A Key Choke Point

- Tensions are mounting between the US & Iran
- Around one-third of the seaborne trade in oil passes through the Strait of Hormuz
- Only limited unused pipeline capacity to offset potential loss

While the US/China trade talks remain the main focus for markets this week, it’s worth highlighting developments in the Middle East where the deployment of the USS Abraham Lincoln Carrier Strike Group and a bomber task force to the region, as well as comments from John Bolton are the latest sign of a ratcheting up of tensions.

These followed comments last week from Iran’s chief of staff for the armed forces, Major-General Mohammad Bagheri. He said that if Iran could not ship its crude exports through the Strait of Hormuz, other countries would not be able to do so either. He stated: “We have no intention to shut down the Strait of Hormuz unless the enemies leave no other choice for us. The US navies know who is in charge of security.”

The debate over Iran’s ability to close the Strait of Hormuz has been going on since the early 1980s.
Although it’s tempting to dismiss this as sabre rattling by both sides, it should be noted that the debate over Iran’s ability to close the Strait of Hormuz has been going on since the early 1980s.

It’s therefore worth recalling a report published in January 2012 by the Centre for Strategic and Budgetary Assessments which argued that “Iran, in particular, has been investing in new capabilities that could be used to deter, delay or prevent effective US military operations in the Persian Gulf. Iran's acquisitions of weapons that it could use to deny access to the Gulf, control the flow of oil and gas from the region, and conduct acts of aggression or coercion, are of grave concern to the United States and its security partners.”

In other words, it may be possible that the Strait could be temporarily closed by Iran should it choose to do so.

To put this into context, the EIA estimated back in 2017 that around 18.5 million barrels a day was travelling through the Strait (approaching one-third of all seaborne trade). About 80% of this oil went to Asian markets with China, Japan, India, South Korea, and Singapore the largest destinations.

The EIA also highlighted that “most potential options to bypass Hormuz are currently not operational”. In particular Saudi Arabia and the UAE’s unused pipeline capacity only amounted to roughly 3.9 million barrels per day.

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This comes at an interesting time for oil markets globally. While in the short term, developments in US/China trade talks have proved the dominant driver, there’s an argument to be made that the continued growth in US shale production is working to offset many of the constraints that have emerged recently (sanctions on Venezuela, violence in Libya, supply disruptions from Russia).

Nevertheless, the speed with which the US has responded

2. China/US: The People’s Daily says in an editorial that China has “full confidence” to deal with difficulties and challenges that may arise during its trade talks with the US. It adds that “what matters most now for China is to stay calm” and states: “Don’t underestimate China’s resilience and strategic determination”.

3. New Zealand: The RBNZ cuts the OCR by 25 bps to a record low of 1.5%. It cites slow global economic growth and the need to support employment and boost inflation as the key factors behind the move. Governor Adrian Orr notes that the U.S.-China trade war and growing trade barriers were one of the bank’s major concerns.

4. Japan: Minutes of the March meeting of the BOJ policy board show that while most members saw no immediate need to expand the current programme, several warned of heightening risks to Japan's
to the comments from Iran helps highlight the scale of the threat. Hardly surprising when the oil exports of Venezuela (1.596 mn bpd), Libya (792,000 bpd) and Russia (5.06 mn bpd) amounted to only about 40% of the amount going through the Strait on a daily basis in 2017.

Beyond the more direct currency implications should tensions rise further in the region and oil prices resume their uptrend, it’s also worth recalling the broader impact rising crude prices had in the summer of 2008.

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**On the Radar**

**May 8, 2019**

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**Geopolitics & Volatility**

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