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The Iran Conflict and Oil Markets

FIRST CAPITAL RESEARCH

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***Please refer page 18 for an important disclaimer*

Iran Conflict Continues to Reshape Global Oil Markets

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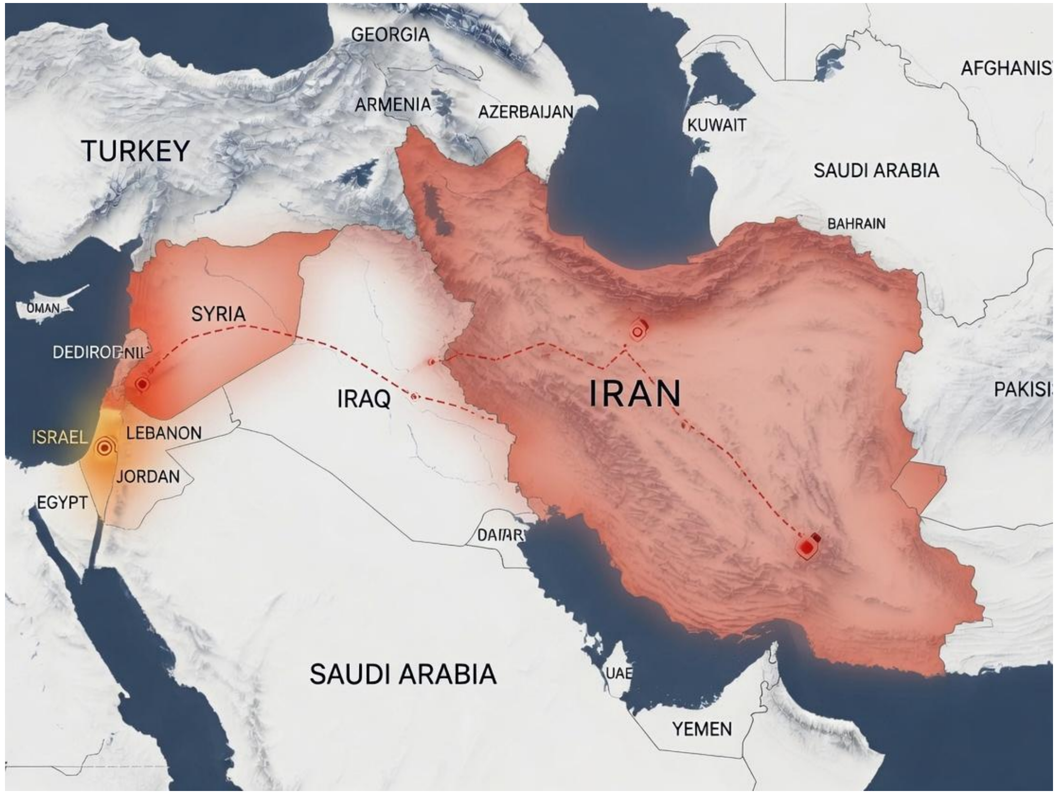
- Entering its sixth month, the conflict continues to elevate geopolitical risk across global energy markets.
- Disruptions in Hormuz and the Red Sea have exposed vulnerabilities in global crude supply chains.
- While alternative export routes provide partial mitigation, capacity and security constraints remain significant.
- Oil prices continue to be driven by the interaction between supply disruptions, demand dynamics, and evolving diplomatic developments.



Oil markets are transitioning from a supply-shock narrative to a de-escalation narrative, leaving Brent supported by geopolitical risk but capped by weakening demand.

Conflict Evolution: February-August 2026

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Feb 28
War begins
U.S./Israel strikes kill Khamenei; Iran closes the Strait of Hormuz.

Mar 19
Wave 1 airstrikes
3 vessels attacked in Hormuz; U.S. strikes back – roughly 80 targets.

Apr 8
Ceasefire agreed
Pakistan-mediated truce; extended indefinitely Apr 21 after early violations.

Apr 13 - May 29
Naval blockade
U.S. runs a naval blockade of Iranian ports alongside the ceasefire.

Jun 17
MoU signed
60-day extension; talks widen to Hormuz, the nuclear program, and sanctions.

Jun 20
Hormuz re-threatened
Iran again declares the Strait “closed” amid a dispute over the Lebanon front; CENTCOM disputes the claim.

Jul 24
Vessel fired on
U.S. forces fire on another merchant vessel transiting the strait.

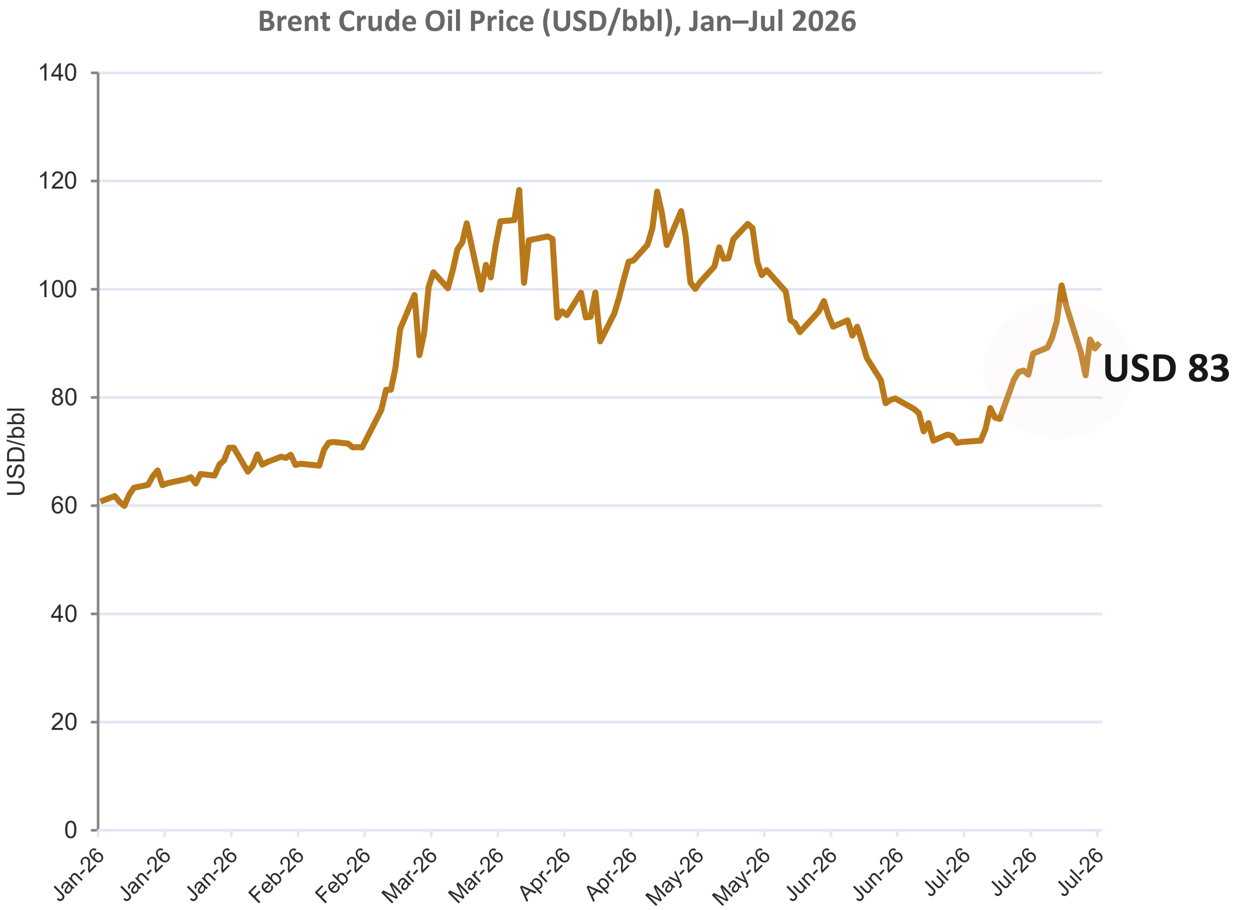
Jul 26 - 27
Pause holds

Jul 28
Re-escalation triggered
By Iranian attacks and U.S.–Saudi retaliation.

Aug 02
Pause holds
Trump suspends planned strikes and signals openness to negotiations.

Brent Remains Supported by Geopolitical Risk

- The conflict added a significant geopolitical premium to Brent prices over the past six months. Brent surged from about USD60/bbl to nearly USD120/bbl as supply disruptions intensified.
- Diplomatic progress and easing supply concerns subsequently pulled prices lower.
- Renewed tensions in Hormuz and the Red Sea triggered a fresh risk-premium rebound.
- Despite continued volatility, Brent remains materially above pre-conflict levels.



Supply-Side Risks Remain the Primary Upward Driver of Oil Price

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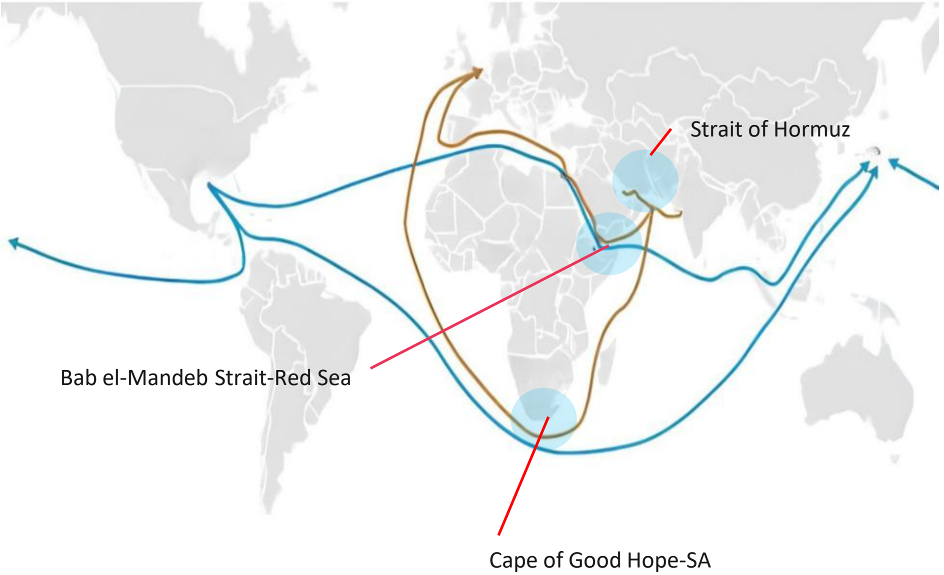
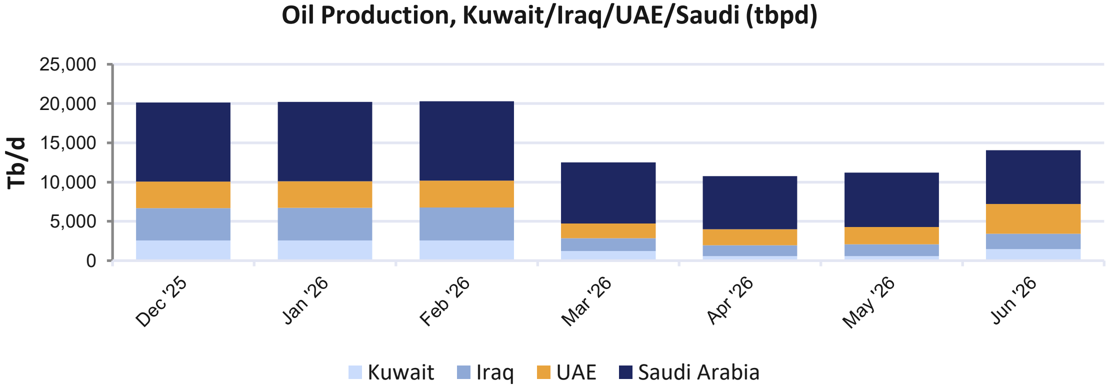
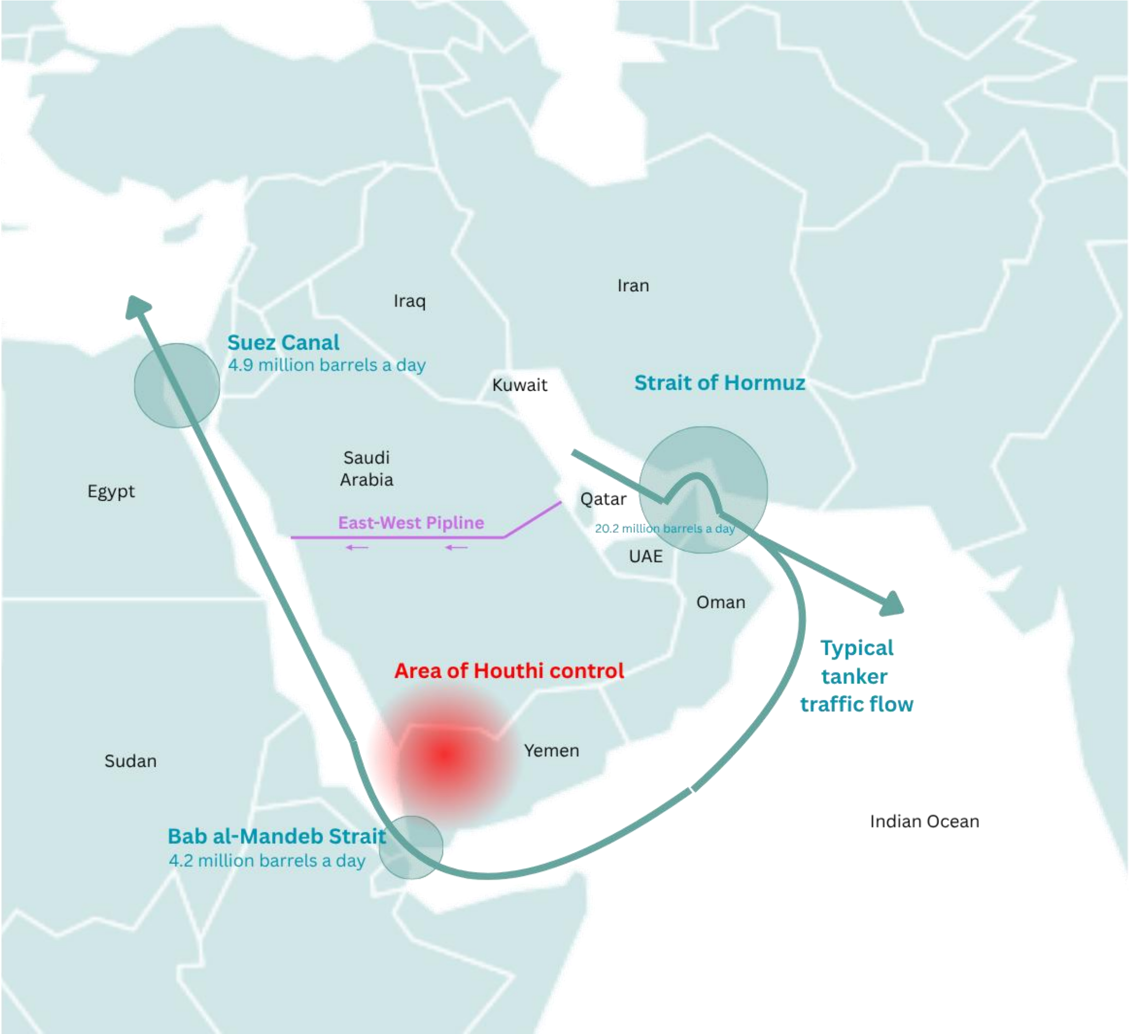
- The Hormuz disruption highlighted the strategic importance of Gulf export routes and infrastructure.
- Vessel traffic through the Strait of Hormuz fell by over 90%, while production across Saudi Arabia, Iraq, Kuwait, and the UAE declined by about 6.7 mbpd.
- Alternative routes via Bab-el-Mandeb and the Cape of Good Hope increased transit times and freight costs.
- Despite a gradual recovery in oil flows, Middle East geopolitical risks continue to support oil prices.





Red Sea Disruptions Reinforce Gulf Supply Vulnerabilities

- Saudi Arabia's East-West Pipeline provides a strategic bypass to the Strait of Hormuz through the Yanbu export terminal.
- Despite this alternative corridor, export flexibility remains constrained by Yanbu's limited terminal capacity of approximately 4.0-4.5mbpd.
- Iran-backed Houthi attacks continue to disrupt Red Sea shipping, increasing transit times and freight costs through diversions around Africa.
- Simultaneous risks across Hormuz and the Red Sea reduce regional export resilience and amplify global supply vulnerabilities.



Near-Term Alternative Routes Fall Short of Replacing Lost Supply

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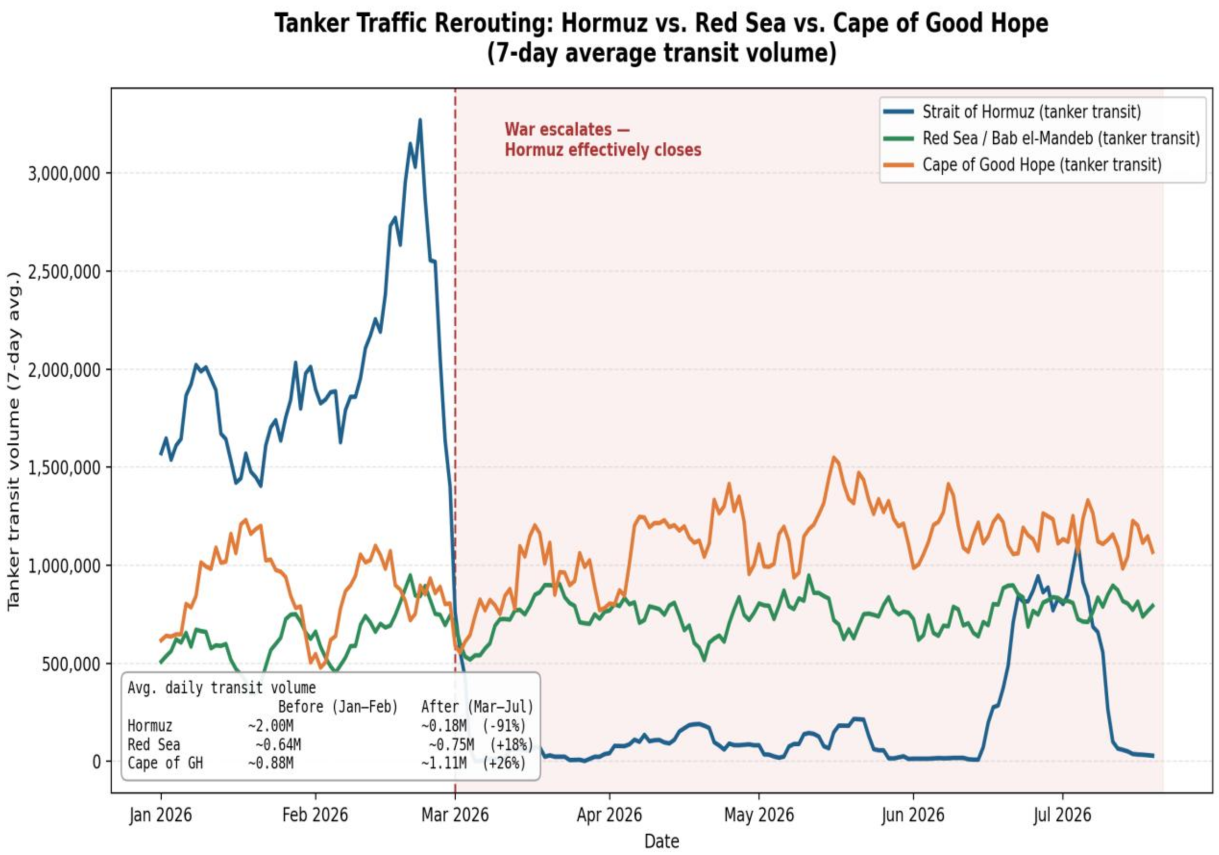
- Alternative route traffic rose after the Hormuz disruption, with Cape of Good Hope volumes up 26% and Red Sea traffic up 18%.
- Rerouted flows increased by roughly 320 kbpd, partly offsetting export disruptions.
- However, these gains replaced only a fraction of the estimated 1.8 mbpd decline in Hormuz transit volumes.
- Longer routes raised freight costs and transit times, leaving an estimated supply shortfall of about 1.5 mbpd.

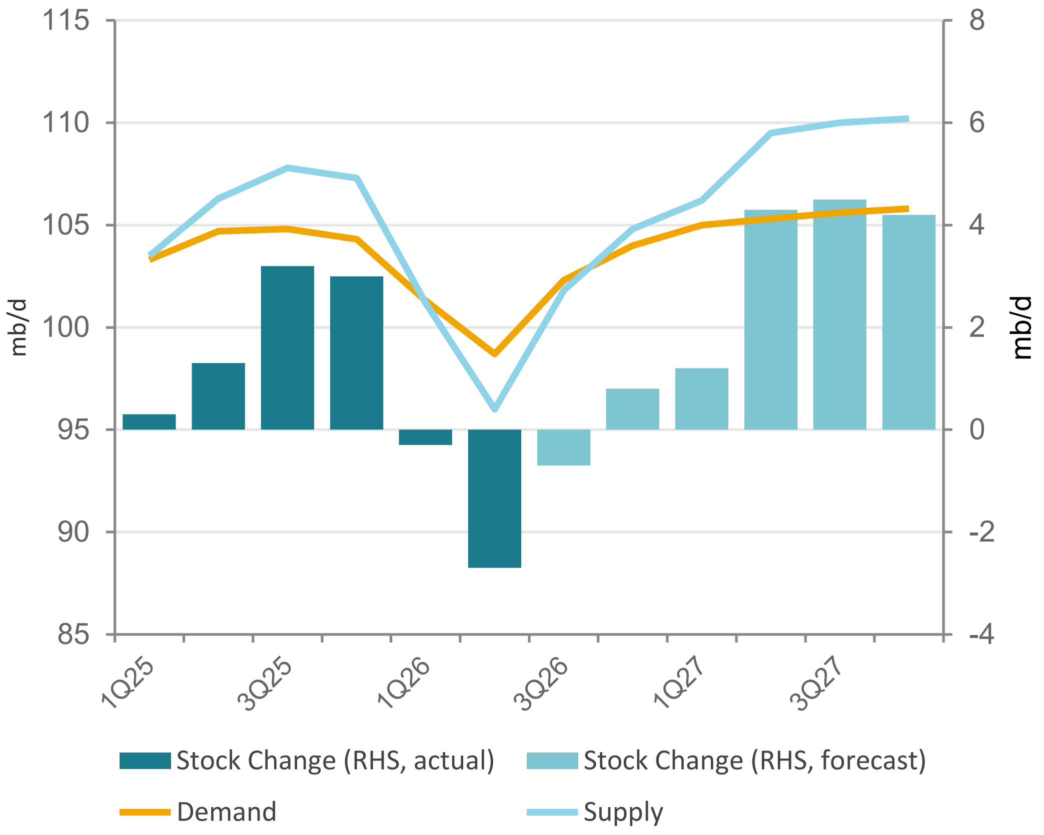


Sources: IMF PortWatch, WTO Hormuz Tracker

Medium-Term Supply Surplus Could Cap Oil Prices

- Recent oil market tightness reflects transport disruptions rather than permanent production losses.
- As Gulf export routes normalize, Middle Eastern production and exports are expected to recover.
- The IEA's 2027 outlook suggests supply growth could outpace demand growth, creating surplus conditions.
- While near-term geopolitical risks support prices, inventory rebuilding and excess supply could limit medium-term upside.

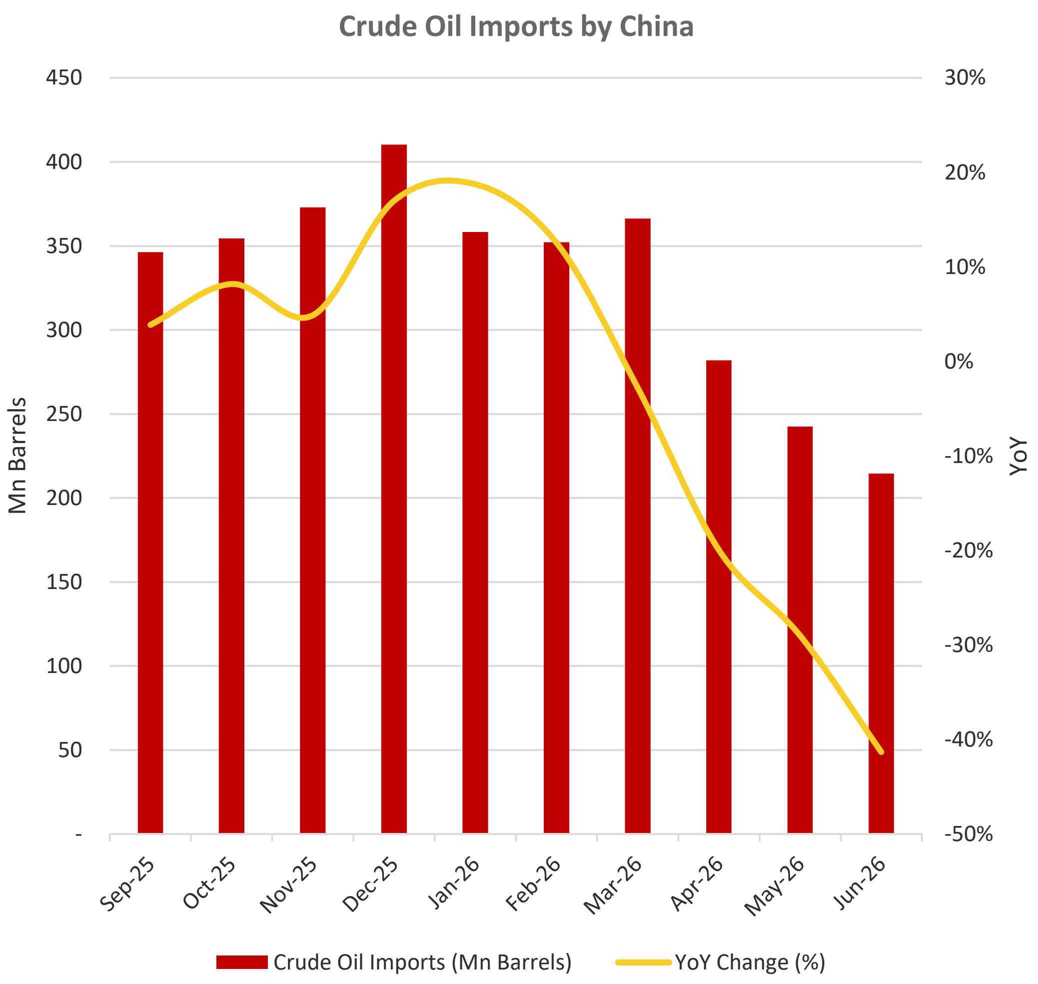
Oil Supply & Demand Balance



Source: IEA

Demand Weakness Is Increasingly Offsetting Supply-Side Risks

- Crude imports into China and Japan have weakened as refiners draw down inventories rather than absorb elevated war-risk premiums.
- Higher oil prices are accelerating demand destruction across key consuming markets.
- Reflecting softer demand conditions, the IEA has lowered its 2026 global oil demand growth forecast by 80,000 bpd.
- Demand weakness is increasingly offsetting supply-side disruptions; however, a meaningful supply-demand imbalance persists.



Source: Bloomberg

Positioning Reflects Hedging, Not Speculation

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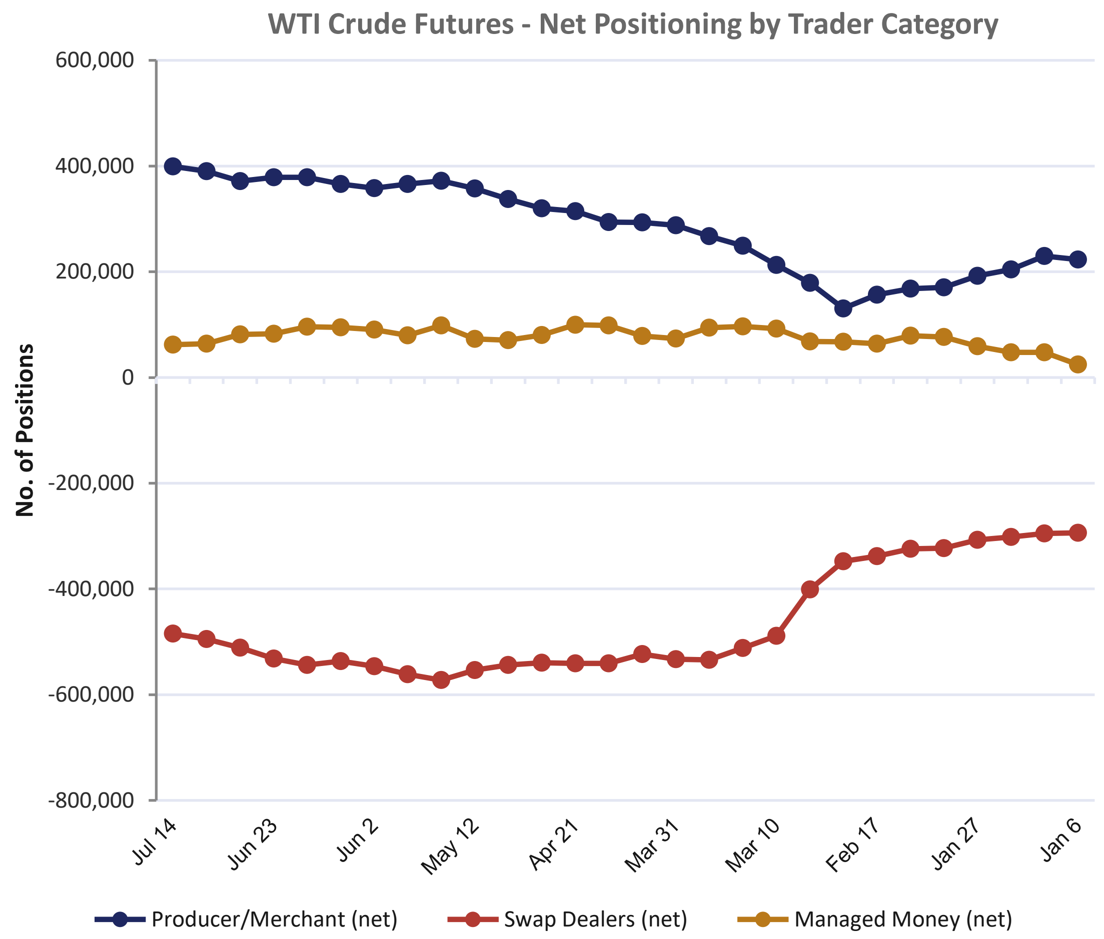
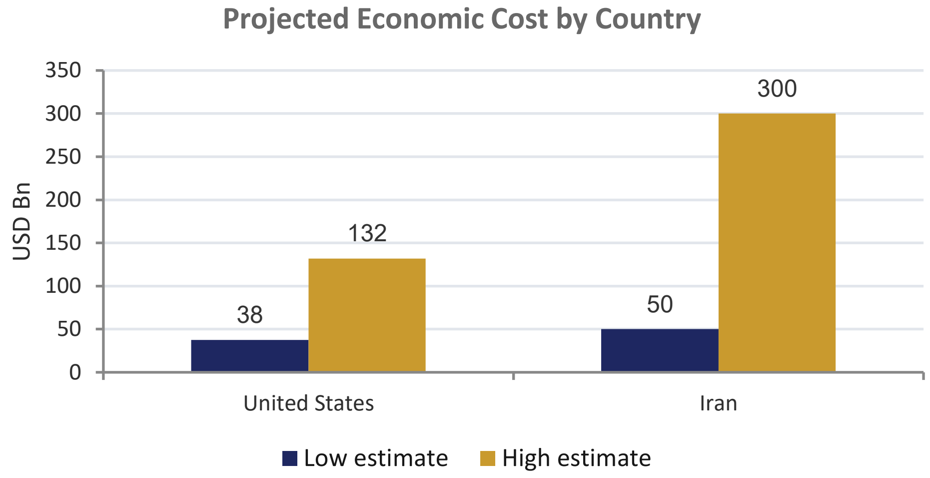
- CFTC positioning data provides insight into how key market participants are positioned across oil futures markets.
- Recent positioning trends suggest the rally has been driven primarily by commercial hedging activity rather than speculative buying.
- Managed Money participants, a proxy for speculative investors, reduced net long exposure as geopolitical tensions intensified.
- This reflects concerns over physical supply disruptions, while limited speculative participation reduced the likelihood of a sustained price spike.



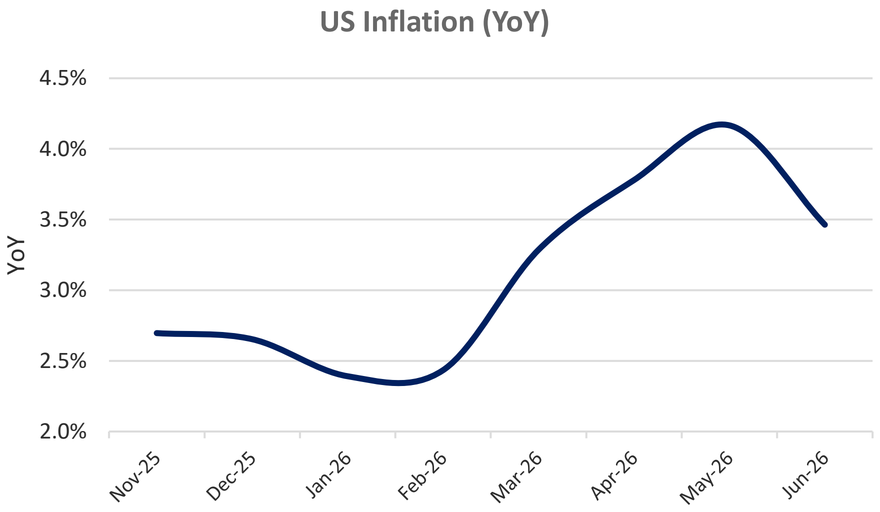
Source: Commodity Futures Trading Commission (CFTC)

The Cost of Conflict Is Rising for Both Sides

- The U.S. faces estimated economic and military costs of USD 25-88bn, alongside rising inflationary and fiscal pressures.
- Iran's economic losses are significantly larger, estimated at USD 144-300bn, equivalent to as much as 40% of GDP.
- Under a prolonged disruption scenario, Iran's oil export revenues could decline by up to 95%.
- The growing economic burden on both sides increasingly strengthens incentives for de-escalation for both parties.

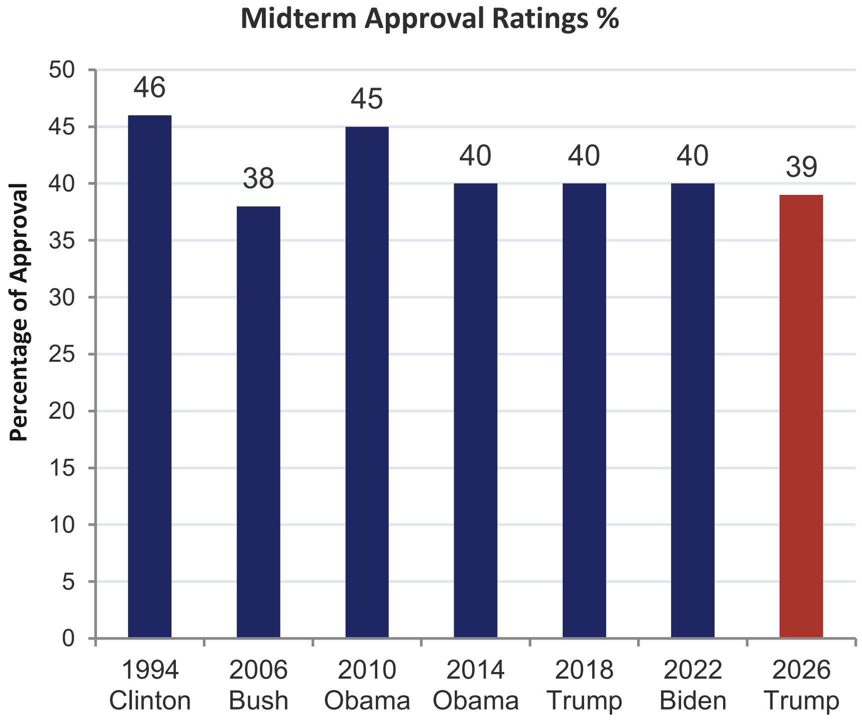


At the moment senate support for the proposed additional USD 95bn war funding package remains pending.



U.S. Midterm Elections May Influence Foreign Policy Direction

- The November 2026 midterm elections will determine control of Congress, increasing the political importance of economic and foreign policy outcomes.
- Trump's 39% approval rating is below most recent midterm comparables, increasing the risk of congressional losses.
- Inflation, energy prices, and conflict-related costs are becoming increasingly important voter concerns ahead of the elections.
- These dynamics strengthen incentives to pursue policies that reduce economic disruption and geopolitical uncertainty.



Trump's current approval rating of 39% is below most recent midterm comparables.

Source: Gallup; latest polling data

Political Incentives Favor a De-escalation Narrative

- The administration is likely to pursue a visible foreign policy achievement ahead of the 2026 midterm elections.
- Recent diplomatic initiatives, including the Gaza proposal, signal a growing preference for negotiated outcomes.
- These developments could provide a framework for broader engagement with Iran.
- A prolonged conflict and elevated energy prices risk becoming a growing political liability ahead of the elections.

Jul 31	**Gaza proposal announced** Opening diplomatic move
Aug 2	**Trump suspends planned strike** Military option pulled back
Aug 2	**Saudi pressure for de-escalation** Regional partner pushes restraint
Current	**Qatar/Pakistan/Oman mediation continues** Active diplomatic channel

Momentum has shifted from escalation to negotiation

The "Victory" Narrative Supports a Negotiated Outcome

- A negotiated outcome with Iran could support de-escalation while preserving a "victory" narrative ahead of the 2026 midterms.
- Recent diplomatic initiatives suggest a growing preference for outcomes that can be framed as strategic achievements.
- However, a negotiated settlement may reduce tensions without fully resolving underlying regional risks.
- Iran's proxy network remains active, leaving the potential for intermittent flare-ups despite any formal agreement.

"...that shows you how much success we're having with Iran. Because if you go four or five months ago, a deal like that would have been impossible."

— Trump, Jul 31, 2026

What We Expect Between Now and the Midterms

- Diplomatic engagement is likely to remain the primary mechanism for managing tensions.
- Intermittent flare-ups remain possible, particularly through regional proxy groups.
- A comprehensive settlement appears unlikely, with underlying regional risks expected to persist.
- Market focus is likely to shift gradually from conflict escalation to broader demand fundamentals.

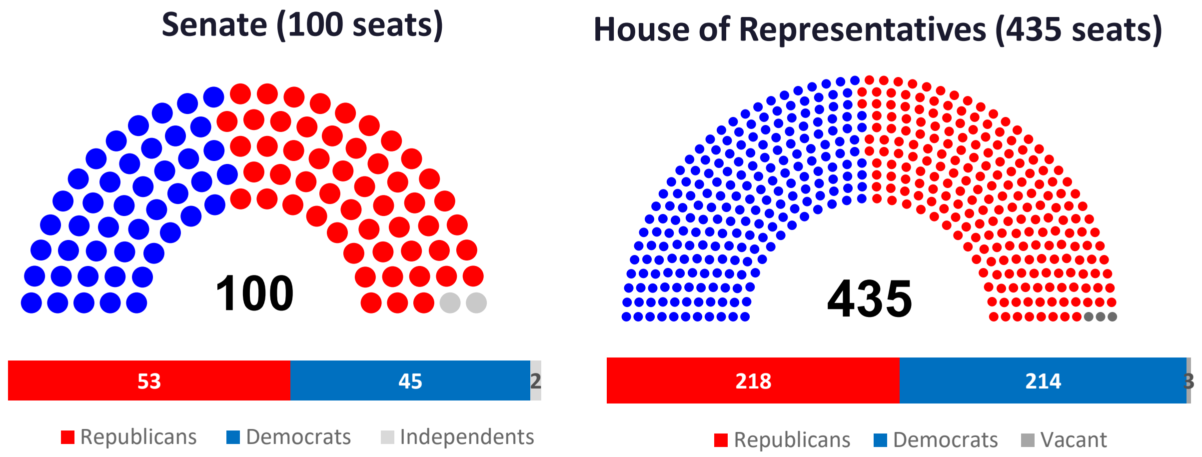
"Based on this request, I have agreed, for the future benefit of the WORLD and, likewise, the survival of a successful and prosperous Iran, to cancel the attack, subject to being able to rapidly make a DEAL."

— Trump, Aug 2, 2026

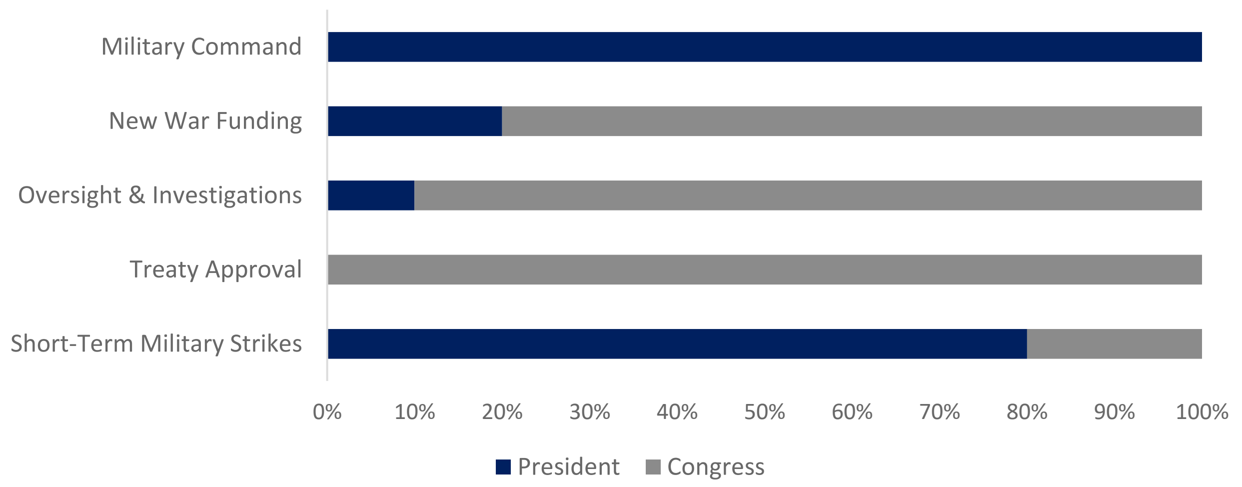
What a Democratic Congress Could Mean for Iran Policy

- A Democratic Congress would likely increase scrutiny of Iran policy and future military engagement.
- Conflict-related funding and defense spending could face greater debate and oversight.
- Congressional investigations into strategy, costs, and execution may become more frequent.
- However, a material shift in U.S. Iran policy would remain challenging, as presidential vetoes require a two-thirds congressional majority to override.

Current Congressional Composition



President vs. Congress: Levels of Authority



Sources: U.S. Congress, CRS, FC Research

Near-Term Oil Prices Are Likely to Remain Range-Bound

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- Supply risks continue to support oil prices, but weaker demand is limiting further upside.
- Rising economic and political pressures increasingly favor de-escalation.
- Any agreement with Iran may reduce tensions, though regional proxy risks are likely to persist.
- Greater congressional oversight could increase political friction, but is unlikely to materially alter U.S. policy.
- As a result, Brent is likely to remain range-bound, supported by a geopolitical risk premium but capped by softening demand.

▲ CAPS THE UPSIDE

Demand destruction - every leg higher in price accelerates the drop in demand seen from China and Japan, which pulls the market back down before it can break out.

▼ PUTS A FLOOR UNDER IT

A fragile, unfinished peace - plus Saudi Arabia's East-West Pipeline bypass - keeps a floor under prices even as talks progress, because neither the war nor the chokepoint risk is fully resolved.

Most likely near-term path: Brent $75–100/bbl

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