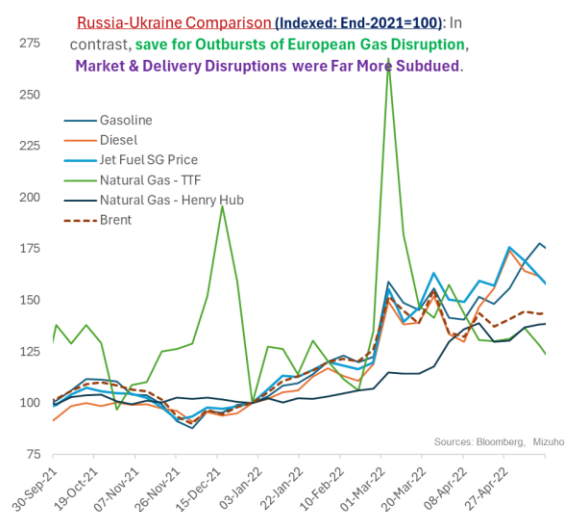
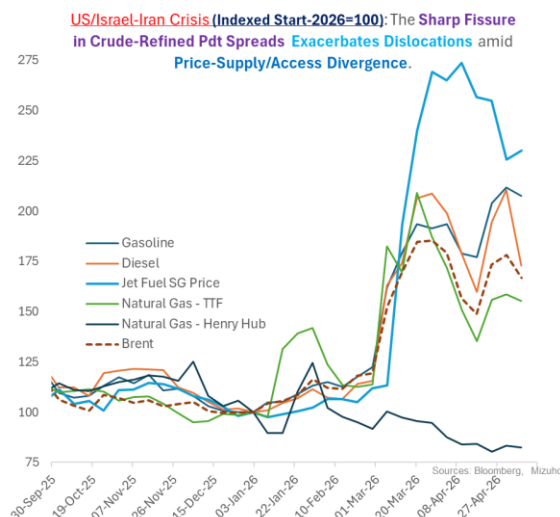


## A Splintered Oil Shock

“Never trust to general impressions ... but concentrate yourself upon details.” – Sherlock Holmes, *A Case of Identity*

- Unlike more “synchronized energy shock” from **Russia-Ukraine**, the **US/Israel-Iran war** is a far more problematic “splintered oil shock”.
- Which involves *amplified, asymmetric, uneven* and *non-linear shocks* delivered via **compromised physical delivery** and **unevenly impacted crude/refined product markets**.
- Specifically, markets must now contend with:
  1. **Uneven Crude Benchmark Spreads**: This reflects *uneven production disruptions with less elastic supply offset*, as determined by the evolving conflict. And *fractured crude benchmarks* mean *cracking oil correlations* with markets and the real economy.
  2. **Sharper Refined Squeeze**: Sharper squeeze (and corresponding price surge) in refined products that **disproportionately raises economic costs/subsidies**. In turn, *accentuating inflation impact and negative sensitivities (economic and fiscal) to higher crude prices*.
  3. **Variable Physical Premium**: **Exceptionally acute “backwardation”** *accentuated by threats of activity disruptions* from **severe** and **economically consequential physical supply shortfall**. More seriously, *uneven access to supply can impose varying delivery premiums that emphasize pre-existing disadvantages/vulnerabilities*.
  4. **Lags & “Non-Linearity”**: *Risk of non-linear supply-shocks will mount as inventories are depleted*. and constraints of production/shipping lags suddenly hurt hopes of a truce.
  5. **Elevated Shipping & Insurance**: More unstable regional conflict dynamics suggest **stickier surge in shipping costs** and **insurance premium**, *materially raising/adding to baseline energy costs*.
- Most of which is **disproportionately disadvantageous** to *already compromised EM, low-income, “twin deficit”, net energy importers*.



- To be sure, **recency bias** predisposes us to the **temptation of comparing this oil shock (“Iran shock”)** *with the Russia-Ukraine episode*.
- That is **understandable, helpful even, as a starting point. But mechanically mapping to Russia-Ukraine risks being flawed**.
- Fact is, without clear-eyed appreciation for **distinct** and **defining differences**, surface level comparisons are susceptible to **critical pitfalls**, if not outright failures, **in risk assessment**.
- For a start, the **“Iran shock” is of a far greater order**, with **strains on production and passage** are **far more profound** and **pervasive** this time.
  - Resultant **pain is not just magnified** but **potentially compounded** as **upstream shocks cascade and interact** across supply-chains.
- Notably, the **widening Middle East crisis**, with *highly fluid military/diplomatic outcomes*, render the **amplitude** and **incidence of energy shocks highly-variable**.
  - **Uneven shock transmissions**, determined by energy-/supply-dependencies will drive **more distinct divergences** (hurting some energy importers more than others).
- What’s more, there may be a certain **asymmetry of adverse supply- and demand-mechanics as the war prolongs** given binding **bottlenecks** and **lags amplifying pain**.
  - For one, **as inventories are drawn down non-linear intensification of shock transmissions** becomes a more distinct threat.
  - More so as *secondary\* cascade of supply disruptions* (downstream) compound adverse demand impact.
- Moreover, **spillover threats to navigation** have resulted in **steep increases in shipping costs – freight and insurance – that may endure longer than the conflict**.
  - Effectively, **shipping will feature prominently and more persistently** as a *significant share of energy import costs*, likely *raising the floor for energy costs*.
- Troublingly, **access to increasingly supply-constrained** and *strategically sought-after crude/refined/downstream* products **will favour means** and (geo-political) **might**.
  - Inevitably, this will *deepen*, and potentially *entrench, divergences* (as sensitivities/dependencies), and *attendant pre-existing disadvantages/vulnerabilities*.
  - *Post-trauma strategic stockpiling* (at least in the interim as alternatives are established) may only serve to *prolong* and *deepen* the *pain*.
- All said, *even when a US/Israel-Iran truce is reached*, the nature of this **splintered oil warns of prolonged ripples from the “Iran shock”**.
- Which will **disproportionately hurt** (already disadvantaged) EM energy/commodity importers with “twin deficit”, *tourism/farm exposures* and *limited tech/industrial offset*.
  - **FX:**
    - a. **Depth of (subsequent) USD pullback on relief from truce** may be **checked by lingering EUR drag** from long shadow of “Iran shock”. But BRL, AUD, NOK and CNH may regain/retain ground better.
    - b. Within the AXJ space, **North Asia FX** is *generally* set to **outperform INR** and **ASEAN FX**.

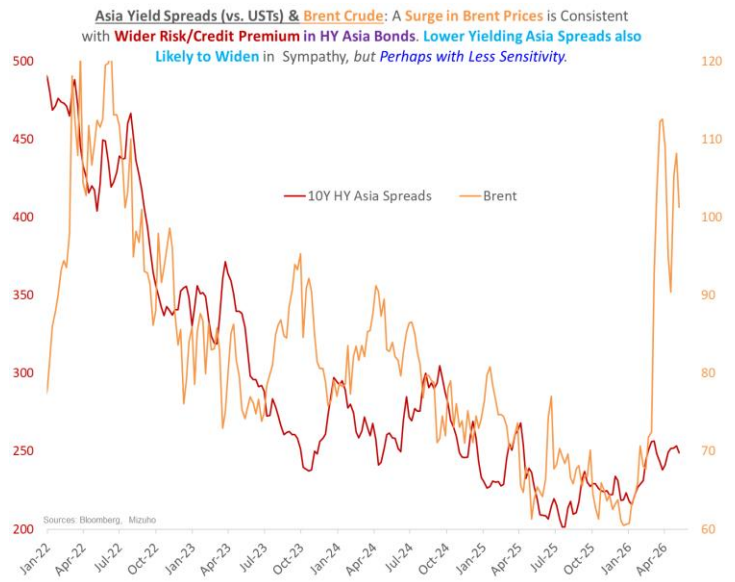
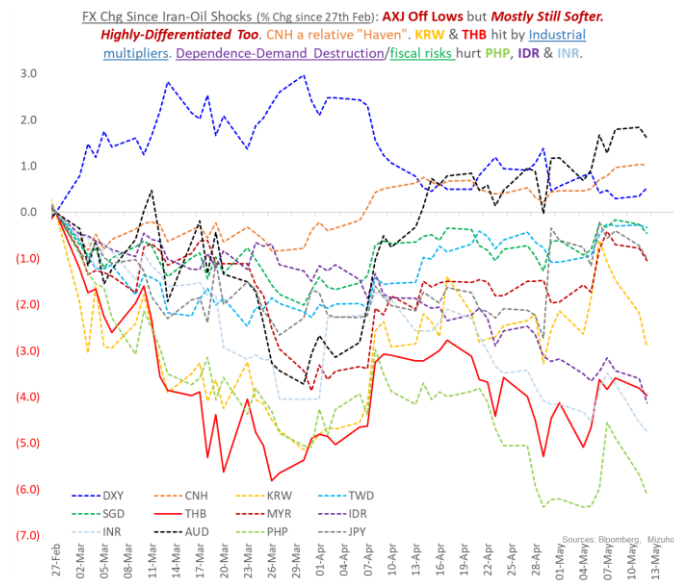
- c. Specifically, a **basket of SGD-CNH-TWD** are well-placed to **outperform** against a **basket of PHP-INR-IDR**.

- **Rates:**

- a. Past the initial bear flattening bias (on rate hike bets), higher and more uncertain energy prices ought to deliver a steepening bias in global yields\*\*.
- b. Specifically, **higher yielding** (e.g. INR and IDR) **Asia bond curves will likely see widening spreads** vs. USTs.
- c. Within the AXJ space we expect **wider spreads between low-yielders** (KRW-SGD-MYR) **against high-yielders** (INR-IDR)

\* Outside of the Middle East

\*\*So long as recessionary outcomes are averted.



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