



Economists warn Middle East war to hit households through oil price spike but say fallout could be short lived



Economists warn Australian households face fresh cost of living pressures in the form of higher petrol bills, as the Middle East war sees oil prices spike. However, markets have had a fairly modest reaction to the strikes on Iran, with analysts noting that the conflict may be short lived.

The local share market was down around 0.2 per cent with less than an hour of trade remaining on Monday afternoon, as gains for energy and gold stocks limited losses.

Asian markets were all lower, with Japan and Hong Kong hardest hit, down to the tune of about 1 per cent.

“It remains to be seen how long this conflict will continue”, Betashares Chief Economist, David Bassanese told ABC News.

“Maybe Iran will back down, maybe Donald Trump will be able to strike a deal fairly quickly”.

Mr Bassanese said markets were in “wait and see mode”, as there were some “safety valves” that could be used to cushion the blow to oil supply.

“The other OPEC (Organization of the Petroleum Exporting Countries) members, other oil producing members around the world can step up and provide oil supply if there are restrictions on Iranian output”.

Oil prices spiked when they resumed trade on Monday morning. Brent crude rose above \$US80/barrel before pulling back to be around 6 per cent higher at \$US77.30 at 3:00 pm AEDT. West Texas Intermediate crude was also around 6 per cent higher at \$US71.09.

AMP Chief Economist, Shane Oliver said oil prices could have a significant spike, potentially to more than \$US100/barrel, above the highs seen at the start of the Ukraine war.

That could add around \$14 dollars to the average Australian household’s weekly petrol bill, he said.

Oil shipping already disrupted

Around 20 per cent of the world’s oil production and a quarter of liquefied natural gas move through the Strait of Hormuz, a narrow stretch of water providing entry to the Persian Gulf.

TD Securities analysts noted that even without an official shutdown, an increase in insurance costs has left tankers sitting outside the Strait.

“Insurance premiums have risen at least 50 per cent and shipping is effectively shut down during the active strikes”, they said.

“Oil production is less important for markets right now than the ability to ship it”.

Shipping analysts at Oil Brokerage told clients there has already been major disruption, with the number of vessels moving through Hormuz having “fallen hard”.

The analysts said data based on vessel tracking had become “increasingly unreliable” due to interference with automatic identification systems. However, they have forecast a short-term resolution.

“A drawn out closure of the Hormuz, and/or wider war in the region is unlikely. Political pressure will build on Iran from its own allies and benefactor countries to prevent that”, the Oil Brokerage note read.

“If the position holds and hostilities yield to negotiations, then the disruptions in freight and oil markets will remain solvable”.

AMP’s Dr Oliver has put a 60 per cent probability on the conflict being a “limited war”, with the US President Trump “finding a way to declare victory in the next week or so”.

That does not mean oil prices will quickly ease, however.

“It may take a few days/weeks before this is clearly apparent so oil prices could still go higher”, Dr Oliver wrote in a note.

He has put a 40 per cent probability on what he called the “high risk case”, with a significant disruption to oil supply.

“Trump may lose the gamble with Iran fighting on for longer, forcing the US to stay involved longer. Iran could descend into chaos, as occurred in Iraq and Afghanistan, necessitating US troops on the ground.

“This could mean a bigger and much longer disruption to oil supplies, conceivably resulting in a doubling in oil prices to around \$US150/barrel, which could drive a sharp fall in shares”.

Petrol price pain a ‘tax on households’

Dr Oliver estimated that for every \$US1 rise in oil prices, Australian motorists would see around a cent a litre added to petrol prices.

“A \$US40 a barrel rise in world oil prices taking them above \$US100 a barrel would add around 40 cents a litre with a 7-10 day lag if sustained”, he said.

Based on an average household using 35 litres of petrol a week, he said around \$14 would be added to their weekly fuel bill in that scenario.

While the rise in petrol prices would add to inflation, Dr Oliver said it would also have a dampening impact on growth, as households were forced to cut back on spending elsewhere in the economy.

“In other words, it will act as a tax on households”.

As for how the Reserve Bank would deal with such a scenario – a spike in inflation alongside households being forced to cut back – Betashares’ David Bassanese said it is more likely to see the central bank on hold than hiking interest rates.

“Implications for the RBA would be fairly mixed, with higher global energy prices a negative for consumer spending and sentiment, while also placing upward pressure on headline inflation (fuel accounts for 3 per cent of the [consumer price index])”, he wrote.

“On balance, however, heightened geopolitical tensions, if they persisted and escalated, would tend to make the RBA less likely to hike rates amid such uncertainty”.

Dr Oliver agreed that the equation was not as simple as higher oil prices equalling higher inflation and therefore higher rates.

“Central banks will focus on underlying inflation and higher oil prices threaten economic growth”.

Further information

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Source: ABC

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