



PARLIAMENTARY ASSEMBLY OF THE MEDITERRANEAN
ASSEMBLEE PARLEMENTAIRE DE LA MEDITERRANEE
برلمان البحر الأبيض المتوسط

PAM Background Note

The immediate Goeconomic Implications of recent security deterioration in the Middle East

12 October 2023

Disclaimer: This background note was prepared by PAM Researchers in their personal capacity. The opinion expressed in the note are the authors' own and do not reflect the view of the Parliamentary Assembly of the Mediterranean (PAM).

1. Background

Before the sudden outbreak of the Israeli-Hamas clash on 7 October 2023, the major geopolitical actors in the area seemed to have embarked towards a repositioning path. After the China-brokered Saudi-Iran deal, Israel and Saudi Arabia appeared to be close to an agreement for the normalization of their diplomatic relations. In that context, the Middle East region had regained its geopolitical momentum and centrality with a number of infrastructural initiatives to connect Asia and Europe – namely the “India-Middle-East Europe Corridor (IMEC)”, the “Development Road Project”, the Russian sponsored “International North-South Transport Corridor” and the China-led “Belt and Road Initiative”. The new bloody confrontation in Israel and Gaza Strip has not only stalled these processes, but has also heightened risks to the regional and global energy security supply, which can in turn result into national socio-economic instability and uncertainty.

2. Today’s events and the markets’ reactions

Stocks Usually Take Geopolitical Events In Stride

S&P 500 Index And Geopolitical Events

Market Shock Events	Event Date	S&P 500 Returns		Days	
		One Day	Total Drawdown	Bottom	Recovery
COVID-19	1/20/2020	-0.3%	-33.9%	63	148
Iranian General Killed In Airstrike	1/3/2020	-0.7%	-0.7%	1	5
Saudi Aramco Drone Strike	9/14/2019	-0.3%	-4.0%	19	41
North Korea Missile Crisis	7/28/2017	-0.1%	-1.5%	14	36
Bombing of Syria	4/7/2017	-0.1%	-1.2%	7	18
Boston Marathon Bombing	4/15/2013	-2.3%	-3.0%	4	15
London Subway Bombing	7/5/2005	0.9%	0.0%	1	4
Madrid Bombing	3/11/2004	-1.5%	-2.9%	14	20
U.S. Terrorist Attacks	9/11/2001	-4.9%	-11.6%	11	31
Iraq's Invasion of Kuwait	8/2/1990	-1.1%	-16.9%	71	189
Reagan Shooting	3/30/1981	-0.3%	-0.3%	1	2
Yom Kippur War	10/6/1973	0.3%	-0.6%	5	6
Munich Olympics	9/5/1972	-0.3%	-4.3%	42	57
Tet Offensive	1/30/1968	-0.5%	-6.0%	36	65
Six-Day War	6/5/1967	-1.5%	-1.5%	1	2
Gulf of Tonkin Incident	8/2/1964	-0.2%	-2.2%	25	41
Kennedy Assassination	11/22/1963	-2.8%	-2.8%	1	1
Cuban Missile Crisis	10/16/1962	-0.3%	-6.6%	8	18
Suez Crisis	10/29/1956	0.3%	-1.5%	3	4
Hungarian Uprising	10/23/1956	-0.2%	-0.8%	3	4
N. Korean Invades S. Korea	6/25/1950	-5.4%	-12.9%	23	82
Pearl Harbor Attack	12/7/1941	-3.8%	-19.8%	143	307
Average		-1.1%	-6.1%	22.5	49.8

Source: LPL Research, S&P Dow Jones Indices, CFRA, 01/24/2021

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results.

The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

Fig. 1

The risks, however, stem from the reaction that such markets have vis-a-vis those shocks, and on their expectations on their long-term impacts, which can result in a higher required risk premium and therefore fuel inflationary trends and, ultimately, even a stagflation period similar to the one of the 1970s.

As pointed out¹ by the IMF Chief Economist, Pierre-Olivier Gourinchas, at present, it may be too early to assess the repercussions of the current conflict on the global economy. Nonetheless, historic trends show that geopolitical events can have an immediate effects on energy markets, but a limited one in equity markets in the short-term (*Fig. 1*).

¹ <https://www.wsj.com/livecoverage/israel-hamas-war-gaza/card/imf-says-its-too-soon-to-assess-economic-impact-of-israel-hamas-fighting-Zrn2pL1kTg1gb80VNW7>

Today, substantial spikes in oil and gas prices have already been witnessed, with a 4% global increase and a notable 15% surge in Europe on a single day, respectively. In addition, the recent surge in energy prices, has resulted in a significant increase in electricity costs, which have reached around 40 euros per MWh, representing a remarkable 15 per cent increase². The decrease in oil and gas prices, recorded on 12 October, show the volatility and unpredictability of the energy markets³.

In Israel itself, as a direct consequence of the conflict, there has been a sharp decline in the Tel Aviv Stock Exchange, plummeting by nearly 6.5 per cent in just one day. Simultaneously, the Israeli shekel faced extreme depreciation, reaching its lowest level in almost 8 years⁴.

3. The potential geoeconomic implications of the Middle East Conflict

A comparison from the past may be useful to grasp the complexity of today's events. The 1990-91 Gulf War had immediate and lasting consequences on the global oil market⁵, leading to price fluctuations due to Iraq's invasion of Kuwait and fears of further military action⁶. Similarly, the 1970s stagflation period stem from the Yom Kippur war and the consequent oil embargo from Arab countries. In this regard, the International Monetary Fund (IMF) concurs that the effect of disruptions to supply chains and commodity markets on domestic growth and inflation due to geopolitical tensions, does exacerbate financial security and increase market volatility⁷.

Today's events present some similarities with the past, but also significant differences due to the different geopolitical context. The conflict between Israel and Hamas has added new challenges to the ongoing efforts by Western countries to diversify their oil and gas supplies away from Russia, following to the sanctions imposed as a result of its war of aggression against Ukraine.

While Israel does not directly supply European Countries with gas, it is worth noting that the country indirectly exports LNG to Europe via Egypt. Therefore, the recent decision of the Israeli government to shut down the gas plant of Tamar⁸, due to security concerns, has worried analyst of further spike in oil prices, potential new frictions in the markets and additional pressure on

² <https://www.nytimes.com/2023/10/11/business/natural-gas-prices-israel-finland-pipeline-leak.html?smid=url-share>

³ <https://www.bloomberg.com/news/articles/2023-10-11/latest-oil-market-news-and-analysis-for-october-12#xj4y7vzkg>

⁴ <https://quifinanza.it/economia/finanza/guerra-in-israele-ecco-quale-impatto-sta-avendo-sui-mercati-mondiali/750524/>

⁵ <https://www.atlantis-press.com/article/125975825.pdf>

⁶ Ibidem, pp. 168.

⁷ <https://www.imf.org/en/Blogs/Articles/2023/04/05/geopolitics-and-fragmentation-emerge-as-serious-financial-stability-threats>

⁸ <https://www.bloomberg.com/news/articles/2023-10-10/egypt-weighting-impact-of-israel-gas-field-halt-on-its-exports>

countries - especially from Europe - that have undertaken an energy diversification effort (Italy alone, for instance, has replaced its 40% gas imports from Russia with Algerian exports almost entirely). The Tamar plant is the second largest of the country after the Leviathan one (*Fig. 2*), serving for both domestic use and for exports to its neighboring countries, mostly Egypt and Jordan. In particular, due to the Tamar's closure, Israel's gas shipments to Egypt have decreased by 20 per cent, which is likely to have an impact on the LNG imported by Europe⁹.

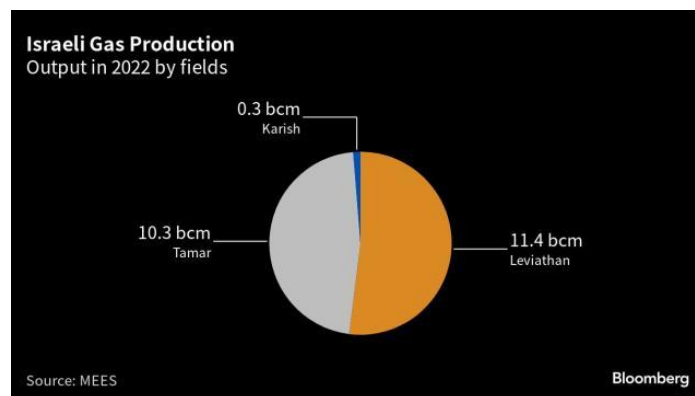


Fig. 2

Nonetheless, the impact of the Israeli decision and of the war in general, so far seem to have had a modest effect on the international markets, as the current rise in Europe's gas prices has been driven by concerns over the recent sabotage of the pipeline between Finland and Estonia. Indeed, international oil prices have returned to previous levels after a tentative – and relatively small – surge immediately after the attack of Hamas¹⁰, signalling that markets do not believe in an immediate conflict's enlargement.

However, the persistent deterioration of the situation in the region - which accounts for about one third of the world's crude oil supply - for an indefinite period remains is likely to bring along considerable risks for global economic stability. During the recent World Bank and IMF Annual Meeting, which took place in Marrakesh, World Bank President Ajay Banga expressed his concerns in this regard, referring to the economic repercussions of the conflict as an 'unnecessary global economic shock'.¹¹

⁹ *Ibidem*

¹⁰ <https://www.nytimes.com/2023/10/11/business/natural-gas-prices-israel-finland-pipeline-leak.html?smid=url-share>

¹¹ <https://www.reuters.com/markets/world-bank-chief-banga-says-gaza-conflict-is-economic-shock-we-dont-need-2023-10-10/>

In the medium to long term, the conflict could lead to decrease in infrastructural development and delays in energy infrastructure development, which is likely to affect ongoing structural projects such as the EastMed. In addition, pressure may mount on oil and gas prices, with a significant impact on the global inflation. However, the latter will largely depend on markets' expectations towards the conflict. Should those expectations *de-anchor* from current previsions, envisaging a long-term and generalized conflict, it will surely mean a prolonged period of inflation, reduction in global investment levels, consumption and increased markets' volatility, thus hampering an already languish economic recovery worldwide.

Nonetheless, despite the recent IMF forecasts¹² on global growth, the Fund has predicted that inflation levels will continue to decrease in 2024. The effects of a prolonged conflicts, however, can be costly and persistent, especially due to the fact that recent inflationary trends have been led by headline supply shocks¹³ (i.e., the pandemic and the war in Ukraine) that can present similarities to today's macroeconomic and geoeconomic scenarios.

M.M. / A.G. / V.A.

¹² IMF Global Economic Outlook, "Navigating global divergences", OCTOBER 2023, <https://www.imf.org/en/Publications/WEO/Issues/2023/10/10/world-economic-outlook-october-2023?cid=sm-com-tw-AM2023-WEOEA2023002>

¹³ https://www.ecb.europa.eu/pub/conferences/ecbforum/shared/pdf/2023/Gourinchas_paper.pdf