

War and natural gas markets: why the worst may be yet to come

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Two months from the start of the U.S. and Israeli war against Iran there remains no clear route to a resolution that will enable the restoration of energy trade to the pre-war status quo. Multiple rounds of negotiations have seen limited progress on the most crucial issues, and a fragile ceasefire still appears to be in place, despite the introduction of a U.S. blockade on Iranian ports, new rounds of threats and multiple attacks on commercial shipping in the Strait of Hormuz.

The diplomatic scenario

Even Republican lawmakers, supporters of the Trump administration's initiative in Iran say that lower expectations are the ones closest to reality. Michael McCaul, a former chairman of the Foreign Affairs and Homeland Security panels, last weekend said that he does not [“see any big breakthrough in the near term.”](#)

Iran's Foreign Minister Araghchi was to meet Trump's envoys Witkoff and Kushner, a visit cancelled when the Iranians delivered a plan to liberate Hormuz in exchange for the lifting of the U.S. blockade on the country's ports. On Monday, meeting with Russian President Vladimir Putin, who congratulated Iranians for [“fighting for their independence and sovereignty,”](#) Araghchi reconfirmed the Iran-Russia axis in this scenario of growing instability.

The U.S. President said that [Tehran wants to soon reopen Hormuz](#) as its economy struggles. However, it seems that the dissatisfaction runs deeper in the White House for what Iran just put on the table. The proposal diminishes Washington's leverages once the blockade on Iranian ports is lifted and delays into the future the resolution of the nuclear standoff. De facto, this has been the major issue bringing the U.S. to war and this development is simply unpalatable to the White House.

In this context, energy markets, just like the conflict itself, appear to be in a state of uneasy quiet. Natural gas market prices in Europe and Asia have yet to return to the highs seen following Iranian attacks on Ras Laffan in March and, while headlines continue to drive price volatility, the market's overall perception of risk appears to have not shifted materially since the first announcement of a ceasefire.

No clarity going forward

A lack of clarity on whether any diplomatic pathway to resolve the key outstanding issues exists, as well as explicit efforts by all actors involved to manipulate market sentiment, continue to dictate energy markets' response. The result is that markets remain in a state of

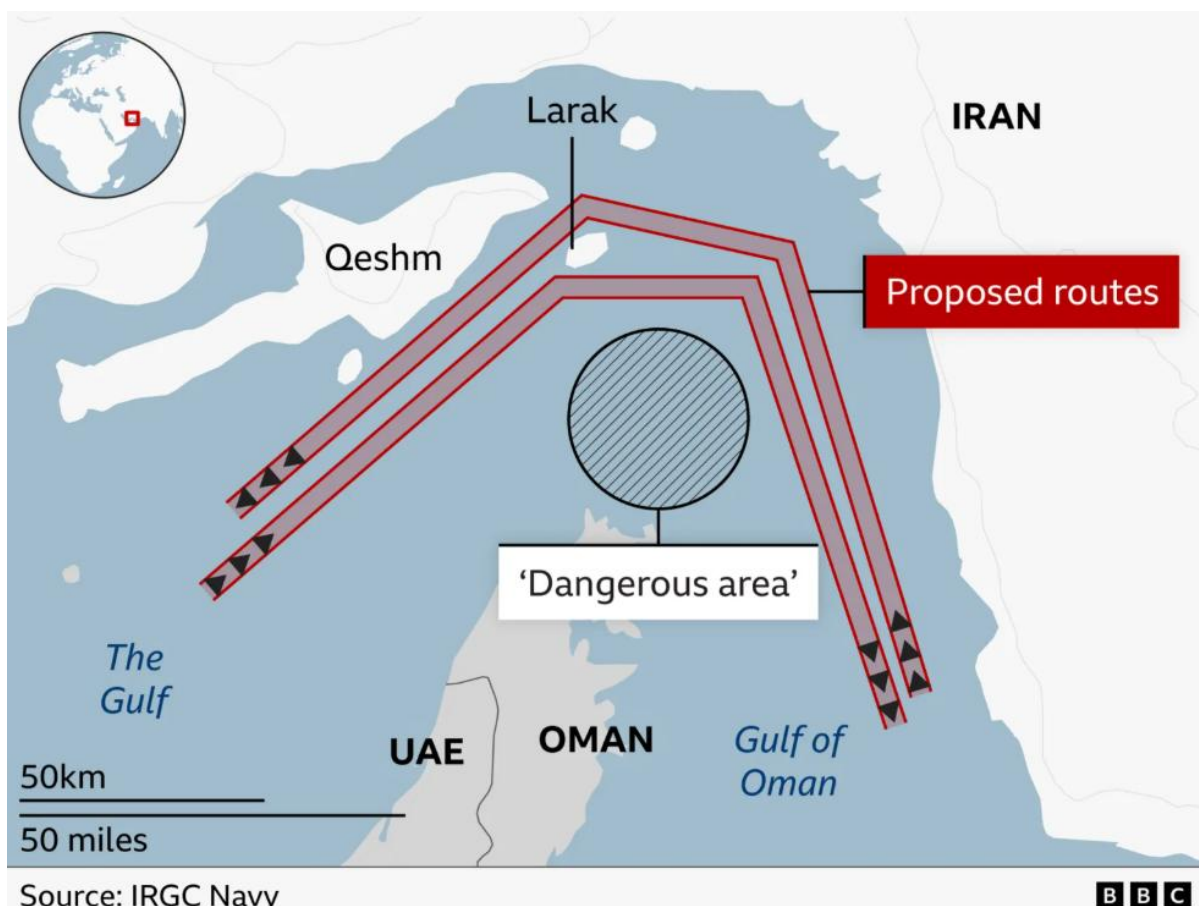
uncertainty, as they are caught between contradictory messages by political leaders and the reality on the ground.

In more abstract terms, it is simply insufficient to amass power tools, as the U.S. and Iran did over the last couple of months, without showcasing demonstrated behaviour and results. Instead, any political unit “must also possess the institutions to mobilise them and the decisionmaking mechanisms to command them.” In this uneasy quiet, stakeholders, including market actors, therefore need to face the reality that expectations that the crisis can be resolved rapidly need to be lowered.

Thus far, reactions of market participants have been primarily focused on short-term crisis management rather than a cautious mitigation of longer-term risks. This has played an important role in mitigating the worst market impacts of the crisis until now. However, this comes at the cost of a progressive erosion of some of the main sources of market flexibility, such as strategic and seasonal storage.

We are now at an especially delicate moment. The current status quo is highly unstable and cannot be sustained for long. Progress on a negotiated solution for the conflict remains uncertain at best, with the outlook for trade flows via the Strait of Hormuz no clearer than at any point since the start of the ceasefire.

Figure 1 - IRGC's Published Routes Through the Strait of Hormuz



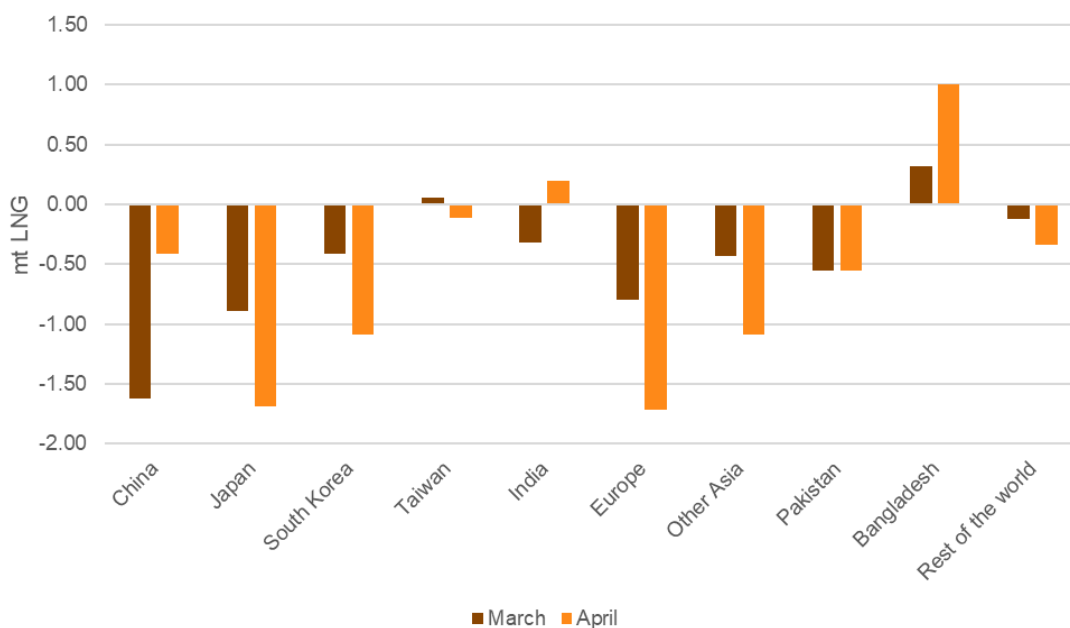
Source: [BBC](#)

As an example, ship-tracking data evidences [the first LNG carrier from the UAE crossing the Strait of Hormuz](#) since the beginning of the war. For two weeks, the ship turned off its signal while reappearing on the west coast of India just recently.

Details about this Hormuz transit are scant and certainly one ship will not be able to overturn the implications of the energy crisis. Moreover, no info is available regarding the possible payment to Iran of a toll fee for the safe passage through the Strait. Very recently, details surfaced about the Central Bank of Iran opening [four special accounts](#) in Iranian rials, yuan, dollars and euros to collect fees for the passage through the Strait of Hormuz.

The news comes as the frustration grows among parties with the negotiations process at a dead end. In the absence of a rapid breakthrough, the commitment to the negotiation process could seriously weaken in the coming weeks. At the same time, as mentioned above, the ability of markets to mitigate the short-term impact of the supply shortfall is progressively being used up. Figure 2 below shows how Europe, China, Japan and South Korea continue to absorb the majority of the supply reduction, but it is unclear for how long these markets will be able to maintain such a deep reduction in LNG imports. For Europe, especially, this reduction directly translates into lower storage injections, although favourable weather pushing demand to unseasonably low levels has helped in mitigating this effect.

Figure 2 - Difference in LNG departing for each major importing market in March and April compared to the average over the six months preceding the conflict



Source: [Vortexa](#)

Gas demand is set to rise, especially in the most vulnerable Asian markets, on the back of rising summer cooling demand. The increases shown above in departures of LNG cargoes towards India and Bangladesh are evidence of this. After two years of silence and in the effort of providing enough gas for at least a month, state-run [Pakistan LNG Limited \(PLL\) re-entered the spot LNG market](#), also secured a cargo from French TotalEnergies at a significant premium compared to pre-war supplies. Power shortages in the country are already ongoing for many

hours a day, underscoring once again how difficult it is becoming for developing economies to isolate themselves from the most negative implications of the energy crisis.

A severe reckoning

These factors are increasing the risk that global natural gas markets will face a much more severe reckoning with the impacts of this supply shortfall in the coming months, should the diplomatic process not yield an immediate breakthrough. With sources of market flexibility depleting, any continuation in the global supply crisis will result in a significantly higher degree of volatility, prices reaching higher levels and impacts lasting well beyond the end of the conflict. Indeed, considering the infrastructural damage to Qatari LNG and the slowdown of regional projects' development, it is difficult to foresee any resolution of the major controversies of the LNG or "normalcy" of the [scenario before 2028](#) at the earliest. An assessment which is also shared by the IEA.

What to expect if no breakthrough can be achieved soon:

- **Political instability and fracturing:** a deepening global energy and economic crisis will exacerbate existing political fault lines and may test existing frameworks and relationships. As exemplified by the announcement of the UAE's exit from OPEC and OPEC+ alliance, even the traditional energy axis are severely tested in the current market context of deep crisis. More often, existing gas and LNG interdependencies will be tested going forward, bringing geopolitics into previously only business-related decisions.
- **A deepening crisis in Asia:** emerging Asian markets remain the most exposed to the supply shock caused by the closure of the Strait of Hormuz. In the event of a protracted disruption, prices will be capped at the level at which South and Southeast Asian governments are no longer capable of participating in the spot market - eventually, governments will be faced with a choice between fiscal stability and deepening energy supply curtailments. The result would be trading a fine line between political unrest and economic stability. Importantly, the political and economic disruption caused by this process will result in a permanent downgrade in the gas demand growth prospects for these markets.
- **Risks building ahead of the coming winter:** established markets are likely to feel the worst of the crisis in the coming winter. Lower levels of storage in Europe will limit the market's ability to absorb weather-driven demand shocks and exacerbate the seasonality of LNG imports. Regulatory action to ensure security of supply and mitigation of winter supply risks appears weak so far.

As the crisis continues to deepen, then, risks that the market will be less predictable and even more prone to shocks continue to increase. Markets, stakeholders and energy consumers need to lower expectations that an upcoming energy crisis can be dodged, just as all actors in the conflict are beginning to lower expectations that political ambitions can be met during this increasingly uneasy standstill.