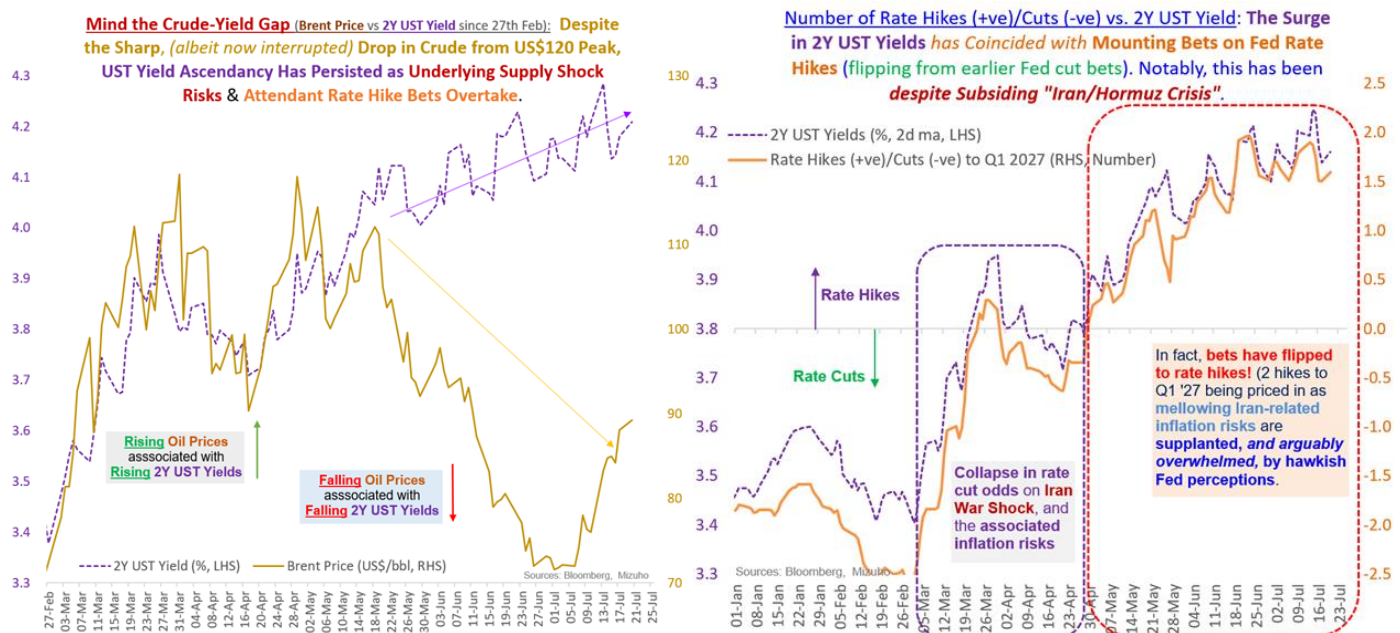


Un-Yielding Risks Defy Oil's Respite

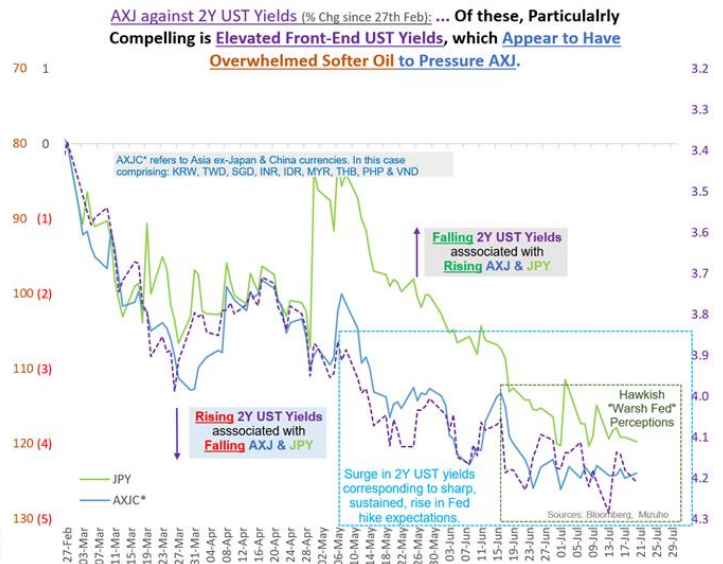
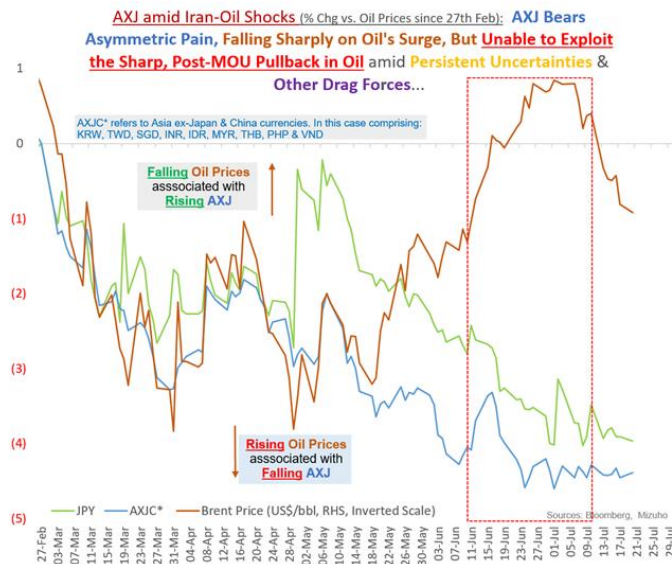
"Well! I've often seen a cat without a grin, but a grin without a cat! It's the most curious thing I ever saw in my life!" – Alice in Wonderland



- Admittedly, (Brent crude) oil prices have retraced back below \$90, on reports of a 10-day truce deal being floated – consistent with the broader trend of softer crude oil since mid-May on hopes of a negotiated truce.
- But this **10-day truce**, even if a realistic prospect, is fraught with irreconcilable tensions that keep risks intact.
- For one, the bigger geopolitical picture instead suggests that **US-Iran divergence has sharpened**, flagging greater risks of descending back into attacks and retaliatory strikes.
- Second, the **Houthi's threat to blockade Saudi oil flow via the Bab-el-Mandeb** (the Red Sea route) simultaneously raises the threats of;
 - Sharply higher oil prices** on further supply shocks if Saudi oil re-routed through the Red Sea is even temporarily disrupted, and;
 - Widening Middle East war** (instability) as the risk of greater Saudi involvement in the conflict hardens.
- Finally, the comparatively **unyielding bond markets** have ostensibly disregarded noise around interim truce, at odds with Crude shocks quelled, to price underlying energy shock risks.
- And the **attendant policy response** (hikes) that is reflected in UST yield ascendancy that's been largely unfettered interim de-escalation (since mid-May).
- Partly because **misleadingly softer crude prices conceal much higher effective cost of energy/fuel** – and by extension, **inflation** and **fiscal risks** – via **materially higher shipping/insurance costs** as well as **record cracks***.
- What's more, crude prices have been **unusually dampened/dragged** by **exceptional** and **likely unsustainable**, aggregate **supply response** that has tapped and burnt through inventory/reserves.

- But in any case, **significantly elevated UST yields** (2Y: 4.2% | 10Y: 4.6% | 30Y: 5.1%) *despite softer oil*, amid prevailing **crude-yield gap**, **inevitably poses a headwind** to both the **real economy** and **markets**.
- Meanwhile, **JPY and AXJ are particularly prone to slippage** a, **defying the usual negative correlation with crude**, as the conspiracy of **higher UST yields** and **heightened uncertainty** overwhelm.
- All said, **softer oil** is merely the “**grin without (the) ... cat**” – the *elusive feline being bona fide geoeconomic relief*.

* “Cracks” are the premium over crude prices that needs to be paid for refined products such as diesel, jet fuel, kerosene etc.



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