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Markets in Transition | Episode 5

Helima Croft, Managing Director & Global Head of Commodity Strategy, RBC Capital Markets

We continue *Markets in Transition* this week with Helima Croft, Managing Director & Global Head of Commodity Strategy at RBC Capital Markets. David Greely sits down with Helima to discuss the escalating situation in the Middle East as well as the U.S. presidential election – and what each may mean for global energy markets.

Helima Croft (00s):

I do think we have to think about the oil supply risk in the event that this does become a broader conflict. We don't know if it is at this point, but certainly it looks closer to a regional war than it did when we last spoke in March.

Announcer (15s):

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David Greely (58s):

Welcome back to Markets in Transition on SmarterMarkets. I'm Dave Greely, Chief economist at Abaxx Technologies. Our guest today is Helima Croft, Managing Director and Global Head of Commodity Strategy at RBC Capital Markets. We will be discussing the escalating situation in the Middle East following recent Iranian missile strikes on Israel in retaliation for Israeli strikes on Yemen and Lebanon. We will also be discussing the US presidential elections and what each may mean for global energy markets. Hello, Helima. Welcome back to SmarterMarkets.

Helima Croft (01m 31s):

Thank you so much and once again, we are on the precipice of potentially a major military development in the Middle East, so every time I meet with you, we are always having to discuss potential geopolitical mayhem.

David Greely (01m 45s):

We're not fortunate for that, but we are very fortunate to have you here to give your insights and perspectives on it. Always happy to have you here talking energy and geopolitics and this is certainly a day for it. So let's dive right in. Let's start talking about these recent events in the Middle East. Just for our listeners, we are recording this podcast on Wednesday, October 2nd. We don't normally tell you that, but of course things are moving quickly. So we want people to understand when the conversation is taking place, and this is a day after Iran fired a barrage of ballistic missiles at Israel. This came in retaliation for Israel striking targets in Yemen and Lebanon and beginning to have some ground attacks into Lebanon and of course we have had the killing of Hezbollah leader Hassan Nasrallah. This feels like the wider escalation that we all fear, right. The escalation of Iran moving beyond its proxies and engaging in direct military conflict with Israel. So I wanted to ask you, Helima, how are you thinking about how this may all play out and what it would mean for global oil prices?

Helima Croft (02m 49s):

Well, certainly it looks like we are seeing the opening of a second front. I mean, that has been something we've been watching, the Lebanon situation really since the war began a year ago. We were looking to whether Israel would make the calculation that they needed to move into Lebanon to create a buffer zone, move Hezbollah off the border to enable the return of 70,000 internally displaced Israelis to the north of the country. What we were not anticipating was the rapid ratcheting up of Israeli offensive operations, spectacular covert attacks involving pagers and you know, walkie-talkies, airstrikes that took out in rapid succession the top echelons that has follow leaders. This followed actually what we saw in August where the Israelis did an operation in Tehran that took out the political leader of Hamas Haniyeh and so the real question is, is Israel now looking to essentially run the table. Does this end in

Lebanon now or do they have Iran, you know, more squarely in their sites and following what we saw yesterday, the 180 ballistic missiles that were fired in Israel, does Benjamin Netanyahu decide that now is the time that he is going to go forward with a operation targeting critical military and economic infrastructure in Iran or does he mainly focus his operations on Lebanon?

David Greely (04m 14s):

What does running the table look like because I remember the last time, you know, you had Iran fire missiles at Israel and retaliation it was like, okay, we gave made our response and then it seemed to quiet down and of course the fear this time is it doesn't quiet down.

Helima Croft (04m 30s):

I mean this is so interesting because again, when we spoke last, we were in Lausanne at the FT Commodity Conference and we were on the precipice engagement between Iran and Israel in the wake of the attacking Damascus on the Iranian consular ability that killed a senior Iranian revolutionary guard official and then we were talking about if we saw some type of engagement between Israel and Iran, would it be limited, would it be designed to show strength while avoiding an outright regional war and that's really how it did play out. The Iranians telegraph in advance that they would be launching missiles at Israel. Israel's retaliation was pretty muted considering that 300 rockets and drones had been fired at their country. Everyone looked like they were basically showing that they could respond and they stood down. Now the question is, given what we have seen in the last 10 days in terms of Israeli risk appetite, does this attack yesterday give Israel the pretext to go in and target for example, significant around nuclear infrastructure?

Helima Croft (05m 37s):

Do they potentially go after economic infrastructure and this is why while market participants I think are paying closer attention to this conflict now is the question, does Israel have Iranian oil facilities potentially sort of car island, do they want to essentially say, you know what, it has been Iranian oil money that has funded the access of resistance proxies, groups like Houthis, Hezbollah, Hamas. Is this the moment where Israel says, you know what sanctions haven't been robustly enforced, Iranian oil exports that are nearly six year high. Do we want to lose the ATM that allows Iran to fund all these groups in the region? So is Iran's oil facilities, are they in the line of sight of Israel? It is not something we were really talking about when we spoke in March, we were thinking about will Iran potentially target regional energy infrastructure like they did in 2019 to internationalize the cost of the conflict. Now the scenarios that we're thinking about more focus on what is Israel looking to do in terms of their engagement with their main regional adversary Iran?

David Greely (06m 45s):

And interestingly this escalation comes with a backdrop in oil market where prices have been under pressure recently until the last day or two where you have had, you know, I probably the conversations before this were, what's OPEC gonna do? Is Saudi gonna bring the million barrels a day back? How does that change the calculus for what Israel might choose to do next?

Helima Croft (07m 08s):

And we're actually having this conversation the day joint ministerial monitoring committee is meeting, you are right, if we had had this conversation a week ago, we would be discussing whether Saudi was looking to unwind its million barrel voluntary cut if Iraq and Kazakhstan didn't get their act together in terms of compliance. The question about has the outlook for demand been fundamentally altered by the, the softer demand that we are seeing in China. That was the conversation, you know, 48 hours ago, and I think now market participants had been looking through this war in the Middle East, basically it faded the multi-year war, Russia, Ukraine, and now we are basically saying it's been a year of this Middle East war, there's been no major supply disruption. I'm going to focus on Chinese demand data, I am going to focus on OPEC, I am going to focus on non OPEC supply growth. Now they are having to think about geopolitics again and the potential for an October surprise in terms of a war in the Middle East that is more disruptive to energy markets than they anticipated.

Helima Croft (08m 15s):

The interesting follow on question, which I am sure you are going to go to is if we do end up in a situation where there is, you know, material disruptions of supply, what is a response mechanism from countries like Saudi Arabia and obviously the White House would once again pick up the phone and call Riyadh like we always do when there is a supply disruption, when there is a run up in prices and I do think the Saudis would be responsive, but just a question is like, would it be an immediate backfill of any losses. Would they wait to see how long these losses were gonna last because I think the Saudis are also, they are a little bit reticent to leap first into these situations. Remember in 2018 when we exited the Iran and nuclear agreement, we called the Saudis and said, Hey look, we are taking Iran to zero. You put a million barrels on the market, they put a million barrels on the market.

Helima Croft (09m 09s):

I was at that OPEC meeting where Khalid Al-Falih was like Saudi Arabia will do it alone if necessary and then in October we issued exemptions from Port of Iranian oil and the market collapsed and so I do think the Saudis are going to be cautious about how they look to fill any loss of supply. They are going to look to see what's the duration of this, what's the size of this. I think they are going to be, not that they going to slow walk it, but I think they are going to be cautious. I think they will add barrels, but they're not going to want sort of flood the market in anticipation that the losses could be extended.

David Greely (09m 44s):

How do you think in addition to that, there have been tensions between Saudi and Iran for a long time as well. How does that change how the Saudis think about this moment?

Helima Croft (09m 55s):

I love having these conversations with you, David, because literally two was at the March 23 FT conference. I think we had this conversation because I had just returned from Saudi Arabia. Saudi Arabia and Iran had just announced the normalization of relation and it doesn't mean that Saudi and Iran have become best friends in the region, but I think the Saudi decision to normalize with their longstanding adversary was driven by their need to de-risk their security environment. They were really concerned about, you know, is the United States actually going to come to our assistance if there is another attack on our country like we saw in 2019 when they, the Iranians hit the Abqaiq facility and I think they basically decided that with the United States support unclear in such a situation, they were better off making a deal with Iran to ensure that vision 2030 could proceed without potential security hiccups.

Helima Croft (10m 55s):

And so I think the Saudis are pretty confident that that deal with Iran is paying dividends. We haven't seen, for example, any Houthi attacks targeting Saudi infrastructure like we had seen before. We haven't seen Saudi ships being targeted in the Red Sea and so the question is, does this deal, does it ensure that Saudi wouldn't be become caught in the crosshairs if there is a more serious confrontation involving Iran, would Saudi be insulated from the Iranian saying, you know what, Western countries that are backing Israel, we are going to drive up your oil prices by attacking Saudi Arabia. I think the Saudis, you know, believe for now that the Iranians are interested in maintaining that relationship with the kingdom. But that said, that does not mean that the Iranians wouldn't look to target other regional energy supplies. It wouldn't mean that everybody in the region is safeguarded. So I do think we have to think about the oil supply risks in the event that this does become a broader conflict. We don't know if it is at this point, but certainly it looks closer to a regional war than it did when we last spoke in March.

David Greely (12m 09s):

And even without going to a full regional war. I think just you brought up the Houthis in Yemen and the Red Sea, like to what extent short of a, a direct conflict between Israel and Iran, would Israel going after some of the Iranian proxies like the Houthis in Yemen, would that possibly make security in the Red Sea safer? Is there a possible path there?

Helima Croft (12m 33s):

The interesting question will be is Israel able through airstrikes covert action and some ground operation to significantly alter the security environment in the region by inflicting major operational damage on a number of these groups. The question I think is can they do everything everywhere all at once and I think that is the challenge is that they are still having Gaza operations, they're now moving into Lebanon. You know, Hezbollah's leadership has been eviscerated, but they still retain their rockets, they still retain significant manpower both in Lebanon and overseas. The Houthis are, you know, there is no signs that they are backing off this fight and then there are these Iraqi militias so, and militias in Syria and so I still think the axis of resistance has the ability to cause significant problems for Israel, for the United States and the region. I'm not sure that they're going to be able to strike a blow against every group that Iran backs in the region. That's why I think the interesting question is do they want to go to the principal sponsor at some stage as opposed to the various affiliates?

David Greely (13m 53s):

And when you think about the Israeli mindset right now, what do you think's driving them because they are certainly taking on a lot more than we've seen in the recent past.

Helima Croft (14m 04s):

When you ask the question about what's driving the Israeli mindset, I, you know, there's so many great experts on the Israeli political scene that really dive into different personalities because we look at the Israeli wartime cabinet and you have, you know, individual from that cabinet that outside a security crisis would not be working together particularly well and so the question is, you know, are there differences in tactics and overall strategy between, you know, Benjamin Netanyahu and Yoav Gallant the defense minister. So the question is like, you know, I think it comes down to what does Benjamin Netanyahu want you know, the people have said that he has always been squarely focused on the Iran nuclear program. He is always that he would prevent Iran from becoming a nuclear power on his watch and so the question is, is the time now for him, and you mentioned we were gonna discuss the US election, does he believe that he has a unique window with the US elections basically a month away to be able to engage in military action without having strong pushback from the United States when we have significant military assets in the region?

Helima Croft (15m 19s):

If he were to decide that now is the time to set back this Iranian nuclear program, is the United States really going to stop him but post-election, you could see I think both a President Harris and a President Trump becoming very wary of getting entangled in another major Middle East war. I mean President Trump has really talked about supporting Israel, but remember when he was in power, he was not in favor of deploying significant US resource to the region. He had very clear red lines like the killing of a American citizen was a red line for Trump and remember that he took out Qasem Soleimani, but he was pretty clear that he did not want to repeat forever wars in the Middle East. So again, if you are Israel, you are probably looking at this window and you are thinking, you know, maybe this is my best shot.

David Greely (16m 15s):

He brought up US military assets in the region and I wanted to ask because they were involved in the defense of Israel against this ballistic missile barrage, a number of US ships shooting down Iranian missiles coming in. What is the risk of the US military being dragged into this?

Helima Croft (16m 36s):

Even if another country in the region starts the fight, do we have to finish it and certainly if you think about the Iran and nuclear facilities, there had been a view that certain facilities, particularly the Fordow facility, which is seen as highly impenetrable, that if you wanted to really disable that facility, if you were the Israelis, you would likely need US air support and US bunker busting bomb technology that had been the previous view to disable that facility that Israel could do significant damage against a facility like but Fordow would require assistance from the United States and so the question is again, if this conflict were to evolve in a way that it becomes more direct Israel, Iran, not just simply like these one-off days of missile strikes and everyone stands down, would the US essentially have to come in and basically finish the job?

David Greely (17m 36s):

I definitely want to come back to the US elections with you, but I feel like I should also ask you a little bit about the other scenario. What happens if the situation doesn't escalate? How are you seeing the oil market play out? You said we would have had a very different conversation a week ago. So I'd like to color in a little bit of what that conversation might've been looking like. A number of observers were feeling that we could be setting up for an oil market washout like in 2014. So I was curious how you were thinking about that.

Helima Croft (18m 04s):

I'm really showing my age on this podcast because so many of us have of a certain age. Remember the Thanksgiving 2014 meeting where at all oil market watchers had to leave the table and basically tell their families like, I will see you in like six hours. But I don't think that we are necessarily set up for a repeat of the Thanksgiving disaster for world market watchers, but I do think that it could be a more limited, I don't want to necessarily want a price war because in 2014 basically Ali Naimi was like, we are doing nothing in the face of us shale like shale, you're gonna break first and he kept saying like, we are not cutting, we are not cutting and eventually, you know, come 2016 they were like, you know what, the cost of this has been inordinately, high shale has suffered, but it is not broken and now we're gonna have to partner up with Russia to climb out of this inventory hole and manage the market.

Helima Croft (19m 08s):

So I haven't heard a lot of enthusiasm for that experiment. What I have heard though, increasingly and we have been writing about this is post that June meeting when there was a taper tantrum is that the Saudis were like, look, we have this million barrels in play, like it's our lollipop. We gave you that, you know, the summer of 23 to show our goodwill to the market to the rest of OPEC. We were going to

take more burden upon ourselves to balance this market. They called it a lollipop and the question is like, are the Saudis now saying like, you know what countries that have been overproducing and have not been complying with their reduction commitments, like we're gonna put you on a diet and the collective agreement's still going to run through year end 2025, but our barrels are unilateral barrels. Sorry guys. Like if you don't get it together, like we're just putting you on a diet.

Helima Croft (19m 59s):

And I think that from their perspective, that is what is in play. It's basically like look, we can decide the timing and the quantity of the phase in of our voluntary barrels and we're not gonna basically be taken for a ride continuously by our partners with an OPEC plus who just think that we have no choice but to continue to do this because of our high spending commitments. Like we can cut spending, we can scale back from implementation of some vision 2030 projects. We are proceeding with our diversification goals, like we've added a million new jobs in 2023. Like we're okay, it's not gonna be great for our balance sheet, but like we can make adjustments, they look to a country like Iraq and say, Hey, you know what, like you have the most expensive public sector payroll in the region. Can you endure \$50 oil?

Helima Croft (20m 52s):

Is this gonna be easy for you? Like you don't have the ability to massively ramp up exports from here because of constraints that you know, Bora, your midstream capacity constraints. Is it worth it for you guys to keep producing several hundred thousand above your OPEC numbers 70 might be painful now not perfect, but imagine what fifty's gonna look like for you and you don't have large foreign exchange reserves that you can call on in a crisis. You don't have large sovereign wealth funding holdings overseas that you can tap. Like we can endure lower prices easier than you can. So I think that's where the conversation lies right now and if Iraq and Kazakhstan kind of don't get it together, like do I think there's like a risk that the Saudis at the December meeting are going to be like, yeah that lollipop like it's coming back.

David Greely (21m 42s):

And there was a, after that infamous ruin Thanksgiving of 2014 that OPEC Plus was really formed in the wake of that. And now we've had Russian oil off the market are sanctioned for about two years now and Russian president Putin's recently been making statements suggesting Russian may limit certain exports of certain commodities like uranium, titanium and nickel in retaliation against those sanctions. But I guess I wanted to ask you like the broader question of in the context of oil not reacting that much to what we are seeing in the tensions, has the market become kind of a little too relaxed about these big geopolitical events and have the Russian sanctions and their impact or lack of impact been part of that?

Helima Croft (22m 30s):

100%, go back to the Russian invasion of Ukraine those early days, February, March, and when you had for the first time a G20 central bank sanction when we sanctioned the Russian Central Bank, when we disconnected Russian banks, you know, really important banks like you know, spur Bank from the swift payment system, a lot of market participants were like, wow, like this is going to impact oil. Like we are going to see the imposition of secondary sanctions on Russian energy because that's what the US did to Iran and we say it is an existential war for the post-World order in Europe. Like we are going to go after their main ability to fund this war and yet think about, you mentioned sanctions on Russian energy, they have been quite circumspect considering what we said was the threat posed by that invasion. Like we did not go after energy transactions. Remember when we disconnected those banks from the Swift payment system and sanctioned the D20 central bank like we, you know, excluded energy transactions.

Helima Croft (23m 32s):

Like we only came up with price caps after the EU passed the six package of sanctions which not only barred Russian seaborne oil going into Europe, but barred the provision of services to remove those barrels to third markets. And all of a sudden I think Janet Yellen was like, oh my gosh, like we could see 3 million Russian barrels off the market if there are no EU and UK services to move those barrels to India. So think about price caps were designed to keep Russian barrels on the market essentially saying, yes, Greek shipping companies, you can move those barrels to India as long as you certify that those barrels are below the cap. But again, it was more of an inflation reduction measure as opposed to a Russian revenue reduction measure. Like we were very focused on keeping the market well supplied and setting the cap at a number that would still provide Russian incentive to move those barrels.

Helima Croft (24m 26s):

And Russia was like, okay, we can go to the gray market as long as we are not using these EU covered ships, like we can sell it at whatever we want. We can, you know, comply to a certain extent, we can basically have optionality to figure this whole thing out. And

what we have seen is that those measures did allow India to back up the truck and take those Russian barrels. So we did not see that multimillion barrel day disruption and because market participants thought that was possible, all of a sudden they were like, okay, we didn't see it here when the war began in the Middle East. They were like, you know what, I'm not gonna take that bet again. Like you better show me that those barrels are coming off the market before I'm going to get bullish on a politically driven supply disruption.

David Greely (25m 16s):

And before I let you go, we have got to talk about the US elections a little bit more. You know, the vice presidential debate was last night, polls remain tight. I wanted to know how are you thinking about the implications of an election for global energy markets and how do the paths forward diverge depending on a Harris or a Trump win in November?

Helima Croft (25m 37s):

What I think is interesting is like President Trump, he's consistent about his drill baby drill American energy dominance that has remained the rhetorical playbook for President Trump. But I thought President Trump was so interesting because remember when he came into office, he had like the OPEC of the 1970s view, like remember the gas station lines and he, every time prices got too high, he would be like tweeting about OPEC being like, you get these barrels on the market. And yet when we had that collapse in prices in 2020 when we had the COVID demand shock and the Russia Saudi price war, right in the middle of that President Trump, when he was getting his call from these US producers saying like, you know, we could go out of business if you don't step in. Like he became like the de facto president of OPEC. Remember when Mexico didn't want to go along with the deal, president Trump came up with a Mexican workaround, like all of a sudden he helped broker the biggest collective supply cut in history to stabilize prices.

Helima Croft (26m 35s):

So he started in one place on OPEC and ended in another. So you never know what, how they're going to change according to events. But again, it was this idea that like American energy resources are being threatened, so he was gonna like come into action. I think Kamala Harris is fascinating because when she ran in the primary, she kind of ran as a California Democrat, she know, keep it in the ground. You know, she was one of the, the sponsor to the Green New Deal when chief an Attorney general in California, she sued the Obama administration interior department to prevent fracking off the California co-sign and then she joined a ticket with Biden and walked back that the fracking ban but now if you listen to her in a presidential debate, she's evolved from saying not only like am I not gonna ban fracking, but remember she said like American energy, you know, production is important to lessen the pent on foreign oil.

Helima Croft (27m 31s):

And I was like, oh my gosh, we are back to the all of the above and I thought that was a very interesting evolution and so, you know, it is that it's a question about when she comes into office, which she revert back to her, you know, more climate absolutist credentials but I do think that this is where the Democrats have kind of landed that when you get hit with, you know, run up and oil prices, gasoline prices become painful for consumers like they do become very focused on keeping the market well supplied and I think certainly from the Harris perspective, seeing the role that natural gas played in helping Europe, I mean the reason we didn't have a winter of discontent was, you know, US natural gas really came to the rescue of Europe and so I do wonder whether there has just been a change in her thinking about the importance of US production to help mitigate, you know, the power of some energy producing states like Russia. So is she going to now govern like she spoke in the last presidential debate.

David Greely (28m 32s):

And there's always the rhetoric and the reality. If you were to be the advisor to the next president, whoever it was, what would you tell them is like the big geopolitical reality that they are going to need to grapple with when they come into office?

Helima Croft (28m 49s):

I think that the question about getting overtaken by events and making sure that you have the resources at hand to deal with unforeseen circumstances. Again, like if we think back to that Russian invasion of Ukraine, I mean Europe was helped out by better weather than expected, but Vladimir Putin was absolutely intent on giving Europe a winter of discontent to show them the cost for supporting Ukraine. Essentially asking them, do you want to choose between heating and eating. Like is this really worth it to you and us natural gas, you know, combined with better weather, really set back that plan for Vladimir Putin and so thinking about being prepared with the resources to deal with crisis and not being caught flatfooted.

David Greely (29m 45s):

Thanks again to Helima Croft, Managing Director and Global Head of Commodity Strategy at RBC Capital Markets. We hope you enjoyed the episode. We will be back next week with another episode of Markets in Transition. We hope you will join us.

Announcer (30m 01s):

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