

Saudi oil supply at risk | Investing themes

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Key takeaways

- Attacks on Saudi Arabia's Petroline drove oil prices higher and weighed on risk assets.
- A challenging environment lies ahead as geopolitics, energy prices, testing of the AI-supercycle hypothesis and bond-market gyrations interact.
- We remain constructive on equities for the medium term, supported by sound fundamentals, strong earnings and relatively low recession risks.
- Further weakness may offer buying opportunities, but risk analysis and management remain paramount.

What happened?

Oil markets opened the week on Monday with Brent trading 3% higher, close to USD108/bbl. The rise was driven by drone attacks on Saudi oil infrastructure. Last Thursday, pumping stations on the critical East West pipeline (Petroline) were attacked – reportedly by militants in Iraq – with damage to two pumping stations confirmed so far in Riyadh and Medina areas. Pumping stations maintain the pressure required to move crude along the pipeline that extends for roughly 1,200 km. This has prompted Saudi Arabia to temporarily suspend the flows through the pipeline as a precaution. For context, this pipeline with a 7mmb/d nameplate capacity, has been instrumental in bypassing the Strait of Hormuz by transferring oil to the Red Sea Port of Yanbu. This port now accounts for the majority of Saudi oil exports, compared to roughly 10-15% before the Iran conflict. These oil flows have played a key role in alleviating supply pressure and preventing oil prices from rising to destructive levels. Some reports have suggested that if the pipeline remains offline, Yanbu port faces the possibility of running low on its oil stocks in around a week.

Equities came under pressure after these attacks, with NASDAQ and S&P 500 futures trading around 1.5% and 0.6% lower, respectively. European markets also reflected these concerns, with the EURO STOXX 50 down by ~0.9%. The weak stock market opening can also partially be attributed to business leaders and researchers arguing for a slowdown of AI advancement, as evidenced by slight tech / US underperformance pre-market. Bond markets – already having priced significant yield moves in the past weeks – showed relative calmness: US 10Y Treasury yields were largely unchanged, sitting within touching distance of 5%, while German 10Y Bunds were 2 bps higher. FX markets showed USD strengthening as all other G10 currencies depreciated against the greenback with EUR declining by more than 0.4%.

What does it mean for investors?

We have continuously flagged the risk to critical infrastructure such as pipelines and ports in the past. The importance of this infrastructure for the global markets – and the leverage that comes with it – makes it a prime target for Iran, the Houthis and other proxies in the region, as we have seen now. The official description of the shutdown as precautionary provides some initial reassurance, however, no

reopening timeline has been provided nor has any detailed damage assessment been published. The market impact will therefore depend less on the label attached to the shutdown than on how quickly flows resume and whether inventories at Yanbu can bridge the interruption.

At current levels, oil prices are high enough to increase concern amongst market participants. A further rise will only add to this pressure. A sustained period of elevated oil, LNG, and fuel prices would primarily act as a negative supply shock for the global economy, pushing inflation higher while weighing on purchasing power, consumption, and investment. The US would remain comparatively resilient given its lower energy dependence, whereas the euro area would be more vulnerable due to its larger energy import bill and stronger second-round effects on wages and core inflation. As a rule of thumb, a sustained 10% increase in oil prices raises US headline inflation by roughly 0.2 ppts and reduces GDP growth by around 0.1 ppts. In major euro area economies, headline inflation could increase by 0.1-0.5 ppts, with a broadly similar drag on GDP growth. However, the longer elevated energy prices persist, the more likely these effects are to become non-linear as higher energy and transportation costs feed through supply chains, compress corporate margins, and lift inflation expectations. Central banks would therefore face a renewed trade-off between containing inflation and supporting growth. Fiscal measures could cushion the impact on households and businesses but risk prolonging inflationary pressures while adding to already elevated public deficits. While recent research suggests that economies can adapt over time to prolonged disruptions in key oil transport routes over the longer term through the gradual adjustment of trade patterns, supply chains, and transportation networks, limiting the impact on potential growth, the near-term economic effects would nevertheless be characterised by higher inflation, weaker consumption, softer investment, and slower economic activity as economies absorb the initial supply and price shock.

Bond markets had already repriced toward a tighter monetary-policy outlook, pushing yields higher across several major markets. A further sustained rise in energy prices could initially reinforce this move by lifting near-term inflation expectations and increasing the probability that central banks will keep policy restrictive for longer. Over time, however, the rates response could become less uniform. If higher energy prices start weighing on growth, yield curves could flatten and longer-dated government bonds might eventually benefit from renewed demand for duration and safety. This is particularly relevant for Europe, where elevated gas prices and the need to rebuild inventories ahead of winter could be further reinforced by the inflationary effects of higher oil costs. The opportunity to lock in elevated yields could potentially further increase the competition for equity markets. Equities have remained resilient so far, supported by strong earnings growth and continued investment linked to the AI capex cycle. However, higher oil and bond yields could create a more demanding backdrop, particularly for energy-intensive, consumer-facing, and highly leveraged sectors. Addition of selected defensive sectors will result in more resilient portfolios.

We therefore expect a somewhat challenging market environment going forward where geopolitics & energy prices, testing of the AI super cycle hypothesis and bond market gyrations alternate or hit the markets simultaneously. Overall, though, we remain constructive for the medium term for equities due to sound fundamentals and strong earnings in particular. Global economies also appear relatively resilient, resulting in relatively low recession risks. Further weakness may thus give rise to interesting buying opportunities. Risk analysis and risk management remain paramount of course.

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