

Bottom Line:

- Oil prices surged toward \$120/bbl in early March as escalating Middle East tensions and the closure of the Strait of Hormuz triggered a large geopolitical risk premium. Around one-fifth of global oil consumption passes through the strait, meaning a major disruption could remove 10–14 million barrels per day from markets and create significant inflation and supply-chain shocks. However, such elevated price levels are historically difficult to sustain as alternative supply and market adjustments emerge.

2026's wild card is disruption risk

This note examines oil and geopolitics and considers how pricing has become increasingly detached from underlying fundamentals. Given the wide range of potential geopolitical outcomes, it remains unclear how markets will ultimately price these risks. In the near term, concerns include capital flight from emerging markets and the potential for deep disruptions across global supply chains. At present, market behaviour appears more driven by risk perceptions than by immediate physical supply conditions.

What has happened?

Oil prices surged toward \$120 per barrel into the second week of March amid escalating conflict in the Middle East, briefly entering historically rare pricing territory. At the time of writing, prices have eased somewhat to just below \$103/bbl. This nevertheless represents a roughly 20–30% increase in prompt oil prices, despite physical supply conditions remaining relatively stable.

The move reflects growing investor concern about disruption risks linked primarily to the Strait of Hormuz, one of the world's most important energy chokepoints. As geopolitical tensions escalate, oil prices have begun to incorporate a significant risk premium, and it remains uncertain how far pricing could move away from underlying fundamentals if tensions persist.

The fundamentals

The geostrategic importance of the Strait of Hormuz lies in its role as the main maritime outlet connecting the Persian Gulf to the Gulf of Oman and the Indian Ocean. Roughly one-fifth of global oil consumption moves through this narrow shipping corridor.

The Strait borders Iran and carries exports from key producers including Saudi Arabia, Kuwait, Iraq, Qatar, the UAE and Iran itself. A complete shutdown would therefore represent one of the largest potential supply disruptions in modern oil markets. In addition to oil, a wide range of global supply chains—including petrochemicals, fertilisers, metals, and other bulk commodities—could also be affected.

Total oil flows through Hormuz are estimated at around 20 million barrels per day. In practice, some of this could be redirected through existing pipelines and alternative export routes, reducing the potential disruption to roughly 10–14 million barrels per day under favourable conditions. However, operational constraints could limit the effectiveness of rerouting during a crisis. If export routes are disrupted for a prolonged period, regional production shut-ins and refinery outages could compound the supply shock.

Strategic petroleum reserves would likely play an important stabilising role in such a scenario. Global emergency reserves are estimated at roughly 1.5–2 billion barrels, which could temporarily offset supply disruptions.

Given that Gulf exporters account for roughly half of global crude oil trade, a major disruption would carry clear stagflationary risks, particularly for energy-importing economies. Countries such as China and India, which rely heavily on Middle Eastern oil imports, would face particular supply challenges.

Caveats

There are also important caveats to the disruption narrative currently influencing oil prices. Iran's conventional military capabilities have been weakened by sustained pressure from the United States and Israel. However, the risk to shipping lies less in conventional naval power than in asymmetric threats to maritime traffic.

Higher oil prices also create incentives for increased production from regions outside the Middle East, including US shale, Brazil, and other Atlantic Basin producers, which could partially offset supply disruptions over time. At the same time, wartime conditions could increase shipping costs and insurance premiums, raising transport costs even if physical supply remains available.

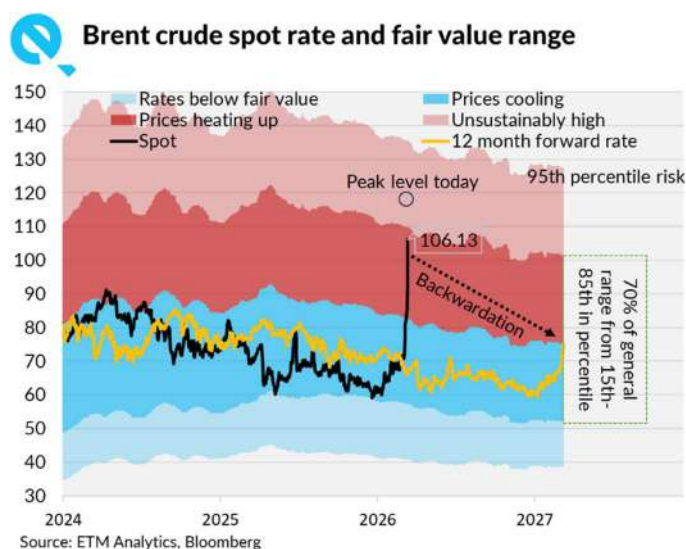
Market effects

Price gains of this magnitude are rarely sustained for long periods, but as long as disruption risks remain elevated, oil prices may continue to embed a sizeable geopolitical risk premium. Financial markets have already shown signs of heightened volatility across equities, bonds and currency markets.

Brent crude rose as much as 29% to around \$119.50 per barrel, while West Texas Intermediate increased by more than 30%, marking the largest intraday moves since 2020. If crude flows through Hormuz were significantly disrupted despite continued upstream production, regional output shut-ins could exceed 4 million barrels per day.

The resulting price shock is already raising concerns about a renewed global inflation impulse, prompting policy responses in several countries. Measures such as restrictions on refined fuel exports or targeted household subsidies could become more common if high energy prices persist.

Quantitative estimations of potential price



Historical trading data and estimates of recovered fair value—defined as the level at which producers could have hedged forward production—suggest that prices could rise further in a severe disruption scenario. Based on past episodes of geopolitical stress, the upper end of plausible price outcomes could approach \$140 per barrel.

However, the broader bias remains toward lower prices over the medium term. The current futures curve provides an important signal: while spot prices remain elevated, the 12-month Brent contract is trading below \$80, indicating deep backwardation.

This suggests that while markets are pricing substantial near-term disruption risk, traders do not expect these conditions to persist indefinitely.

Strategy and outlook

Given the volatility in oil markets, investors are likely to adopt more conservative positioning in the near term. Equity markets, bond markets and risk-sensitive currencies may remain under pressure if energy prices stay elevated.

The secondary effects on inflation expectations, central bank policy trajectories and capital allocation decisions could therefore weigh on risk assets in the coming months. While oil prices could be squeezed higher if geopolitical tensions escalate further, underlying supply dynamics suggest that, over the longer term, Brent prices are more likely to converge toward a range of roughly \$75–85 per barrel.

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