

Oil prices hit highest level since May after Middle East and Russia attacks

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Key points

- Brent crude futures stopped just short of \$US110 a barrel late on Friday, the highest price since May
- The rally came after Saudi Arabia intercepted a missile heading for a key Red Sea oil port and a Ukrainian drone hit a large Russian refinery
- CommBank economists say diesel supply is under more strain than crude, with seaborne diesel exports down about 13% on a year earlier in September

What pushed oil higher

Brent crude, the global oil benchmark, stopped just short of \$US110 a barrel late in Friday's trading session.

That's the highest price since May this year, CommBank Head of Commodities and Sustainable Economics Vivek Dhar said in a research note.

Dhar said the late rally was attributed to two events: Saudi Arabia intercepting a missile heading for the Red Sea port of Yanbu, and a Ukrainian drone striking a main unit of a large Russian oil refinery.

Why is Yanbu critical?

Yanbu exports oil carried by Saudi Arabia's East-West pipeline, which bypasses the Strait of Hormuz.

It supplies the global market with about 4 million barrels of crude a day, equivalent to about 4% of global oil demand, Dhar said,

"The East-West pipeline, Yanbu and the Bab el-Mandeb Strait are all live fronts of the Iran war today," he said.

Dhar said any successful attack on Yanbu would likely mirror the market reaction when an attack on the pipeline forced it to shut down on 11 September.

Back then, Brent futures rallied above \$US105 a barrel. But the jump in prices for physical oil and Asian diesel was "more substantial", he said.

Diesel is the bigger squeeze

Preliminary International Energy Agency (IEA) figures for September show seaborne diesel exports fell about 13%, around 0.7 million barrels a day, on a year earlier.

At the same time, net seaborne exports from the Middle East and Russia fell about 60%, and rising exports from the US and China only partly made up the gap. Dhar said the ongoing Ukrainian attacks on Russian refineries reduced hope that Russian diesel exports could ease global shortfalls.

Oil has some buffers, including pipelines that bypass trouble spots, rising supply outside the Middle East and lower Chinese imports. But diesel and other fuels mostly rely on higher exports from China, he said.

China's fuel exports eased from August to September and they're expected to weaken again in October, Dhar said.

What CBA expects next

CommBank's economics team still sees a diplomatic settlement between the US and Iran as the most likely outcome, putting the chance at about 75%.

But "the timing and pathway there remains uncertain", Dhar said.

A deal that looks like a ceasefire should see Brent return to \$US85-100 a barrel, while a deal that lifts the US naval blockade on Iran should see it fall to \$US70-85.

CommBank now also sees a strong chance - about 35% - that an agreement comes only after a limited escalation.

That means Brent "may stay above \$US100 a barrel in the short term", Dhar said.

But either side could overplay its hand, leaving oil and fuel stocks running down in some parts of the world.

Dhar said that could push Brent towards \$US150 a barrel; a level high enough to force lower demand in emerging and developing Asian economies.

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