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TRANSCRIPT

Event

The Iran War at Six Months: Energy, Markets, and National Security

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FEATURING

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Joseph Majkut: Good afternoon. Six months ago, the United States and Iran launched a series of attacks – the United States and Israel launched a series of attacks against Iran. Iran answered by pressuring the shipping through the Strait of Hormuz, which has created the largest disruption of oil markets in memory, and one that has lasted much longer than many of us thought was going to be possible. But the first strange thing, and we want to address in today's conversation, is why this hasn't yet realized enormous price spikes. When we looked at the start of this crisis many thought this would lead to oil prices in excess of $120 a barrel, even higher. And yet, today we're trading at about $90 a barrel.

The second interesting dynamic that we've observed over the last six months that I want to touch on today is the dissonance between U.S. military success. We destroyed Iran's navy very shortly after the start of the conflict. We've achieved air dominance. But Iran has had remarkable ability to coerce economically over pressure on the strait. And economic coercion seems to be bounding the military might of the United States. As we look back at six months of this conflict and look forward, our conversation today is meant to focus on, you know, what changes will stay permanent, and how should analysts, observers, and interested parties think about the stories of this conflict.

I'm joined by three experts who are going to help us unravel these questions and give us their perspectives on what six months of this conflict means. Clay Seigle wrote for us the first scenarios of potential oil market disruptions just before the conflict began. Roger Diwan advises financial firms and energy companies on how to navigate these geopolitical challenges. And Kevin Book, my partner in crime in Energy Shots here at CSIS, follows the details like no one else.

Gentlemen, welcome to today's conversation. Thank you for being here.

Clay, maybe we can start with you. You did write for CSIS the, you know, four energy disruption scenarios of how a conflict with Iran would potentially escalate and affect oil markets. Looking back now, did you have it mostly right?

Clayton Seigle: Well, thank you for having me. Good to be back here.

I think that we saw substantially all of the four scenarios manifest during the past six months. For those who need a refresher, there were two on the part of the United States and Israel and two on the part of Iran, each of which contemplated the interdiction of shipping and also attacks on infrastructure. And so we have, over the – primarily in the first phase of this war. Think about last March when missiles, drones were really actively flying. We did see attacks on both sides' shipping and infrastructure. And to that I would add attacks on military bases. We knew that the United States and Israel were going to pummel Iranian facilities, but I think we didn't appreciate at the time that we would see attacks not only on oil and gas infrastructure, but also on the forward military bases, more than a dozen of them, in the gulf. That has really affected United States force posture and actually its capability to prosecute the war, and if you want to call this phase, its aftermath. We saw all of the above.

Dr. Majkut: And as you look at the – just the longevity of this disruption, has anything surprised you?

Mr. Seigle: Oh, several things have, but I think that foremost among which has been the behavior of one of the most important oil consumers in the world, which is China. We can drill down on that during our time together if we have time, because I think that's an important one. China was the largest importer of crude oil in the world at 11 million barrels per day, and slashed its import volume by, not quite but close, to half at its lowest point in about June.

So it dropped by four-plus million barrels per day, which freed up those four million plus barrels for other buyers, particularly in Asia-Pacific, that would have probably experienced shortages had it not been for that move. And so that – we're still kind of scratching our heads, thinking about the series of measures that Beijing took in reaction to the war, but really importantly why it has chosen to sustain them over the last two or three months. That's paramount for oil price formation.

Dr. Majkut: Why don't we go immediately to that question? We can cover the rest of the pillars later. Roger, S&P covers global markets. You guys are studying the Chinese example. What do you think is behind both the capacity to reduce imports so significantly, and to do it for so long?

Roger Diwan: Yeah. Thank you for inviting me and glad to start with China, and as a balancer of the market, but there's another important structural factor that we should talk about. But on China in particular – and, Clay, you're right – they dropped import almost to – by 5 million barrel per day at one point, May and June. And the question is how you do – you do that.

First, I think the level of export we're comparing, which is last year, they were running about 2 million above demand. So there is 2 million of slack in that import volume that they could remove immediately, which mean another 3 million of destocking. And they were willing to destock for a few months because they have been stocking very fast in the last 18 months. If you're going to use your stocks for strategic purpose, this is the time.

And what we saw there in China, in a way, is a continuation of something we've seen in other commodities, correct – in in the minerals commodity, in coal. They seem to be acting as a balancer of prices by using their storage during price spike and when prices goes under a certain level to store. So there is a broader commodity picture here to draw that China is trying to keep prices within ranges that work for itself – most importantly for its security, for its economic growth, et cetera. So there is a Chinese story by itself which is quite important.

The other consequence of the China adjustment is that China stopped exporting product. And that is where you see right now the real tightness in the market, in the diesel market first and foremost and in the gasoline market, and the fact that China's not exporting; that the Russian export have – are coming to a halt, almost, for diesel and gasoline; and the same in in the Persian Gulf. So now you start to see where the crunch really is. It's on product. And here China is passive or an active actor in the sense that if you look at global refining capacity right now the only place that you have spare capacity outside of the Gulf is really in China.

Dr. Majkut: So you mentioned the, you know, Chinese actions across a variety of commodities, appealing to their own sort of growth, prices internally. Are macroeconomic considerations part of this as well? I mean, you know, China has an export-dependent economy. That's sort of the brightest part of the Chinese economy. A global recession created by energy shortages would be an enormous problem for economic conditions in China as well. Do you think that's on the mind of Chinese policymakers?

Mr. Diwan: I think certainly it's on the mind. I'm not sure it's the key driver. I think when you build strategic stock of that size and you're willing to use them, there's many uses, many use cases if you want, and a lot of them can converge. The question is, how much leverage does – it gives you?

Just as an example, I mean, President Xi and President Trump is going to meet twice this year. If we have shortages of diesel and gasoline, is that an ask towards China to reopen its export window for product? How that leverage is used or not used, discussed or not discussed, is quite important. So it could be economics, but I like to think about it in price ranges which are good for China and the world.

Mr. Seigle: You know, Joseph, to Roger's point, when you have built this nest egg, this oil savings account like no other in the world, and you're sitting at the beginning of this war on maybe 1.4 billion barrels, you have the luxury of not being forced to buy the high as so many other refiners in Asia-Pacific were scrambling to do in March. But the question is – I would have understood if they had had that import buying hiatus and we were at 120 (dollars) or something. But since we've pulled back below one hundred (dollars), it's very interesting to see China's buying appetite continue at a relatively low level – maybe rebounding a bit, but it's nothing like it was before.

Dr. Majkut: Yeah. And what I can't tell is how much of this is microeconomics, right – firms responding to prices and trying to maintain profitability – versus some sort of strategic decision that's being made out of Beijing.

Kevin.

Kevin Book: I mean, so the endogenous economic decisions are obviously a big part of it, but the flexibility China has been buying itself through decades of transitioning towards an electrified transportation economy shouldn't be overlooked either. If we're trying to find 3 million barrels, you know, the IEA found 600,000 barrels per day delta versus year ago in electrification substitution for petroleum, which is pretty significant if you think about it. There's no other fleet in the world that big, nor is there an economy in the world where the end-use sectors can be modulated by government action in the same way and to have such an effect.

Now, there's probably a third other element, other than all these others that you've mentioned, and that is economic slack. So China had room in its economy to exert that sort of command intervention to bring down some of those end use consumption barrels. And that isn't necessarily good news. I don't think you think of that as a strategic asset, but it's something they could make use of.

One of the interesting things that Roger brought up though, that I think is really important, is that when you look at a crisis like the one we had just had, innate in everyone's conception of the globe trading freely is that the barrels will find a home. But when governments get in the way of trade – and we didn't just see it in China. We saw Japan saying that, you know, the strategic barrels would go for domestic refining consumption. South Korea said, well, look, we're going to limit products exports to year-ago levels. These kinds of interventions prevent the balancing of markets happening the way that you might think of it on paper. And those dislocations can start to exacerbate shortages. So on the one hand there was very good news on the crude side. But now that we're looking at, for example, gas, oil, diesel, you know, more than twice the price of crude, we can see the consequence of what happened on the other.

Dr. Majkut: You know, I'd like to shift to the question of pricing a little bit. Kevin, maybe we can start with you. I know you don't make price forecasts. (Laughter.) But in April you said that $100 looks like the new 60 (dollars). And I think that was a statement about sort of we had we had come from a fairly low price environment preceding the war. We saw this increase. That's a non-negligible amount. It's not the catastrophe that some people thought we would see. Kind of, what do you think should underlie people's thinking about prices now? So we don't really know when this conflict is going to end. We don't know when Strait of Hormuz approaches anything like what we thought of as normal, you know. But the buffers that have been supplying oil into the system seem to be running a lot more thin.

Mr. Book: So the nature of that quote was not only to get quoted, which you say something like that and people are going to remember it and hold you to it, but the idea that there was something asymptotic about 60 (dollars) earlier in the year, right, when the price would fall to 60 (dollars) and then sort of sort of stay there. January 7th was the local minimum we had when we felt Brent futures close just a little below 60 (dollars). And so 100 (dollars) was sort of the new asymptotic floor was the implication.

Now, maybe it turns out to be 90 (dollars) or something like that, but the point is that it's not 60 (dollars). The point is that all the assumptions that went into how we thought about this year going forward have changed in some very big ways. And one of them, obviously, Roger mentioned one of them, was that there were huge stocks available. And those stocks are now less available. We've had, what – pick your number for stock draw. I think everyone has one. But if your floor is the 600 the IEA has by year end, and you can go up from there, that's a pretty significant change. Strategic reserve draws also.

And then a certain amount of economic patience, right? There's only so much you can expect from people for so long before you run into trouble. And so right now if you look at it as a share of disposable personal income, you could say it's a good news story. You know, here in the U.S. gasoline is only 2.4 percent of real DPI, and it was 3.6 (percent) at the height of the Ukraine war price peak in 2022. The Trump administration officials are saying that. They're saying, look at the comparables, and look at how much better we're doing. But if you were at 1.8 percent before and you have other inflationary pressures on your wallet, there's only so long before this is going to become a bigger crisis too. And so time is running out. Time is running out. Money is running out. Reserves are running out. And it's all happening at once.

Dr. Majkut: And yet, I mean, this weekend I paid just over $4 a gallon for regular unleaded here in Washington D.C. So I've got the urban price effect setting in there as well. If you look back to 2008, not necessarily the comparison you want to make, but prices were well over $6 a gallon in today's dollars. So it really is seen that, like, while they're up from where we were, we've yet to kind of broach catastrophe or political crisis.

Mr. Siegle: But the political pressure, of course, doesn't come from the 2008 inflation-adjusted analog – (laughter) –

Mr. Book: That's fair.

Mr. Seigle: – nor the DPI, the dot plots, et cetera, right? What do people really know? They know that it's currently four (dollars) and it used to be three (dollars), nationwide average.

Dr. Majkut: And may still be going up.

Roger, you wanted to make an intervention.

Mr. Diwan: Yeah. I wanted to come back to what Kevin was saying about – the price is telling you something. And it's telling you we're not into a serious crisis. But people like us, who've been watching these markets for all our careers, I mean, there is foundational elements of what we understand the market to be that are really maybe gone, maybe not completely there. I mean, I'll give you an example of three. When we – any oil market analyst assume that the Strait of Hormuz is open, that we have the OPEC three to manage extra supply, and we have spare capacity in the world, OK? These three elements are not there anymore.

All our models are built on understanding these things. How much the strait is open or closed at any time? We can debate it; we don't know. That's, basically, the main artery of the system from the heart to the body, and we don't know if it's blockaded or not at the different time, and we might be waiting for a heart attack, basically. that's what we're discussing here.

The OPEC core, the notion that at one point we have a market without any regulator in it, is bearish, correct, and the market doesn't know yet how to discover that price.

And the last one is we're basically without spare capacity, first on refining but maybe on crude. What does it mean? And we have two escalating war(s) going on.

Dr. Majkut: But should we think about the last six months as being a sort of different regime where demand response in China and other places are doing a lot to moderate price volatility on the other side of the supply and demand balance?

Mr. Diwan: Yes, and that's the element that in a way have emerged, which is that China or you have a demand management that is as powerful as the supply management. I mean, OPEC swinging 5 million barrel per day on a dime for two, three months? Never happened. China did it on the demand side. So a very different management on the other side. But all these structures are new, and we don't know exactly how they're going to be used and how they're going to be leveraged politically in the future.

Dr. Majkut: And neither do you have the same communication apparatus. Like, OPEC has an office in Vienna. They have meetings. They tell people what they're going to do.

Mr. Book: You want China to hold a demand cartel meeting every month –

Mr. Diwan: Exactly. (Laughter.)

Mr. Book: – for your –

Mr. Diwan: I mean, who are the five people around the table deciding the import levels in China? I don't know, but I'm sure they exist.

Mr. Book: Do you think OPEC is at risk? I think one of the narratives that came out of this is that this broke OPEC. We heard that in 2008 when OPEC couldn't come up with barrels for a short world before, but here they still are very much an organization. What do you think about that?

Mr. Siegle: Well, here most of them still are.

Mr. Book: Well, a fair, fair point.

Mr. Diwan: I mean, you can have an organization. The question is, is it acting in the market? And it's to be seen. I mean, I don't think these conditions will tell – are telling us anything.

But an OPEC without the UAE to swing volumes beside Saudi Arabia and Kuwait – and I'm not sure that Saudi Arabia is willing to say, like, we're the only two doing the job.

Mr. Seigle: And you have to wonder what could follow UAE's historic exit. So, for us market observers, not that big of a surprise that Abu Dhabi decided to go in a different direction. Lots of hints along the way.

But the question is, what's next? It seems that Saudi Arabia probably still has critical mass to set oil supply policy and govern the market, especially if it continues to have Moscow's participation, as it were. But without another key player – like, it probably only has one more to lose, and I have my eyes on Iraq. And the Iraqis are probably thinking they're also in the Gulf; wait a minute, one of the richest countries in the galaxy decided that the cost-benefit of staying in the group didn't meet its requirements. We have bigger bills to pay here, guys, and so more acute cashflow requirements, liquidity concerns. And so they'll constantly be reassessing that cost-benefit and deciding whether they should stay in.

Mr. Book: The reason I brought it up, Joseph, is you were asking about what the enduring effects were going to be from all this. And so, you know, did this break OPEC is – you know, it's a good sort of tabloid-quality question –

Dr. Majkut: (Laughs.)

Mr. Book: – that deserves, I think, maybe to be decomposed into a more sober analysis.

But, you know, Clay's point is, I think, well-taken. You know, what are we getting? And I think to that I would – I would offer that we went into this year with OPEC deciding that it wanted to trade balancing for market share, right, were sort of willing to run the taps anyway. And now we're going to see a lot of these countries having to run the taps to pay for reconstruction. So the difference may not be that material.

Mr. Seigle: If they can get the oil out.

Mr. Book: If they can get the oil out.

Dr. Majkut: Yeah. But the question is, like, how long does that – you know, does the game theory of the market change? Are you going to start seeing behavior where we need – we're trying to get money out of the system now. We've had a prolonged price shock. We have energy security concerns, which we hear about from policymakers all the time now. We haven't talked yet about what this means for future demand in oil markets, but I don't think its long-term effects are likely positive. Maybe you see more behavior of countries trying to get the revenue – these large exporters trying to get the revenue while they can.

Mr. Book: Well, as to that demand, you know, we've heard about that, you know, get the revenue while you can because of climate change. It's coming for your barrels, so sell them all at once. You know, and, eh, where are we on the other side of that? You know, we're still – we're still in a world of changing climate, but as policy priorities go it is not at the top of the lists in the West, as it once was.

On the demand side, you and I had an Energy Shots episode where we laid out sort of four things that would change for importing countries. One would likely be diversification of sources and routes. Another, the building of reserves – strategic reserves, commercial reserves. The third would be a diversification into domestic energy, particularly electrification, if they could, but also coal, which is there, and energy. And the fourth was a real effort at efficiency. And, you know, one of the things that we can see right away, it's not just that the consumers are diversifying, but the producers are diversifying routes as well. And that keeps coming up about pipelines in the gulf. But also the reserves builds. You know, these are showing up. We can see now that strategic reserve expansion is on the agenda.

Mr. Seigle: Can I proffer a fifth?

Dr. Majkut: Yeah, of course.

Mr. Seigle: Which is – are we up to five?

So, disarming the conflicts is also something that should be tabled for the geopolitical lens, or prism of this discussion. And so these countries in the gulf that have been part of this war, you know, they have to live with their neighbors permanently, one would presume. And while the administration's policy that was just announced today, about, you know, an economic D-Day on those that are still – have economic ties with Iran and are purportedly enabling Iran to continue doing what it's doing – well, those countries have to decide the extent to which they are going to be pulled this way or that way. And I don't think it's going to be all one way or the other. It's not like a pendulum that swings to one extreme or the other. It's probably going to be somewhere in the middle, because, as I said, they have to live with the consequences.

Dr. Majkut: Hmm.

Mr. Diwan But, in a way, what we're saying is if Hormuz were open, we will have a surplus, and the market knows that. So that gives you some fear on the bearish side. But the chances of Hormuz to be open like it was six months ago, I think it's a tail end risk at this stage. So what we don't know, and this is the difficult, it's not going to be permanently closed. It's difficult. It's not going to be permanently open. But that's a wide range. And where are we on that range is anybody's guess at this stage, is how much pressure we're doing at what time, how much the technology's shifting, how much the Iranians can do. It's going to be quite different with, also, risk on the – on the assets if there is an escalation in the conflict.

Dr. Majkut: And, in fact, this is a matter of debate this week, right?

Mr. Diwan: Right now.

Dr. Majkut: The administration, through official and unofficial channels, is talking about how many tankers can flow in and out of the Strait of Hormuz via the southern Omani route, right? We've seen the UKMTO, just before we came on to broadcast, said 74 ships, tankers, have made the crossing in the last 72 hours. If you – sort of you make some assumptions about inflows and outflows balancing, you get about 10, 12 ships a day, 8 million barrels a day of crude oil is not an absurd number to think about, products as well. Far from normal, but much more than we had just a couple months ago. And, you know, whether or not the U.S. is able to maintain the security of that shipping is an enormous question.

Mr. Seigle: And yet, the risks have also proliferated geographically. And so in the intervening weeks we now have the Red Sea. We have flows from the Red Sea south to the Asia-Pacific largely curtailed at Bab al-Mandab. Very few ship owners are willing – and operators – are willing to do business there as before. And we've also seen the risk proliferate all the way through the northern route out of the Red Sea to an energy terminal in the Mediterranean. So, you know, that's another – that's another factor worthy of our consideration.

Mr. Book: I think it's a factor worthy of expanding on, actually, because what you're describing is a secular change in how energy infrastructure is now exposed to kinetic risk. We have seen it, of course, in the Ukraine war, but now the new precision Ukraine has with targeting Russian refineries, which are constrained from repairs by U.S. sanctions among other things, certainly contributing to the products shortage that Roger mentioned. But in addition to that, we're seeing a new willingness to strike economic targets, and even an expansion of the battlefield. So Mohsen Rezaei, the secretary of the Iranian Supreme National Security Council, said yesterday, "Iran will regard any country's participation in or support for America's economic war against the Iranian people as an act of war."

And that opens the target set wider than just regional partners of the United States. It opens the target set to anybody who's perceived to be going along with the sanctions pressure that Treasury announced today and intends to bring to bear in coming weeks. And what manner of attacks are we talking about? Well, because the weapon set doesn't just include ordnance, but also cyber ordnance, which can be very effective, as we've seen, then we have proliferating risks to energy infrastructure – in sort of a much broader sphere, as a sort of enduring consequence of the Iran war, back to your theme.

Mr. Diwan: I mean, just to comment on that, if you look at today's announcement or non-announcement, of more sanctions on Iran, I mean, we've been in this town for a long time. There have been serious sanctions on Iran and seriously enforced through all the administrations we've been through. So the notion that you're bringing an extra layer and there's so much in the system that you're going to be able to remove, I think everybody is looking at these things, like, the people before were not clowns. I mean, they were working hard on stopping Iran. So the incremental gain we have is very small, I would say, only in terms of sanction.

However, what Kevin is saying is that the response to that incremental level of sanction is now putting all the energy asset in the region on the table on the Iranian side. So you have a very different reaction and strategy on the Iranian part, which is to basically say, if you escalate a little bit, we're going to escalate a lot more.

Dr. Majkut: Does that – does that create a tough choice for countries in the Gulf region or in – you know, anybody in ballistic missile range of Iran, where you're sort of choosing between absorbing secondary sanctions from the United States or missile fire from Iran? How can the U.S. sort of balance those?

Mr. Book: I mean, I think the choices are evident in what we've read, publicly stated, that some of the producers in the region have been asking the Trump administration not to take that next step towards economic targets because they're concerned about reprisals.

Dr. Majkut: You know, one of the things I've sort of observed over the – over the course of the conflict, with a couple key exceptions – Ras Laffan, the LNG exporting facility in Qatar, petrochemical facilities in Saudi – is much of the kinetic action seems to be sort of focused on tankers, on shipping, more temporary targets, right? We haven't seen too many instances of Iran firing on infrastructure that's going to take years to rebuild. Am I missing something, or is that a fairly well-calibrated picture so far?

Mr. Seigle: Well, I think they've been fortuitous outcomes in the case of quite some number of attacks against refineries as well. And –

Dr. Majkut: And the role of U.S. interceptors and other air defenses.

Mr. Diwan: I think also these facilities were better defended in the sense that the interceptors, et cetera, were much more targeting the key supply infrastructures.

Mr. Seigle: It's possible that some damage to refineries and associated infrastructure may not be fully known and appreciated at this stage.

Mr. Book: And the Houthis are continuing the attacks on infrastructure, even if Iran is less so now. And so we can see the reports anyway of refineries on the kingdom's west coast are showing up. And so – or damage to refineries. And so that – I mean, this is a big challenge, right? So pipelines can be repaired in days to weeks. Ships can be a challenge environmentally for a very long time if there are spills, but relatively short-order consequences from a supply system.

When you get into things that are under high temperature and pressure and have incredible mechanical complexity, like refineries or LNG liquefaction facilities, you're now in the months to years. And when you look at explosions at LNG facilities that have happened over the course of the industry's history, some of them have literally been offline for years. And so you have to – you have to think, but for those interceptors, but for where things were, what does the next phase look like? And I think that is why a number of the countries in question have some concern.

Dr. Majkut: Well, you look – you look the other direction too. Like, Kharg Island – President Trump has known about Kharg Island for 40-some years. It was raised as a potential target of U.S. military action. But they've kind of held off. One explanatory factor may be, you know, we're trying to – we want there to be the ability to export in the future so Iran can rebuild on its own oil revenues. If you blow up the ability to load tankers, it gets incredibly hard to resume exports quickly.

Mr. Seigle: That's thing number one. And then, kind of from the perspective of our own risk mitigation, it could be quite costly. I have no doubt that the United States armed forces could take Kharg Island, seize control of it, et cetera. But they'd come under a lot of fire on the way to doing that. And it would result in probably substantial losses. And so that's one lens through which the administration's policies are going to be judged. And I think that they have, wisely, maybe sidestepped a risky prospect like that.

Dr. Majkut: Let me bring us back to the debate around current flows, because I'd love your combined wisdom on this question. Surely, if the U.S. Navy is escorting tankers, they know how many they're escorting. They know the bill of lading. They'll have a good sense of what kind of flows have been able to be restored. But commercial databases are showing much less traffic than the administration is claiming. Eventually, these two numbers should converge, right? We shouldn't live with sort of 5 million – 4 million barrels a day of uncertainty for too long. What would be the indicators you're watching for to sort of tell us, you know, how much is actually flowing through the strait? When will markets be able to give us good information on this?

Mr. Seigle: Well, naturally, as observations and tallies of the volumes that have made it through Hormuz. And so we have things like the AIS beacons that are sent out on the transponders. We also have satellite imagery that can help, you know, corroborate it and fill in the gaps. But when we see an increase in delivered oil from Hormuz origins, and when we see the level of oil on the water increasing, we'll have our confirmations.

Mr. Diwan: Same.

Mr. Book: Yeah.

Mr. Diwan: I mean, the data will be able to tell us. But it's difficult to believe there is such a discrepancy that there's 5, 7 million barrel per day that we're not seeing in the – in the data. And by the way, if that's the reality, Iran is also probably getting the data too. And I think they were pretty clear today that there was – they would be targeting ADNOC and a – and a South Korean company, both companies who are basically running the shuttle service through Hormuz.

Mr. Seigle: Yeah, that's right

Mr. Diwan: So, again, here this is a dynamic military environment. I mean, what can they do/not do? How much we're degrading their ability to see what's going on in Hormuz we don't know. I mean, clearly, we're going after radars, after everything that allow them to see what's going on. But how long, also, can we keep that permanent vigil and this shuttling? I mean, it costs a lot of money. (Laughs.) The Navy has to stay there, cannot be resupplied from the Gulf.

Dr. Majkut: Right. Yes.

Mr. Diwan: I mean, we heard about all the problems on the Lincoln. But all these things are related. How long can you, basically, keep that shuttle service going on? And who's paying for it?

Mr. Book: Not just that. We also are running a full naval blockade of Iran's ports. And at the same time that we're conducting blockades or at least notional blockades in Venezuela and offshore Cuba. This is a very materiel-, labor-, and cost-intensive way to prosecute a policy. So to say that this is – if this is going to be the way it goes going forward, we're going to need more defense capabilities and we're going to need more budget for it.

And there's a – everybody who ever studied economics of energy in college had some late night bull session about what the fully loaded cost of oil would be. And there were people who would say: You should count all of the defense budgets because that's what makes it go. (Laughter.) And other people would say: No, it's a free market. And somewhere in between there were a lot of beers consumed. (Laughter.) We're not consuming beers now, but you have to start to think about what the carrying cost would be. Maybe you are in your mug, Joseph. (Laughter.)

But the carrying cost for the stakeholders, President Trump has said, you know, maybe we should be charging for this because we're delivering a good for the world. And there is some question about how sustainable this will be, given the costs. What if a new administration with a different perspective on the region were responsible for caring for the strait and decided to stop?

Dr. Majkut: Or a different perspective on global public goods?

Mr. Book: Fair.

Dr. Majkut: Go ahead, Clay.

Mr. Seigle: I have a suggestion on tradecraft and kind of basic accounting, because you asked, when will we know how much oil is getting through. Four or 5 million barrels a day is too big of a discrepancy to be probably physically possible for a very long period of time.

Remember that prewar, peacetime, on a good day there is great variation in the number of loadings and transits in any chokepoint or loading facility. So it's really important to compare apples to apples and oranges to oranges with that same denominator of the number of days that you're measuring. And I would caution the trackers and the observers against putting too much eggs in the basket of one day or a couple of days of tallies; it's really about an average over some period of time. You could take a week. You could take 30 days. But that's when the smoothing really takes effect and you get a sense of how much oil is being exported.

Dr. Majkut: Right.

Mr. Diwan: And this guy knows something about ship tracking.

Dr. Majkut: Yes. Well, and, you know, Kevin mentioned the blockade. I seem to remember one of us at the table recommending very early in the conflict that the U.S. blockade Iranian oil exports. You know, we've made a lot of interceptions over the past couple months as a means of creating yet further economic pressure on Iran. What's your assessment, Clay, of how that's going? Has it worked? Or are we sort of – does that tool sort of create – further the siege mentality in Iran and strengthen leadership?

Mr. Seigle: I believe that it has worked as intended. The intention was to send that signal in Iran, basically turn the old Iranian argument 180 degrees and say, hey, look, if everyone else doesn't have the freedom to export energy you guys aren't going to have carte blanche either, which is what they had in March and early April. They were actually exporting more than they were before the war started.

Dr. Majkut: Yeah. We lifted sanctions and restrictions. Yeah.

Mr. Seigle: Like, guys, what are we doing? So it can't be that level of asymmetry in terms of who can do what.

The hope was that we would take that inflection point, and having rattled the saber and sent the message and gotten the attention in Tehran to negotiate an off-ramp, which of course requires mutual compromises, climbing down from the maximalist positions. We haven't seen that part. And so what we saw with the abortive MOU – and of course the deadline just passed, I guess, last week for the 60-day window to come up with a final agreement – both sides move pretty quickly away from their representations and obligations in the MOU. But is Iran really going to accept anything less than those basic provisions, which are the right to sell oil, the right to have their un-freezed assets, and some form of reconstruction? Probably not.

The other thing that's happened in the intervening period is that the Houthis opened fire in the Red Sea in response to, to be fair, to what they saw as Saudi provocations – bombing the airport in Sanaa, et cetera. So what we have now is the Red Sea also at risk, and so this just complicates the path to a solution.

Dr. Majkut: You know – go ahead, Kevin.

Mr. Book: So just about this blockade business, it's sort of, I think, indicative of where we are in our sanctions regime that we've gone from financial enforcement to physical enforcement.

So this started in Venezuela, right, the pursuit of tankers on the open sea for the enforcement of sanctions against those tankers. And this is – again, this is a very costly way to have to manage what would previously have been engineered in the wiring of dollar trade and connected to sort of more commercial means. It's now become a – today, Secretary Bessent basically said we're going to be bringing pressure not only through the sanctions but in tandem with the blockade.

You know, looking ahead, before there was an Iran war, we were starting to wonder if we had seen in Venezuela the end of the efficacy of the ramped-up sanctions of the last few decades. And this sort of suggests that, yes, we still have. They can be very powerful and very effective, but maybe not alone.

Mr. Diwan: No, but that's also a fundamental change. I mean, the whole idea is the U.S. is going to use its military might for its – and its economic might together to do blockades of countries it has a problem with and to use it as a tool, using that chokepoints the same that we were doing before just with the finance – now we're doing physically – justify others doing the same. I mean, we're in a different world than we were a few months ago on all these different criteria. How you use force, how you use chokepoints for economic statecraft has changed.

Mr. Seigle: You guys are right to bring up the Venezuela analog because, if you think about it, the quarantine that the Trump administration imposed I guess in January, in December, was working, and so Venezuela was not able to freely sell its oil. Apparently, it wasn't fast enough for the Trump administration and its objectives and its timetable, and so it resorted to the Maduro op in January.

So if you think about whether that could be applicable here, we have the embargo. I think it's accomplishing the goal on the – on the waters, on the high seas, in depriving Iran of the revenue. Will it result in the political change on the administration's timetable is the question. Otherwise, we may be gearing up for another round.

Dr. Majkut: So one of the – one of the – you guys have all watched this market longer than I have, but one of the big shifts over the last I want to say five years, maybe since 2018 and the maximum pressure sanctions on Iran, has been the rise of the dark fleet, right, tankers that are sort of outside of the normal commercial insurance and regulatory governance mechanisms helping countries evade these kinds of sanctions. Now, if the blockade gets stronger, and Russia is pressured on its exports because of attacks on its refinery complex, Venezuela is no longer exporting through the dark fleet because of U.S. involvement there now, could the end of this war or the end of this conflict actually bring us back to a world where you have less dark fleet, less incentive to have a sort of secondary parallel oil market, or is that thinking too fantastically?

Mr. Seigle: I mean, from my mind, it all depends on the demand signal to have a separate tanker capacity that is dark and outside the compliant regime. And if the sanctioning or tariffing or whatever environment dictates it, then supply will find a way to demand. This is the lesson that we've seen.

Mr. Diwan: Yeah. I mean, if the U.S. was still the rule enforcer of open maritime sea lanes, you would not need a dark fleet. But if the U.S. is part of the problem, you're going to need for a bigger dark fleet because you want to evade more sanctions. So I'm not as optimistic as you are. I mean, there's a new dark fleet emerging as we speak to shuttle just across Hormuz to give it to the other part of the dark fleet to send it to somewhere else to evade the sanctions on the other side. So we have two dark fleets now to do the same job.

Mr. Book: Well, perhaps three, because actually the transponder off traffic moving through the Omani lane under the guidance of the U.S. Navy is traveling dark, or your statistical resources would probably be catching more of those transponders. And actually, Clay's point about the – sort of the growth of the dark fleet was an artifact of the price cap, which was an interesting response to a sanctions challenge. Which is that it hurts to really put pressure on major oil-producing economies. And so the idea that you would somehow pressure price rather than quantity created this immediate need for something that would be outside the aegis of those sanctions and that price cap. So the dark fleet was a solution for that. If the price cap goes away, which is another – sort of, as sanctions lose their potency, you know, and the pain of imposing them starts to exceed the benefit of doing so, you may start to see an organic reduction in dark fleet demand.

Dr. Majkut: So return to the start of our conversation. We entered this incredible energy shock, like the sort of, you know, midterm exam in your energy security course is what happens when the Strait of Hormuz gets blocked. And, against expectation, the world has, at least thus, far weathered this without economic catastrophe. Goldman, the last time I looked, had us at about a 30 percent chance of recession this year, not significantly over baseline and not over the – over the likely threshold that we might have – that some were pointing to earlier this year. But that seems to have come about because of some different factors all working in concert.

Chinese imports are down. There's demand destruction in emerging markets. The U.S. has been exporting a lot more, particularly products. Though, as Kevin and I showed on our show last Friday, those distillate stocks are getting very, very low in a few key markets around our country. And governments and firms have been willing to eat into stocks under the idea that this is sort of temporary, that will eventually have to resolve itself. Which factor are each of you most worried about breaking – in which case, the economic problems associated with this could get much worse, perhaps quickly? Clay.

Mr. Seigle: Well, in the physical market, two things. Number one, the U.S. exports, certainly on the crude side, were made possible by the transfer of these valuable resources from the strategic petroleum reserve into the commercial inventories. Those are time-delineated and barrel-delineated. You can only spend them once and it will take a long time to rebuild. But in any case, the authorization that the president made, especially 172 million barrels, is almost worked through. Only a little bit left to go. He could always authorize more, but it's precariously low at under 300 million barrels. So I'm concerned that that cushion that the oil market has, along with OPEC spare capacity, is so thin that we'll have less policy flexibility in the case of future disruptions.

The other thing that I'm watching for is in the paper markets. And one of the hallmarks of this war that's made it so different than other supply disruptions that we've studied over the decades, is in the past if you had a bullish fundamental position, a legitimate way to play that is to be long crude futures. And that does not work in this situation, when, arguably, the greatest influencer on how people think about the war is continuously setting expectations for a quick conclusion and a favorable economic outcome. So no trader, even if you think that there's going to be a shortage in the future, wants to be holding an expensively long futures position. If that ever changes, that calculus, then we are going higher, and materially so.

Dr. Majkut: Kevin.

Mr. Book: Well, to be fair, you know, the president didn't just talk the market down successfully, which is very hard to do – and he did successfully do it repeatedly. But then he sailed it down as well. So Project Freedom, as we originally knew it, became a successful evacuation of barrels from the gulf, which fundamentally delivered the price response that maybe sort of more experientially or communication-wise the president had been promising. So there's reason for those traders to be worried. What rabbit could come out of the hat next? And that is – if you go back to the Biden administration, when they would sort of hint that maybe there'd be an SPR draw and, you know, the Brent front month would sell off a couple bucks just on the hint of a possibility, this is a much, much different world.

But, look, I think what we have to wonder is, if everything goes well and we just live in a world that's a permanently changed strait, we're still looking at a structural deficit that has to be made up somewhere. And that investment has to happen in the Western Hemisphere, and everywhere else. But we're also not out of the woods yet. The idea that there could be deeper damage of a longer and more enduring nature because of a resumption of active hostilities in a less-resourced military conflict, where infrastructure stays damaged for longer, is still out there. So the salutary case that we're treating right now is still, I think, very benevolent in its outlook, relative to the fact that this is a war, and it's one of two energy wars, as Roger mentioned.

Mr. Diwan: And they're both in an escalation phase. And I think people don't see it day to day, but what we're seeing in Russia, Ukraine is going after the – not only the energy asset, but the physical asset, much deeper in the territory. Both countries seem to have great offensive capabilities and not much of defensive capabilities anymore. So that makes that conflict a lot more damaging on the assets. So something we need to think about. I mean, the curtailment of diesel exports from Russia are problematic for the world. I mean, it – basically, when the Europeans put sanctions on Russian oil they took the diesel from the U.S., which means all the countries who used to buy diesel from the U.S. – Brazil, et cetera – now buy it from Russia. So if you stop that flow, you're going to have a real issue globally.

So you have that. We lost overall our shock absorber on the stocks, on the strategic stocks. And winter is coming. And we're low on the LNG stocks. So, you know, we only talked about oil, but there is a number of commodities here impacted. I mean, this war has changed the role of gas and how we think about the demand for gas in the future with both wars, right?

Dr. Majkut: Expand a little bit on that. I mean, how is that changing how global markets are thinking about the role of gas?

Mr. Diwan: I mean, the perception of gas – it was the fuel more than the bridge – is it had legs for 15 year of growth from where we are, with the rising demand for electricity and, you know, putting it on the water. It's growing. And we have a large wave of supply coming on. But suddenly, on the receiving end, like, I don't want to be that much dependent on gas, because even if I'm not buying from the Persian Gulf, when the Persian Gulf closes, prices go up. There's a redirection of flow. So do I need to have that much gas in my mix? Should I have more coal? Should I have more renewables, more batteries? How do we need to manage energy security, resilience, trade flows? So that is changing.

It's changing on fertilizer. It's changing on helium. It's changing on carbon, for minerals. So a lot of different commodities – I mean, more importantly, how the gulf countries themselves see their future and their strategies to globalize into this environment. I mean, these are big questions that this war has opened. And the open-ended side of the conflict, and we don't know how much it's going to escalate, it's going to impact crude oil prices. But it's going to impact really a much broader set of issues.

Dr. Majkut: One observation I would make is, despite being now nearly six months into the conflict, you haven't seen governments sort of treat it as a long-term disruption. Most of the policy interventions thus far have been price supports for consumers, releasing of stockpiles. We haven't yet seen sort of 1970s-style, you know, strong efficiency standards on new vehicles or on energy more generally, outside of some smaller emerging markets. Like, I'm sure in – like, in those – Philippines and other places, India, these are, like, critical shortages, in many cases. But from a global perspective, you haven't seen real attempts – I think here of, like, Japan or Korea – at changing the future energy portfolio. How long does this conflict need to last before somebody starts thinking, hey, we need to make some big changes here?

Mr. Seigle: Well, also in the seventies, it wasn't a six-month period when stuff was implemented. But I think that – and, from talking to people who are involved, throughout, you know, that region, Northeast Asia, et cetera – the conversations are well underway, and thinking about strategies to de-risk. It goes way beyond – I mean, pipelines, pipelines, pipelines. Everyone wants to say if you build enough pipelines, we'll be sufficiently de-risked. I would caution against over-indexing on pipelines. And the reason why is all pipelines deliver to some terminus, whether it's a ship-loading terminal or whatever. Show me where the pipeline ends, and let's assess its geopolitical risk. And then I'll tell you to what extent we've helped solve the problem.

Dr. Majkut: Well, and as Kevin indicated, a lot of these conflicts seem to be getting more and more borderless, right? As autonomous vehicles and offensive capabilities sort of remove us from the traditional theaters of military conflict, your ability to escape these risks just because you're 1,500 miles away is not clear.

Mr. Seigle: Yeah. There's distance, and then there's the players. There's the proliferation of those strike technologies that can defeat air defenses, also to nonstate actors. And look at the Houthis, you know, to start with.

Dr. Majkut: Yeah.

Mr. Book: So –

Mr. Diwan: But – sorry, go ahead.

Mr. Book: Well, so just to build on what Clay was saying, the idea that we're – well, so two bites and you should be very, very shy. If you're once bitten and you're twice shy, you should be like four, sixteen times shy. I don't know what the exponential shyness is. But we do know what happened in the seventies, right? So the Arab oil embargo produced a demand and sort of standards response. We created a lot of agencies. A lot of things happened. But the real changes in consumption that came after the Iranian Revolution reflected what happened after the second bite. And so this is the second bite. And our thesis is that this is going to bring real changes. We are on the other side of the catalysts now. And the changes will take time to play out, but, you know, it seems very hard to expect that fossil energy demand writ large is going to look the same as it would have prior to this happening only five years, four years after the start of the Ukraine war.

Dr. Majkut: And that's not necessarily a statement about totals, but it might be distribution.

Mr. Diwan: Well, it might be both. So we're in the – to just say the same thing with different words – (laughter) – we're in the curtailment phase of the demand, and we will move into the destruction phase of the demand. And those are two different mechanisms. Curtailment is you still have the capacity and you're basically being more efficient or not use it, et cetera. Versus the demand destruction, is your capital stock is turning. And we're seeing it with hybrid vehicle sales, EV sales globally. I mean, since March you have a real takeoff, and you have a push at the same time, then a pull. I mean, China is pushing certain technologies. Batteries this year is going to be an all-time high. Solar is going to be an all-time high. So you're starting to see the shift.

So the bet I would want to take with Kevin, February '26, in a way, is kind of the highest point we have for oil demand globally. If we're having that discussion in February 2028, do you think we will be higher than February 2026?

Mr. Book: So those who've bet against oil demand have lost every single time. (Laughter.) I'm very reluctant to do that.

Mr. Diwan: Well, I give you a time limit, though.

Mr. Book: What I would do is I would change the bet. Well, no, I think – I think we could easily – if the war stopped inside of several weeks from now, then, yes –

Mr. Diwan. Yes. I would agree with that.

Mr. Book: – I think those recovery scenarios all make sense. If we have this ongoing uncertainty, or worse, escalation, then perhaps no.

Dr. Majkut: Does that include only consumption? Are you thinking about rebuilding of stocks as well?

Mr. Diwan: No, I was talking consumption.

Dr. Majkut: Consumption?

Mr. Diwan: Yeah.

Dr. Majkut: All right.

Mr. Book: It's a tough enough bet as it was.

Dr. Majkut: Yeah. Clay, did you want to get in on the pot?

Mr. Seigle: You know what sounds less compelling now than it did in our first forays in the seventies is turning down the thermostat and putting on a sweater, for various reasons. I'll leave it there.

Mr. Diwan: Europe did that.

Mr. Seigle: Yes.

Mr. Diwan: Three winters ago.

Dr. Majkut: Yeah.

Mr. Seigle: Yes, and it's absolutely – it's not a joking matter in places like Ukraine, when people actually can freeze in the winter. So that's real.

Mr. Book: But, politically, it's a terrible strategy here in the United States. You know, one of the things that's happened from fracking is that we've heard from our government how successfully we've achieved energy independence, dominance, pick your word, whatever. Some degree of net import – net imports has ended. Now we're net exporters. So it's real energy security, no matter how you slice it. But there's two things that have happened along the way. One is that sort of mentally we expect an energy patrimony. So there's probably less political tolerance for this sort of price increase than there was before we had such a successful exploitation of horizontally drilled hydraulically fractured wells. And then the second part is that we actually pushed a lot of molecules into the world and produced price stability for a very long time. And so we grew comfortable with that price stability. And therefore there's less public patience with volatility now as well.

Mr. Seigle: Agreed. If we have so much here domestically, and it's been such a success, and I think it has, why do we have policies that are resulting in these higher prices?

Dr. Majkut: Right. I think this fall gives us a test as to, you know, what the politics of price increases look like. The only thing that seems to be keeping gasoline prices or diesel prices, for that matter, off of headlines is the now sort of surprising degree of anger around datacenters, which is itself partially an energy issue, but a different part of the system and one, so far, insulated from the effects of this war.

Let me close here with a question. I think, you know, there is an impression in Washington that we get to the other side of the midterm and the president has more options. Perhaps escalation. Perhaps making a deal with Iran that would be unpopular with political constituencies today. How are you thinking about the next four months? Clay.

Mr. Seigle: Well, I'm not thinking about President Trump feeling a shortage of options. And so I think that he feels that the whole policy toolkit is wide open to him. In the next four months, I think the main thing I'm keeping my eye on is the volumetric supply of the world from this part of the region, it includes not just the gulf but also the Red Sea, and the extent to which demand holds in or gets curtailed by high prices. Which is what Roger has accurately put on our radar to watch.

Dr. Majkut: Right. Kevin.

Mr. Book: So the idea that the president is holding off until after the election and then he could pursue military escalation, certainly can't rule that out. The other way to think about it, though, is that if he has a political reversal, Congress turns over, then he's going to pursue what he did in 2019 after the 2018 midterm reversal, which is more executive power. And where is the greatest executive power? Well, foreign policy is really among the top options. And so I suspect that more economic force projection and kinetic engagement could be in the offing if the election doesn't go the president's way. And that may sound strange after the – you know, the level we're at right now, but I simply wouldn't rule it out.

Dr. Majkut: Roger.

Mr. Diwan: Yeah. I think in Washington we always forget that the other side have agency. And the Iranians, I think, have been playing this, understanding there will be another escalating round. And they're getting ready for that. So, in a way, escalation is going to be, I think, costly for both sides. And it's not a good news that we're thinking that there is another round, because I think the energy assets are going to be, this time, potentially much more into the forefront, if the Iranians feel that the regime is at stake between the chokehold on the export and a kinetic response.

Dr. Majkut: And the buffers would be much thinner.

Mr. Diwan: Yeah.

Mr. Seigle: Well, if you guys are right about that, and there's another round coming that could jeopardize energy security, then we also have to worry about potentially more precipitous policy considerations here in town to react to that.

Mr. Diwan Yeah, around export control and things like that. Yeah.

Dr. Majkut: Well, we will follow it all with you. Thank you for today's conversation. You know, it's remarkable to be able to learn from you experts, and to watch these enormous changes happening in real time. And thank you for all the insights you've shared today. Colleagues who've joined us, thank you so much. Do check out the work of our colleagues here at CSIS. We're covering the military capabilities of the United States in the region, Iran's strategies, and, of course, following the energy story as it emerges. This is Joseph Majkut, signing off.

(END.)