

Considerations and possible contingencies for Owners and Charterers in case of further escalation of conflict, involving Iran and potentially affecting shipping in the Persian Gulf and Strait of Hormuz

October 2024



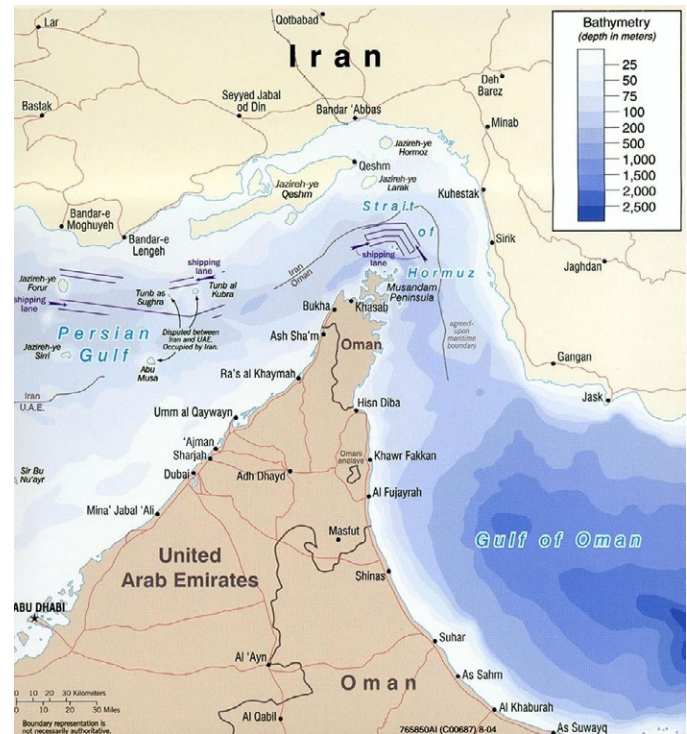
It remains to be seen if the huge collateral damage caused in Southern Lebanon by Netanyahu's push to degrade Hezbollah's capabilities, will undermine his appeal this week to the Lebanese population to "free their country", and end the war in a realistic timeframe. The fears are that the intensifying conflict results in more direct attacks between Iran and Israel, which further destabilize the region and drag in other actors in spiralling retaliatory violence. Earlier this week, there were credible threats that Israel would target Iran's oil infrastructure on Kharg Island prompting Iran to send their crude tanker fleet into the middle of the Gulf out of harm's way. Shipping in the region is exposed in an extremely tense situation.

Diplomatic efforts continue and Hezbollah has publicly endorsed Lebanon ceasefire efforts, for the first time not conditioned it on stopping the war in Gaza. However since Hezbollah leader Nasrallah's assassination by Israel on 27 September, and reportedly 2 of his potential successors in strikes afterwards, US officials have told Western media that the Biden administration had resigned itself to trying to shape and limit Israeli operations in Lebanon and against Iran. Following a call between Biden and Netanyahu on 9 October, Israel reportedly has vowed its response to Iran will have public approval from the White House, which suggests a more limited retaliation, staying away from oil and nuclear infrastructure. Gulf Arab states have been warned by Tehran not to allow use of their airspace for attacks against Iran, and Gulf states have assured their neutrality.

The fears are that the intensifying conflict results in more direct attacks

The ongoing escalation of the past 12 months, and the ease with which Iran, with assistance of its proxies, can disrupt shipping in its back yard, concerns all shipping interests in the region. Many are considering a range of scenarios up to and including closure of the Strait of Hormuz by Iran. If Iran tries this, Oman has ratified the UN Convention on the Law of the Sea, meaning its waters could be used for transit passage by merchant and military tonnage (see map below). Washington as a policy does not recognize the right of coastal states to regulate passage in key waterways anyway. While the situation changes almost daily, Iran has its own vested economic interests not to try and block Hormuz, so notwithstanding a miscalculation, analysts are forecasting enough restraint to steer us away from that eventuality. This is implied in the currently small risk premium priced into oil prices which remain in the \$70s/bbl.

If the market decides that significant escalation is happening or is on the cards, there will be little time for decision-makers to react, especially in the area of shipping. While freedom of navigation rules stand in theory, as we see from the current situation in the Red Sea, merchant shipping will judge threats for itself. Strong risk aversion could lead the market to tighten, and freight, Additional War Risk Premiums, and other costs such as blocking and trapping insurance, to spike rapidly. As the vessel owners and operators work around the clock to assess the overall risks in the region, they face potentially difficult conversations with the Charterers and whether it is safe to perform contractual obligations in and out of the region.



There is no alternative route for the circa 26 million tonnes of petrochemical product which currently exports by sea tanker through the Strait of Hormuz. Marginal volumes of product could be shipped by road to ports on the East Coast of UAE or Oman, but this capacity will run out almost instantaneously. A main alternative to curtailing production to manage inventory levels, except acquiring additional shore storage, is to charter ships for floating storage, and secure them early enough to get them into the region before blockage of Hormuz.

The Iranian Revolutionary Guard have conducted isolated disruptions to shipping before in the Gulf, typically in the form of targeted actions following Western interference. To scale up disruption in the Gulf and Hormuz, Iran would not be able to lean on

its regional proxies, and would be actively, directly involved itself. It would risk eliciting a much stronger international military and diplomatic response, which is another deterrent to direct Iranian attacks on trade.

It is difficult to fathom what further escalation will mean in terms of loss of lives. For shipping, vessels can ultimately avoid going into the region, but the economic impact a closure of the Straits of Hormuz will have on the shipping markets will be more severe than even blockage of the Suez canal, as there is no other route. Ships will be forced to deviate into other regions creating surplus tonnage and imbalancing trade flows. This pales in comparison to the overall impact on the global economy if energy prices surge, and manufacturers in the region find themselves completely shut off from global trade and forced to shutter production, which could serve to further destabilize the region.

Iran has its own reasons for keeping Hormuz open given its own dependence on exports of oil and other products to power its economy. Primarily to its main trading partner China which accounts for more than 1/3 of Iran's total exports. Its own economy would be hit hard by a Hormuz closure.

Finally, considering the US election in less than 1 month, Israel may perceive a benefit to dragging out its response to Iran's missile attack of 1 October, to wait and see the nature of the support it can expect from the White House. A more measured response

in the interim may temper simmering markets. In commenting on 9 October that it will not allow Lebanon to become "another Gaza", the US continues to highlight the humanitarian catastrophe, and said it was working to revive ceasefire negotiations. The current shows of force are only deepening and widening ideological differences – for a sustainable, mediated "balance" to bring stability to the region, there can be no clear winner.



by **Simon Cass**
Managing Director
Quincannon Associates DMCC

For up the minute market intelligence and support, please contact ship@quincannon.com with any inquiries.

