

MACROCOSM

## Our Hot Take on Iran’s Attack on Israel

Sunday, April 14, 2024

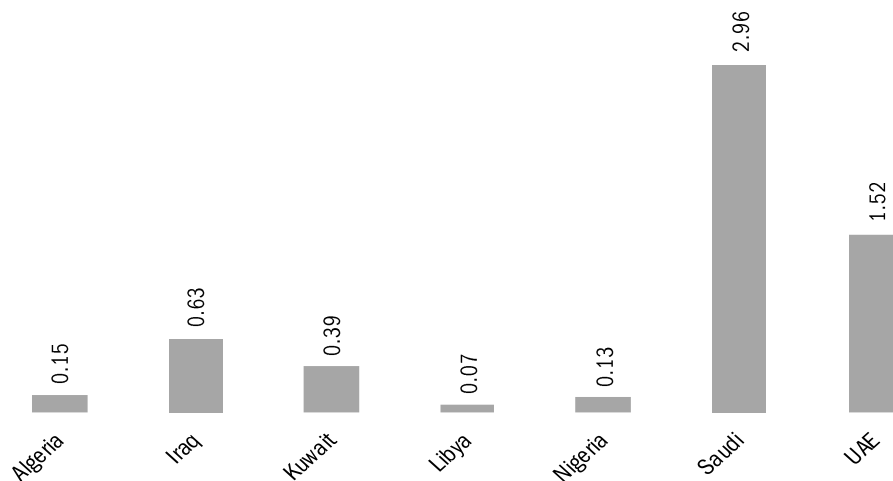
Donald Luskin and Michael Warren

The allies who saved Israel quote Don Corleone: “I want no acts of vengeance.”

Saturday’s attack on Israel by Iran was a black swan that oil markets have feared. Prices have been moving up across our forecasted trading range “(see [“Oil 2024: Black Swans, But More Demand Growth”](#) January 22, 2024) all year as Iran’s proxies have virtually shut down crude shipments through the Suez Canal, diverting and delaying [10% of global crude oil flows and 14% of refined product flows](#). The Brent benchmark broke above the \$85 top of our range on April 1, the day of the lethal attack on Iranian military commanders in Damascus. That was the day the post-October 7 environment became globally dangerous. That – no coincidence – was also the day of the top in the S&P 500 (obviously we didn’t know the attack was coming when we called for a correction five days earlier – see [“One Year On, Bank Credit Finally Shakes Off Silicon Valley Bank”](#) March 26, 2024).

- We’ll do our best to capture the decision-environment that will govern the next moves in this dangerous game.
- But whatever happens, the oil markets – the markets most directly impacted by all this – come into it abundantly supplied with massive swing capacity on the sidelines (please see the chart below). And

Spare crude oil production capacity (barrels per day, millions)



Source: Bloomberg, TrendMacro calculations

### Update to strategic view

**OIL, US STOCKS, US POLITICS:** Oil broke above the top of our forecasted trading range when Israel attacked Iranian personnel in Damascus. Now, with Saturday’s attack on Israel by Iran, oil markets have a true black swan. The Western media narrative, shaped by government sources, has framed Iran’s attack as “retaliatory,” attempting to circumscribe Israel’s response. The West’s interventions saved Israel from calamity on Saturday, so Israel has little scope to depart from its allies’ wish that there be no counter-retaliation. Iran says it is done, even though the attack had little effect. An embargo or Western sanctions designed to punish Iran by limiting oil production would have little effect on markets. China is effectively Iran’s only export market, and Saudi spare capacity alone could replace Iran’s entire production. We’re comfortable calling the top in oil. Equities have been in a correction since the day of the Damascus attack. Given how far they’ve come and how fast, we can’t be sure...

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*in an election year in which President Joseph R. Biden Jr. will likely do whatever it takes to keep gasoline prices low.*

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Of course, the threshold question is whether Iran's Saturday attack will prove to be only one domino among many – or whether it ends the matter as a global risk and Israel can return to the essentially internal task of destroying Hamas in Gaza.

... the correction is over. But it might be, thanks to the bracing effect of having survived this crisis (assuming we indeed have).

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- Such questions are indeterminate by their very nature. But the decisions that will determine the answer will be made by the principal actors in light of their needs not only to deal with what they see as existential military objectives, but also to satisfy the requirements of multiple constituencies at home and abroad – and we can make estimates of those things.
- From the moment the crisis began on Saturday, the headlines in the Western press virtually without exception used the adjective [“retaliatory”](#) to characterize Iran's attack. Inevitably these stories, published hours before the actual attack, were based on information from representatives of Western government seeking to shape the narrative in advance. It feels like the intention was to condition the mental landscape to suggest that the Iran attack balances the books and can be the end of the matter. That's a mandate to Israel not to retaliate, and Iran not to do anything further.
- No word like “retaliatory” was used on April 1 to describe Israel's attack that killed the Iranian commanders in Damascus whom it believes to have been architects or abettors of the October 7 attacks. Indeed, Israel has never confirmed (or denied) that it was responsible. [Same-day coverage in the New York Times](#) cited anonymous Israeli sources to confirm responsibility, so who knows – except that every story since, in the *Times* and everywhere else, has taken it as historical fact that Israel did it.
- So *as an abstract ethical matter we wouldn't blame Israel one bit if they wanted to hit back at Iran now.* [We are seeing press reports](#), and have heard from surprisingly credible sources, that one response would be to deploy [an electro-magnetic pulse weapon](#) to knock out electronics in Iran, which would be tantamount to shutting down Iran's economy instantaneously (Israel has [been said to have such a weapon since 2012](#)).
- But we doubt Israel will hit back that way, or at all, in the absence of further egregious provocation. That's because *we know one thing for sure – we know that Israel survived Saturday night with as little damage as there was only because of the intense involvement of allies with remarkably capable countermeasures at their disposal – principally the US and the UK, but others too, improbably including Jordan.* [They're all calling](#) for Israel to let sleeping dogs lie. Israel, which only weeks ago was [having a public debate about the need to go it alone](#) in light of Biden's wavering support for the operation in Gaza, surely now realizes there is no such thing. If their global protectors tell them to stand down at this point, when so little damage was done (thanks to them), then they likely will. [Biden has told Israeli Prime Minister Benjamin Netanyahu exactly that.](#)

- Israel did so in a similar situation in 1991 when the US protected it from [a fusillade of Scud missiles from Iraq](#), a last-ditch scorched earth stratagem from Saddam Hussein when the US and its allies were expelling him from Kuwait.
- For Iran's part, even though Saturday's attack was a conspicuous flop, [they are saying there won't be another](#). Honor is satisfied, or at least so they say.
- *Iran can continue to make mischief in the region, even without another conspicuous direct attack on Israel.*
- In terms of likely impacts on oil markets, again, the Yemeni Houthis rebels, Iran's proxies, have already effectively shut down oil transport in the Red Sea and the Suez Canal. But that's a sunk cost. It has already happened.
- There could be attacks on shipping in the vastly more important Persian Gulf. Indeed just before Saturday's attack [Iran's Revolutionary Guard paramilitary group seized](#) an Israel-linked Portuguese-flag container ship in the Straits of Hormuz. *Further attacks imperiling oil transport would be catastrophic to markets – there's no alternative route out of the Gulf. But that would be not an attack on Western oil consumers so much as on all Iran's oil-producing neighbors and fellow OPEC members. Not likely.*
- Neither is there any chance Iran will embargo its own outbound oil. On paper, if it did, that would punish the world by depriving it of the export share of Iran's 3.18 million barrels per day of crude production (please see the chart below). [But the vast majority of that goes to China](#), which is one of Iran's few friends. Not likely.
- We must consider also the possibility that Western nations will seek to punish Iran – [they have universally condemned the Saturday attack](#) – perhaps by tightening sanctions. It is only the tacit relaxation of sanctions by the United States – since Biden took office, in order to lubricate the renegotiation of the Obama-era Iran Nuclear Deal – that has permitted Iran's production to climb to the

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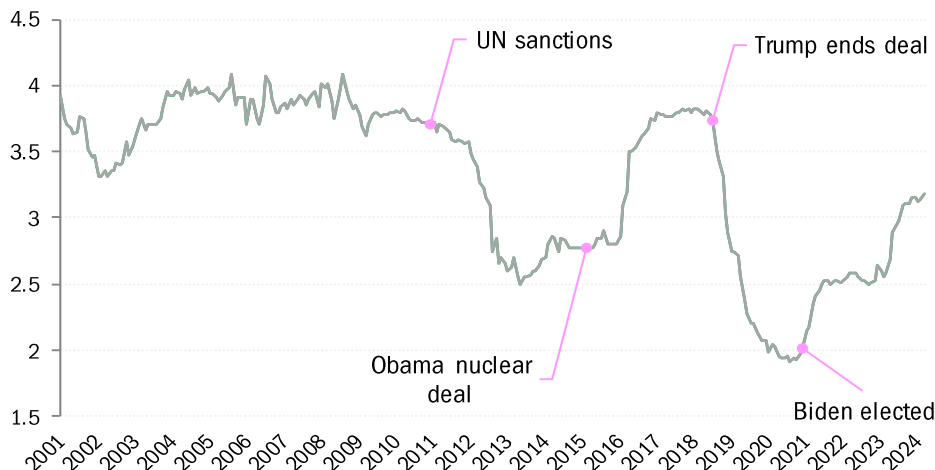
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Iran crude oil production (barrels per day, millions)



Source: Bloomberg, TrendMacro calculations

present 3.18 million barrels from 2.14 million when Biden took office.

- *In this election year, there's no way Biden will tighten those sanctions. He needs to keep the price of gasoline as low as possible to keep inflation heading lower. And because in the heat of recent events he got jammed into complete military support of Israel in this crisis, he needs to mend fences with his Muslim voters in swing states, and for that matter his entire Left flank which is rabidly anti-Israel. He will likely even argue that a revival of the nuclear deal is more important than ever.*
- But even if some combination of embargo and sanctions drives Iran's production lower, Saudi Arabia alone has enough spare capacity to instantly make up for even a total shutdown (again please see the chart on the first page).

As we always say in situations like this, we are in both the fog of war and in the hands of the gods.

- But if we had to bet – and we do, that's the business we're in – we'd bet that this crisis is over.
- *We're comfortable calling the top in oil here.* When the geopolitical risk premium is no longer so urgently required, the more-than-fully supplied environment will be better recognized in markets.
- As to equities, we didn't call for a correction because we knew the Middle East was going to have a new crisis. We called for a correction just because corrections happen all the time, we're overdue for one, and we sense that (other than the Middle East) all the good news is out for the time being. So now we've had some degree of correction – not much, really. Maybe the bracing effect of having survived this weekend's crisis will be enough to end it. We doubt it, but we'll see.

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## Bottom line

Oil broke above the top of our forecasted trading range when Israel attacked Iranian personnel in Damascus. Now, with Saturday's attack on Israel by Iran, oil markets have a true black swan. The Western media narrative, shaped by government sources, has framed Iran's attack as "retaliatory," attempting to circumscribe Israel's response. The West's interventions saved Israel from calamity on Saturday, so Israel has little scope to depart from its allies' wish that there be no counter-retaliation. Iran says it is done, even though the attack had little effect. An embargo or Western sanctions designed to punish Iran by limiting oil production would have little effect on markets. China is effectively Iran's only export market, and Saudi spare capacity alone could replace Iran's entire production. We're comfortable calling the top in oil. Equities have been in a correction since the day of the Damascus attack. Given how far they've come and how fast, we can't be sure the correction is over. But it might be, thanks to the bracing effect of having survived this crisis (assuming we indeed have).