

January 2020 Berman Newsletter: *The Soleimani Assassination & Oil Price*

How will the assassination of the Iranian General Qassem Soleimani affect oil prices?

The price rally that began in early October was losing momentum before his assassination on January 2, 2019. WTI increased about \$2.00 per barrel on Friday (Figure 1). It is likely that prices will move higher next week as traders test the market's sentiment about the potential for Iranian retaliation.

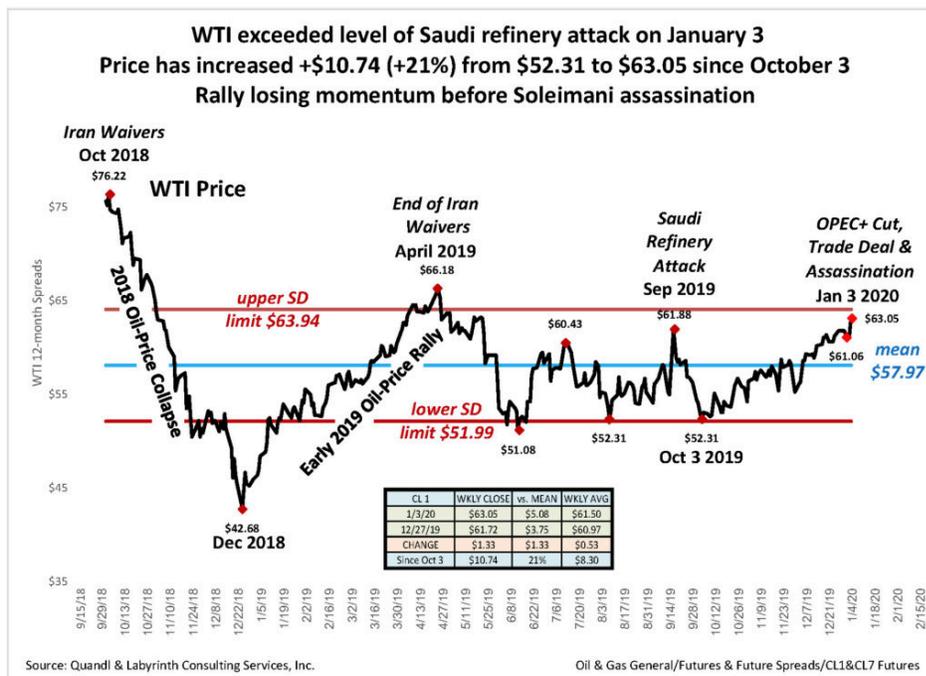


Figure 1. WTI price exceeded level of September 2018 Saudi refinery attack on January 3, 2019. Source: Quandl and Labyrinth Consulting Services, Inc.

Barring outbreak of conflict between U.S. and Iranian forces or their proxies, however, I expect oil prices to flatten and then fall during the first quarter of 2020.

Oil prices began a 3-month rally in early October when WTI price was \$52.31. Price has increased since by \$10.74 (21%) to \$63.05 (Figure 1) exceeding the \$62 level of the September Saudi refinery attacks.

Previous price rallies reached similar levels before failing. That is because they were based mostly on expectations of supply constraints and not on actual market tightness. This rally represents more of the same.

The current rally required two major factors: the OPEC+ production cut in late November and the long-awaited announcement of a U.S. China trade deal a few days later. The rally quickly

lost momentum and prices began falling in late December when the assassination of Iraqi General [Qassem Soleimani](#) sent them higher again..

There are two main reasons that I doubt that the Soleimani assassination will have lasting effect on oil prices. The first is because price volatility was not substantial compared with other volatility events.

Figure 2 shows implied oil-price volatility since 2000. The greatest volatility responses were the 2008-2009 Financial Collapse, the Arab Spring uprisings in 2011, the oil-price collapse of 2014-2015 and the attack on Saudi oil refineries in September of last year.

Last week's volatility was much less significant than those, and than lesser spikes over the last two decades.

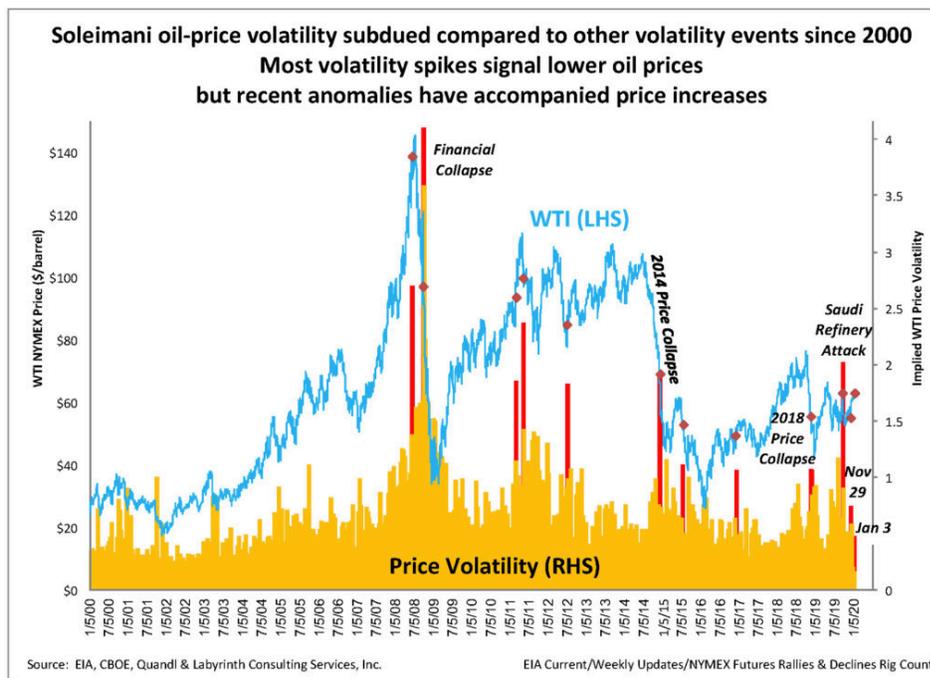


Figure 2. Oil-price volatility accompanying the Soleimani assassination was subdued compared to other volatility events since 2000. Source: EIA, Quandl and Labyrinth Consulting Services, Inc.

Before the assassination, the 3-month price rally showed signs of losing momentum. Brent front-month price increased +\$2.35 to \$68.60 on January 3 when the assassination was announced but it had fallen -\$1.91 to \$66.25 beforehand (Figure 3). The assassination had little more effect on price than to adjust the rally back to its earlier trajectory.

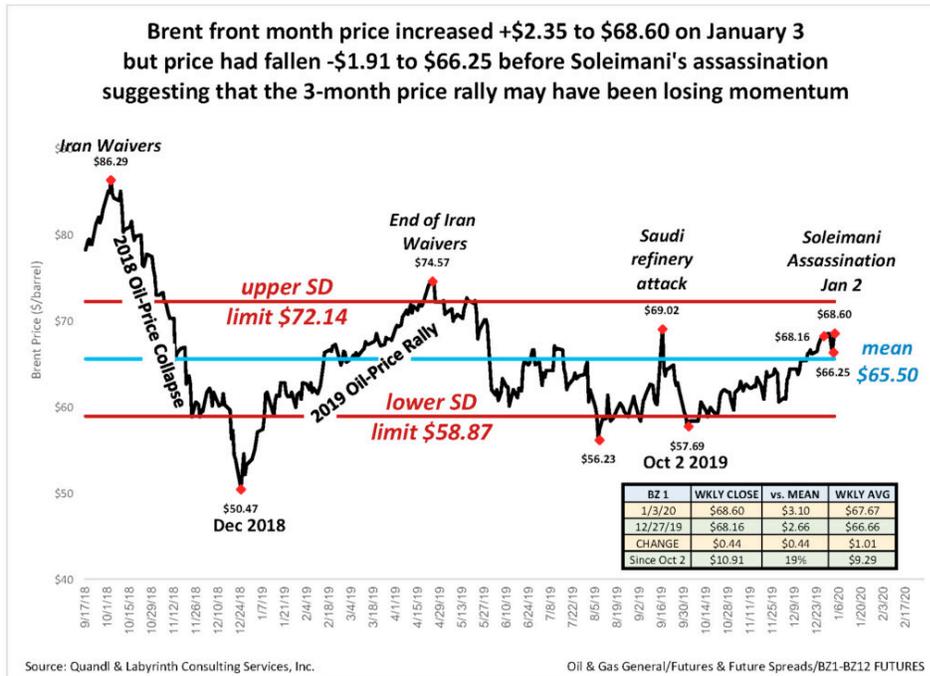


Figure 3. Brent front-month price increased +\$2.35 to \$68.60 on January 3 but it had fallen -\$1.91 to \$66.25 before Soleimani's assassination. This suggests that the 3-month price rally may have been losing momentum. Source: EIA and Labyrinth Consulting Services, Inc.

The second reason why this event will not have lasting effect on oil prices is that the resulting "fear premium" has been relatively small so far.

The price increase indicates only about a \$2.00 WTI and \$3.00 Brent "fear premium" based on [comparative inventory](#) data. Comparative inventory (C.I.) vs WTI spot price for December plots on the blue yield curve for 2015 through 2019 (Figure 4). This indicates that WTI should be approximately \$61/barrel at that inventory level. Current front-month price of \$63.04 is, therefore, only about \$2.00 over-valued.

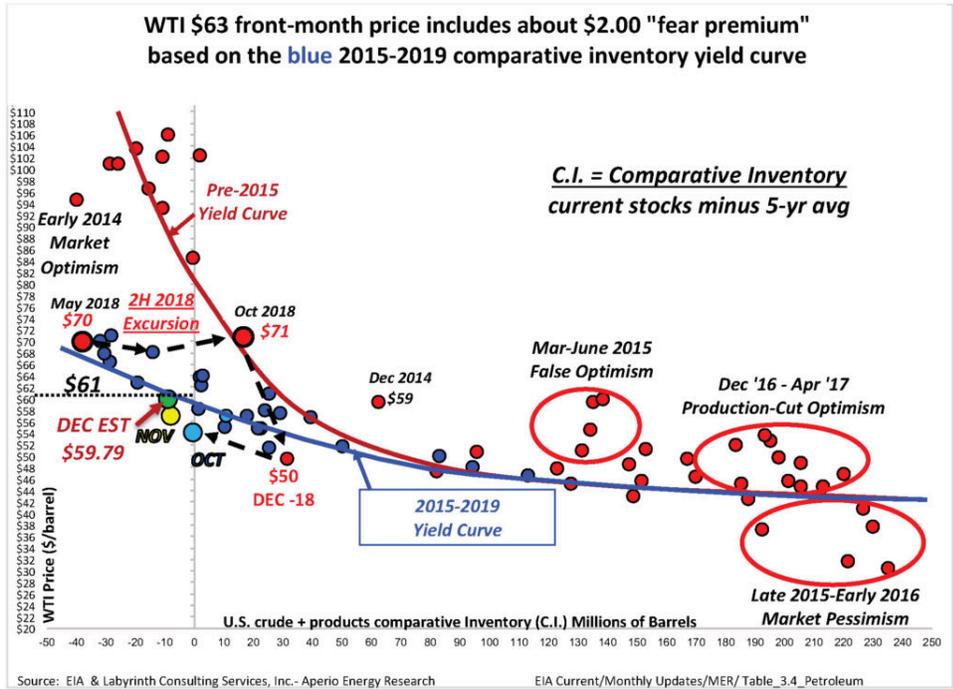


Figure 4. WTI \$63 front-month price includes about \$2.00 "fear premium" based on the blue 2015-2019 comparative inventory yield curve. Source: EIA and Labyrinth Consulting Services, Inc.

The relatively flat slope to the yield curve reflects a low sense of supply urgency by oil markets. This is consistent with the limited price response a few months ago to attacks on Saudi oil refineries. That had an immediate effect on physical oil supply. There is no reason to expect that the more abstract potential for future supply loss from this event should have more effect on oil prices.

Low fear premium and price volatility suggest that markets probably do not consider Soleimani's assassination a substantive cause for more than a temporary spike in oil prices. That may change in coming days or weeks depending on Iran's response.