Crude oil update: Short-term risks of an Iranian oil supply shock

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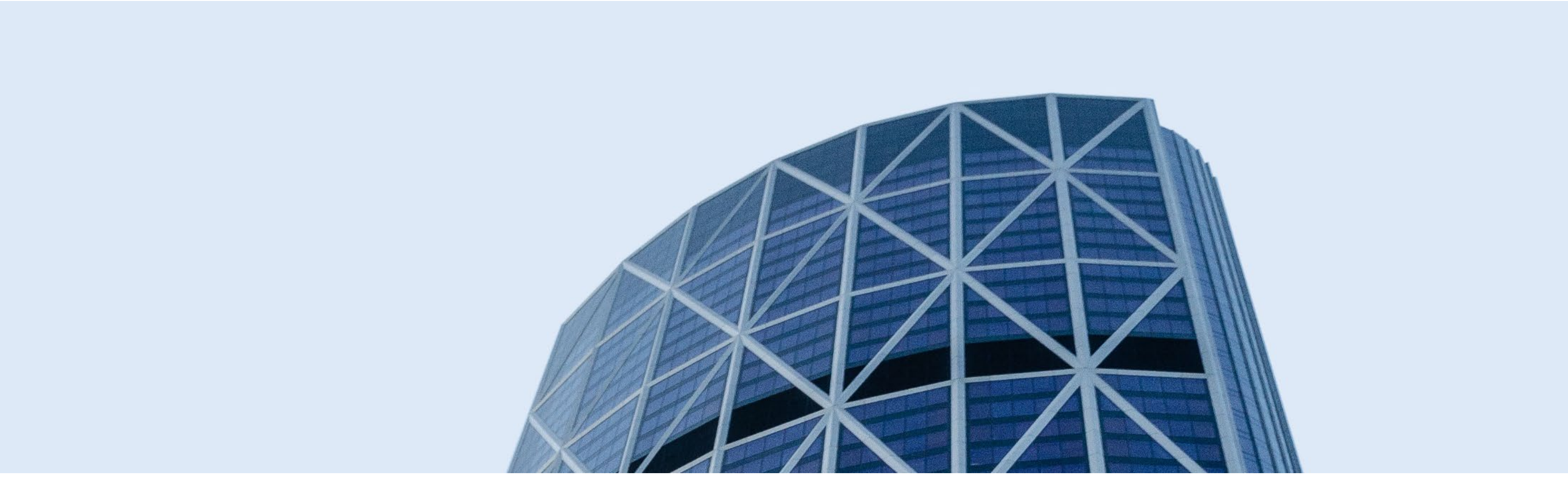

Iran is currently experiencing widespread protests fueled by severe economic strain, including high inflation, a collapsing currency, and declining living standards. The situation has escalated into broader anti-government unrest, prompting a heavy security crackdown and raising concerns about deeper internal instability and heightened tensions with the US and its allies. Hope for a peaceful resolution prevails, however rising tensions are putting global markets on edge. With recent developments in Venezuela, this further exacerbates energy supply/demand complexity.

While Iran's oil production has not yet been materially disrupted, the situation is significant for energy markets, as Iran is a key OPEC producer and its proximity to the Strait of Hormuz—a critical chokepoint for global oil flows—adds to the risk. Consequently, oil prices are rising amid growing geopolitical uncertainty, with markets anticipating the potential for prolonged unrest, stricter sanctions, or regional escalation that could threaten exports or transit routes and further increase the risk premium in oil prices.

Energy market impacts

Markets have largely ignored political noise surrounding Iran over the last several years—including tariffs, sanctions, and related measures—based on the observation that Iranian barrels have always consistently reached the market despite US sanctions. As a major oil producer, Iran currently pumps approximately 4.2 million barrels per day—equivalent to about 4% of global supply. Any risk or event that could significantly disrupt this production—even temporarily—would be notable, considering that the global supply/demand balance in 2026 is projected to average a monthly oversupply of about 2.3 million barrels per day, according to EIA estimates.

Our models indicate that a hypothetical three-month disruption in Iranian oil production would mechanically increase Brent crude prices by at least $7 per barrel. However, this is a conservative estimate given that such an event would almost certainly be accompanied by a significant rise in the geopolitical risk premium, which is still low by historical standards. Indeed, a disorderly regime change could prompt a 10% to 20% premium above fundamental values, potentially resulting in an aggregate increase to $70-$75/bbl Brent prices ($65-70/bbl West Texas Intermediate).

For now, the news on the ground suggests that drilling activities have not been impacted by the public unrest, and we view the increase in prices over the last several days as reflecting the view that the Iranian regime will fall, with limited impacts to oil production.

That said, a more disruptive outcome whereby Iranian oil is deprived from the market (10% ~ 20% probability), would catalyze the aforementioned outcomes. Signposts to watch for include:

- Whether workers in the oil industry join the protesters by striking or sabotaging infrastructure.
- Whether a change in leadership results in lower oil output driven by a lack of leadership stemming from Tehran.
- Whether a regime change results in a blockage of the Strait of Hormuz, through which 20 million barrels per day of oil is transported.

It is worth noting that workers in the Iranian oil industry enjoy better benefits relative to other Iranian workers, which explains why a disruption is not our base case. It is also likely that other major oil producers would step in to absorb some of the lost capacity, but it would take several weeks to cover the lost barrels.

Investment implications

The recent rise in oil prices reflects the increasing probability that the Iranian regime will fall. If the regime shift results in a temporary cutoff of Iranian production, Brent could spike as much as $10 per barrel. For now this is not the base case.

Asset markets would have a varied reaction to a spike in oil prices, depending on the exposure to energy. Higher energy prices and rising geopolitical risk premia increase the cost of doing business for many companies, pressuring margins. To hedge against that risk, concerned investors could adjust their exposures to commodities and/or to equity markets exposed to the energy and oil sectors Investors could also consider their currency exposure, potentially taking positions in Norwegian Krone, Colombian Peso, or Brazilian Real.

Investors with exposure to the Canadian market are uniquely positioned, as energy is a dominant sector within the S&P/TSX at 14.8%. The Canadian dollar has also historically trended alongside oil, although that relationship has weakened over recent years. Broad-based Canadian equity, Canadian balanced and global tactical balanced investments provide exposure to energy, while sector-specific funds can be used to amplify allocation. Some funds, such as the CIBC Multi-Asset Absolute Return Strategy, have the capability to invest directly in the commodity itself via oil futures.

To help with tailoring exposure and mitigating risk, speak to your CIBC representative.