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News Analysis

Energy Markets Rattled as War Leads to Supply Disruption

Introduction

Over the last few weeks, energy markets around the world have been thrown into turmoil as escalating conflict in key producing regions disrupts the steady flow of oil and natural gas. Critical transit routes, particularly the Strait of Hormuz, have become increasingly vulnerable, raising fears of supply shortages. Because a significant share of global energy exports passes through such chokepoints, even limited disruptions can trigger sharp price increases and uncertainty across international markets.

The resulting instability is already being felt in rising fuel costs, heightened inflation, and growing concerns about economic slowdown. Countries heavily dependent on energy imports face the greatest risk, as they struggle to secure reliable supplies at affordable prices. In this context, the current crisis highlights the fragility of global energy systems and underscores the urgent need for diversification and resilience in energy production and distribution.

Impact on Europe's Oil and LNG Markets

Europe is experiencing a severe and widening deficit in both oil and liquefied natural gas (LNG) as a direct consequence of the war involving the United States, Israel, and Iran. The conflict has disrupted key energy flows from the Middle East, a region that remains central to global supply. For a continent heavily dependent on imports, these disruptions have translated into immediate shortages and heightened vulnerability.

One of the most significant impacts has been on global oil supply. Estimates indicate that between 9 and 11 million barrels per day (mb/d) of oil have been removed from the market due to production cuts and transport disruptions linked to the conflict (1). This massive shortfall has tightened global markets, leaving Europe struggling to secure sufficient crude and refined products, especially as alternative suppliers are limited or already operating near capacity.

In addition to global losses, Europe-specific disruptions are also substantial. Around 3 to 4 mb/d of oil flows linked to the Strait of Hormuz—a key supply route for European imports—are at risk or partially disrupted (2). Given that a notable share of Europe's imported crude and petroleum products transits this corridor, even partial closures have contributed to a structural supply deficit across the continent.

The LNG market has been even more severely affected. Approximately 80 million tonnes per annum of global LNG supply—nearly 1/5 of total capacity—has been taken offline due to damage to facilities and halted exports, particularly in Qatar (3). On a shorter-term basis, this equates to losses of about 1.5 million tonnes of LNG per week, highlighting the scale and immediacy of the disruption. (4)

Map 1: Energy Facilities Damaged in Iran Conflict

Sources: New York Times

Europe's dependence on LNG has increased significantly in recent years, especially after reducing pipeline gas imports from Russia. However, the war has disrupted key LNG export routes through the Strait of Hormuz, through which roughly 20% of global LNG trade normally passes. This has created intense competition with Asian markets, making it harder for European countries to secure cargoes and refill storage. It is worth noting that approximately 10% of Europe's LNG imports originate from Gulf countries, mainly Qatar, making the region particularly vulnerable to any disruption in the Strait of Hormuz.

As a result, Europe faces a dual deficit: insufficient oil supplies and constrained LNG availability. These shortages are compounded by low storage levels and rising demand, particularly during peak consumption periods, increasing the risk of energy insecurity. Unless supply routes stabilize or alternative sources are rapidly secured, Europe is likely to remain under significant energy pressure in the near term.

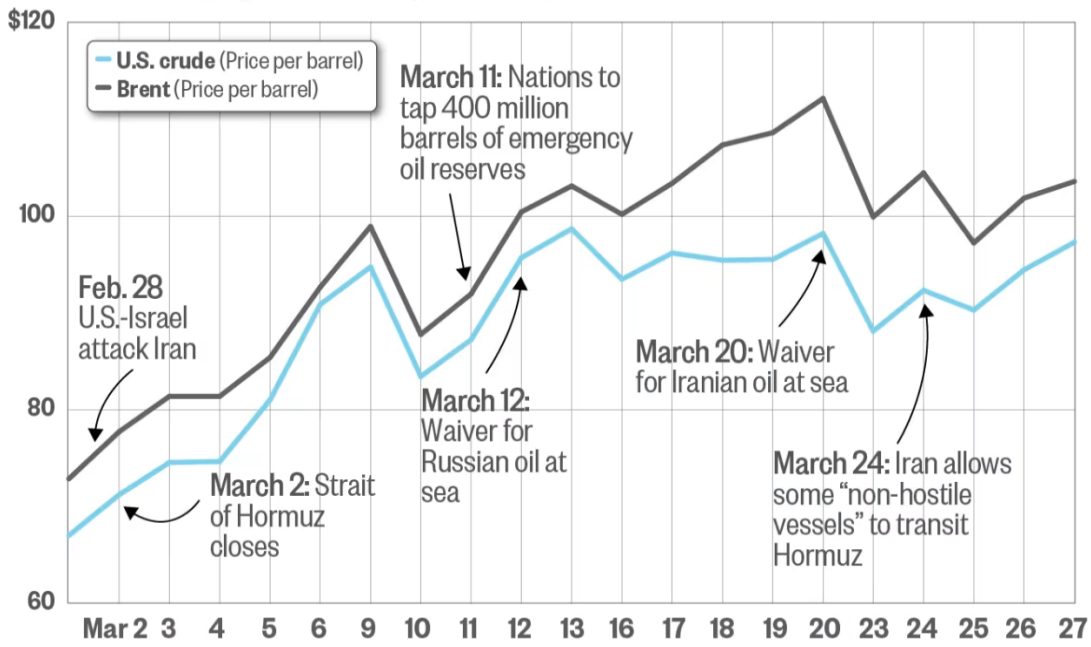
These supply shocks have translated directly into rising energy prices. Oil prices have surged above $115 per barrel, with some of the fastest increases on record following the outbreak of the conflict. Natural gas prices have also spiked sharply, reflecting both physical shortages and market speculation. The result is a broad-based increase in energy costs across economies worldwide.

Higher energy prices are now feeding into inflation, becoming a major concern for policymakers. Central banks have warned that the conflict is shifting the balance of risks toward rising inflation, as more expensive fuel increases transportation, production, and heating costs across the economy (5). This inflationary pressure threatens to slow economic growth while also complicating monetary policy decisions.

In response to the crisis, the International Energy Agency (IEA) has coordinated a historic release of strategic oil reserves. Member countries have agreed to release approximately 400 million barrels of oil into the market, the largest emergency action of its kind, in an

effort to stabilize prices and offset supply disruptions (6). This measure is intended to provide short-term relief and prevent further price spikes.

Figure 1: Oil Price Surge in Spotlight



Source: FactSet data based on most-active oil contracts

However, despite the scale of the intervention, the pressure on oil and LNG markets remains high. Strategic reserves can only provide temporary support and cannot fully replace the large volumes of disrupted supply. As long as the conflict continues and key transport routes remain insecure, global energy markets are likely to remain tight, volatile, and highly sensitive to geopolitical developments.

Impact of EU Methane Rules on Europe's Energy Supply

The European Union's Methane Emissions Regulation (EUMR) (7), adopted in 2024, represents a major step in climate policy by targeting methane leaks across the oil, gas, and coal supply chains. The regulation requires strict monitoring, reporting, and verification (MRV) of emissions not only within the EU but also for imported fuels. While its environmental objective is to reduce one of the most potent greenhouse gases, the policy has significant implications for Europe's energy supply, particularly given its heavy dependence on imported oil and LNG. (8)

A central concern is that the regulation effectively restricts access to a large share of global energy supplies. Studies suggest that by 2027, up to 43% of natural gas imports and 87% of crude oil imports currently used by the EU could be deemed non-compliant with the new methane standards (9). This creates a structural supply risk, as many exporting countries

may not be able—or willing—to meet the EU's stringent reporting and emissions requirements within the required timeframe.

As a result, the regulation could lead to a significant supply gap in both oil and LNG markets. Estimates indicate that as much as 114 billion cubic metres of gas and nearly 10 million barrels per day of oil demand could go unmet under current rules. For Europe, which is already facing tight markets due to geopolitical tensions and reduced Russian imports, such a gap would exacerbate existing vulnerabilities and increase reliance on a smaller pool of compliant suppliers. **(10)**

The impact on LNG is particularly critical. LNG supply chains are complex and often involve multiple upstream sources, making compliance with methane tracking requirements more difficult. This raises the risk that key suppliers could redirect cargoes to less regulated markets, reducing availability for Europe. As a result, the EU may face intensified competition for compliant LNG, especially during periods of peak demand, further tightening the market.

In oil markets, the regulation could force European refineries to shift toward a narrower range of compliant crude grades. However, global availability of such crude is limited, potentially leading to reduced refinery throughput and even closures. Some analyses suggest that EU refinery activity could decline sharply, increasing dependence on imported refined products such as diesel and jet fuel, thereby weakening Europe's energy security.

The supply constraints introduced by the methane rules are also likely to have significant price effects. Reduced availability of compliant oil and gas could push import costs higher—estimates suggest crude oil import prices could rise by around $9 per barrel—while gas prices could increase sharply due to tighter supply **(11)**. These price increases would feed through to households and industry, raising energy bills and affecting the competitiveness of energy-intensive sectors.

In conclusion, while the EU Methane Regulation is a critical tool for achieving climate goals, it introduces substantial challenges for Europe's energy supply. By restricting access to a large portion of global oil and LNG, the policy risks creating supply shortages, increasing prices, and reshaping trade flows. Its ultimate impact will depend on how flexibly it is implemented and whether global suppliers adapt quickly enough to meet the new standards without causing significant disruptions to Europe's energy system.

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