheaper. The five leading Chinese manufacturers accounted for 12% of vehicle registrations in Europe in June, compared with 7.7% in the same month last year.

It is not just cars. Trucks as well. In China, according to an ICCT study, the electrification of trucks is developing rapidly. As many as 230,000 trucks weighing more than 13 tonnes were sold in 2025 (5,000 in Europe in 2025), three times more than in 2024. This year, these sales account for nearly 30% of this segment. China is also developing hydrogen-powered trucks. For medium-sized trucks, the percentage of electric vehicles sold in 2025, 22% in China, was close to the European figure of 21%.

Conclusion: "Water will be more important than oil this century" Boutros Boutros-Ghali.

The former United Nations leader was right, but it is too early to reduce our exposure to oil stocks. An end to the Iranian conflict could trigger a fall in oil prices, but the outlook is far from clear. The decline in prices will be limited by the need to rebuild inventories in Western countries and increase them in many emerging countries, such as Pakistan and the Philippines, which have been badly affected this year.

We are also positioned in nuclear power and the development of electricity demand.

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