Markets as political tools in an energy war

Authors: Francesco Sassi and Giovanni Bettinelli

Since the start of the U.S. and Israeli war against Iran, which has led to the closure of the Strait of Hormuz and to direct attacks on energy infrastructure that severely damaged two LNG trains at Ras Laffan, many commentators have been surprised by the relatively subdued reaction of markets. On one hand, forward prices for the next 12 months have risen well above pre-war levels, indicating a perceived risk that the conflict could drag on that regional energy flows will be affected in the long-term. However, in what has the potential of being the greatest energy crisis in history, the levels reached appear to be nowhere near those required to generate the kind of demand-side response required to balance the market.

This apparently anomalous reaction of markets has reached a new landmark in the last two days. On 22nd March, the White House issued an ultimatum to Iran, threatening direct attacks on Iranian energy infrastructure if the Strait of Hormuz was not re-opened in the following 48 hours. The Iranian response, predictably, was to threaten attacks on all regional energy infrastructure in retaliation, in what could have been yet another dramatic escalation in the impact of the war on global energy balances. These tit-for-tat threats were, then, followed on Monday 23rd March by a sudden announcement by President Trump that that “very good and productive” talks for the “complete and total resolution of hostilities” had been taking place. The same Truth Social statement extended the deadline for the ultimatum by five days. Both Brent and TTF, which had seen a slow rise in prices throughout the day in response to the risks created by the ultimatum, reacted with an immediate collapse of ca. 10%.

This immediate market response occurred despite doubts over the veracity of the claims made by the White House and little clarity over whether Israel has bought into such an effort to resolve the war rapidly. In fact, the reality on the ground appears to be in stark dissonance with a rapid diplomatic resolution and, in the matter of just a few minutes, different authorities in the Iranian regime have denied any diplomatic discussion with the U.S. on ending the war. Attacks on Iranian cities continue, the planned arrival of troops later in April, which could suggest preparation for ground offensive, has not changed. Moreover, as recently as last week, the White House sought $200bn in funding to continue the war.

These facts therefore raise the question of whether the White House’s announcements were just a temporary distraction aimed at calming the market’s concerns over an escalating conflict and a deepening global energy crisis. This could buy the U.S. more time to create more military pressure on Iran and to prepare for a longer war. At the same time, it is also possible to interpret the denial by Iranian sources that any diplomatic process has started as being aimed at limiting the decline in energy prices and maintaining pressure on the White House. There is therefore a concrete possibility that markets are not reacting to a real change in market conditions, or delaying any response, while instead they are manipulated by all actors involved.

While the U.S. and Israel remain dominant and relatively unchallenged from a conventional military perspective, the economic impact of the disruption of trade via the Strait of Hormuz is the primary leverage held by the Iranian regime in this asymmetric conflict. The paradox here is that lower energy prices would give the U.S. more freedom in pursuing its strategic objectives and continuing the conflict for longer, but they are predicated on market perceiving that the war will be over soon. In what has now clearly become a war defined primarily by control over energy flows, then, market prices have become a political tool over which both parties seek control, and the events of recent days could be interpreted as an example of this dynamic.

When, at the end of January, we looked at how geopolitical forces are set to influence global gas markets, we raised the prospect of markets becoming less efficient when energy flows become highly politicised: the last two days are a clear example of such an environment. At present, energy prices are not effective indicators of market realities, but rather political tools in the hands of market participants, which actively shape their evolution by pushing specific narratives. This makes markets, which are being swayed by contradictory messaging and unclear strategies, not capable at present of effectively assessing and pricing risk. A situation which resembles, to some extent, the first weeks in the wake of the Russian invasion of Ukraine in 2022, just with other international actors involved.

This absence of clarity is also a direct consequence of the concentration of decision-making power in the hands of President Trump. This has been from day one a key trait of his administration, characterised by frequent rhetorical escalations and retreats, seemingly to defy all established norms and apparent rationales in international politics. As a result, officials have tended to contradict themselves and frequently aim in their public remarks at maintaining the maximum level of optionality open for the President himself, without committing to a clear message or strategy. Perhaps the clearest representation of this dynamic is President Trump's statement that he would "feel it in his bones" when the time to end the war will come. This personalisation of foreign policy means that more sudden shifts in rhetoric and strategic stance are to be expected, as the administration is not moved by a clearly defined and predictable ideology, but rather by the idiosyncrasies of a single individual.

In this environment, market participants should:

- Expect an exceptional degree of market volatility to continue as a direct result of attempts by all parties in this conflict to control the narrative and leverage market responses for their own objectives;
- Expect short-term market dynamics not to be driven by fundamentals, but rather by political posturing and rapidly shifting narratives; and
- Understand that markets, especially highly liquid ones with significant paper trading activity, are likely to remain incapable of effectively pricing future risks and may be caught by surprise when the physical realities of the deepening global energy shortfall eventually catch up to them, possibly later in Q2-26 and Q3-26, particularly should the war continue

Looking beyond this specific crisis, one may expect that, as much of the current apparent irrationality of markets is driven by the specific traits of U.S. politics in the Trump era, it could then be expected to subside once his second term comes to an end. However, it is also true that energy flows and markets are becoming an increasingly crucial tool for the dynamics of power in global politics. This is occurring at the same time as international norms and multilateral frameworks fail in a more unstable multipolar world affected by growing great power competition. These factors make it possible that the explicit politicisation of energy prices seen during the ongoing energy war over the Strait of Hormuz could become a pattern repeated in future crises. As we described in our analysis of the long-term consequences of this war, it remains true the most dangerous mistake would be to take these developments as only black-swan events and not as part of wider trends in international politics which can be expected to continue.