



Will Tensions Between Saudi Arabia and Iran Ignite Oil Prices?

Description

Relations between Saudi Arabia and Iran have been more or less strained for decades. But after the execution of a prominent Shiite cleric in Saudi Arabia and a hostile reaction from Iran, tension between the two countries seems to have reached a boiling point. The spark also caused oil prices to rally briefly.

So how exactly did we get to this point? And more importantly, what does it mean for energy producers such as **Crescent Point Energy Corp.** (TSX:CPG)(NYSE:CPG) and **Penn West Petroleum Ltd.** (TSX:PWT)(NYSE:PWE)?

How we got here

The current troubles began on Saturday when Saudi Arabia announced the execution of 47 “terrorists,” including prominent Shia cleric Nimr al-Nimr. Demonstrations followed soon afterwards in a number of countries. In Iran protesters even stormed the Saudi embassy and started fires.

The next day the Saudi foreign minister accused Iran of being complicit in the attack. And in response Saudi Arabia cut all diplomatic ties with Iran. Other regional allies, including Bahrain and Sudan, followed suit.

Why this could lead to higher oil prices

Investors are very aware of the Middle East’s instability, and oil prices certainly reflect this. Even last year, when violence escalated in Yemen (a country whose production is less than Crescent Point’s), oil prices rallied. And there is another big factor at play this time: the relationship between the United States and Iran.

Americans are without doubt getting flashbacks to 1979, when its embassy in Iran was overrun during the Iranian revolution. In the ensuing 444 days, 52 Americans were held hostage.

So far at least, the U.S. is calling for restraint. But if tensions flare up in the Middle East, America will undoubtedly back Saudi Arabia. This could mean new sanctions against Iran, which would be a big

positive for the oil price.

Why we shouldn't overreact

While any news of Middle East instability is a positive for oil prices, we shouldn't be jumping to conclusions. Unless the Western powers get involved or there is an actual armed conflict, supply will not face any disruptions.

In fact, the current tensions could even be a negative for oil prices. If energy investors were hoping for coordinated action from OPEC, the Saudi-Iranian tensions should snuff out that possibility. Meanwhile, there's little chance of new sanctions from the United States (at least while a Democrat is in the White House), and even less chance of new coordinated sanctions from major world powers.

The market seems to have recognized all of this. After more bad economic news emerged from China, oil prices turned south once again, erasing all of its earlier gains on Monday. Investors in Crescent Point and Penn West have a long road ahead of them.

CATEGORY

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