On The Mark

January 2020

How will the U.S. and Iran conflict affect oil?

Key Takeaways

- Historically, a Middle East crisis has led to spikes in the oil market, which have been followed by recessions. However, record domestic oil production has made the U.S. less dependent on foreign oil.
- Economic sanctions have battered Iran's oil production, thus are less likely to destabilize global oil supply.
- The latest tension will require a significant and sustainable increase in oil prices to derail the US economy.

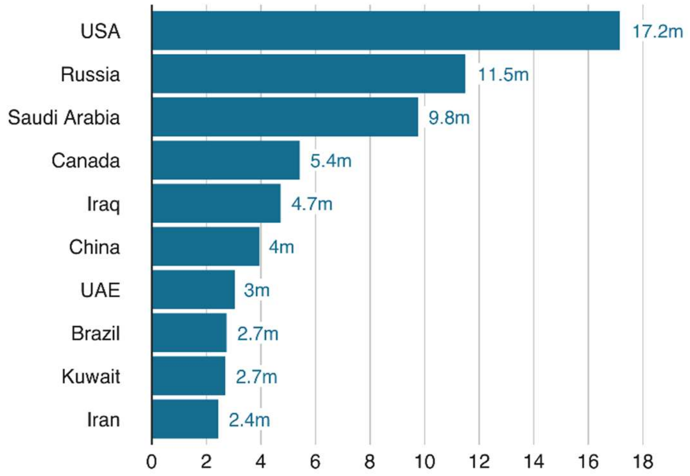
Historically, a sharp rise in oil prices has led the US economy into a recession. In fact, the last three recessions were all preceded by sharp increases in oil prices.[1] Given the historical relationship, the latest tensions between Iran and the U.S. have understandably led to angst among investors. Fortunately, the situation is not as threatening as it has been historically for three reasons:

First, the U.S. has become the world's largest oil producer as a result of the shale boom, outpacing the second largest producer by nearly 50%.[2] US crude oil production has more than doubled over the last decade[3] reducing our reliance on imports. The abundance of shale oil has dislodged the historic tie between geopolitical conflicts and the price of oil. In other words, higher foreign oil prices are less of a drag on the US economy.

Second, Iran has lost its standing in global oil production. The economic sanctions have led Iran's oil production to dramatically drop off cutting at the heart of its largest source of revenue. Iran's oil production was nearly cut in half from 3.8 million barrels per day in 2018[4] to just more than 2.4 billion barrels per day in 2019, accounting for less than 3% of total world production.[5]

Top 10 oil producers

Countries by million of barrels produced in a day



Source: BBC.com

Finally, it would take a significant and sustainable increase, such as a 70-80% year-over-year increase in price of oil, to negatively impact growth.[6] So far, tensions with Iran have had a limited impact on markets. Oil prices did rise after the December 2019 attack on the U.S. Embassy in Iraq but have since pulled back.[7]

With Iran and the U.S. intent on preventing further escalation, investors should not panic, but rather prepare for volatility after a blockbuster 2019 rally. Without major military escalation, the latest tension with Iran does not immediately change the situation: steady growth, low inflation and friendly central banks all support stock markets.

[1] https://www.cnbc.com/2020/01/03/spiking-oil-prices-have-led-to-recessions-in-the-past-and-thats-why-the stock-market-is-on-edge.html
[2] https://www.bbc.com/news/business-50982313
[3] https://www.eia.gov/dnav/pet/hist/LeafHandler.ashx?n=PET&s=MCRFPUS2&f=M
[4] https://www.bbc.com/news/world-middle-east-48119109
[5] https://am.jpmorgan.com/us/en/asset-management/gim/adv/will-tensions-with-iran-cause-an-oil-spike
[6] https://am.jpmorgan.com/us/en/asset-management/gim/adv/will-tensions-with-iran-cause-an-oil-spike
[7] https://oilprice.com/oil-price-charts

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