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Israel-Hamas conflict: four potential geo-military scenarios

An Israeli ground invasion of Gaza is the baseline scenario and seemingly all but assured at this stage. There are escalatory scenarios involving a broader conflict with Hezbollah and even Iran. The macro transmission channels are via geopolitical risk premia and energy prices. Global economic impacts would increase if Middle East oil supplies, especially via the Strait of Hormuz, were threatened.

Key Takeaways

- Events in Israel and Gaza are first and foremost a human tragedy. As the situation remains highly volatile, we sketch four scenarios illustrating what could happen next.
- A ground invasion of Gaza is the base case. Markets probably largely price this in.
- In this scenario, the impact on energy markets would likely be limited to reduced Israeli gas supply, tighter international policing of Iranian oil sanctions, and the removal of the expected increase in Saudi oil supply.
- There is a meaningful risk of escalation of the conflict to other Iran-backed actors, most obviously Hezbollah in Lebanon. Israel would be left fighting on two fronts – in Gaza and on the Israel-Lebanon border. In the most severe, but unlikely, escalatory scenario, Israel and Iran could enter outright conflict.
- In these scenarios, OPEC spare capacity is probably sufficient to cover the loss of 1.4 million bpd of Iranian exports. But there would also be a wider risk to the 20% of global flows that pass through the Strait of Hormuz. Oil prices above \$140 per barrel may be a plausible, if unlikely, worst case.
- Finally, there is a (unfortunately small) probability of de-escalation and ceasefire without a ground invasion.

military scenarios and macro-economic implications, while trying to remain aware of the sensitives around these terrible events.

Four geo-military scenarios

We see four main geo-military scenarios from here (see Figure 1).

1. Contained ground invasion of Gaza: 60%

Our base case is that Israel launches a ground operation aimed at removing Hamas and recovering hostages. Israeli troops are massing in significant size along the border, and the Israeli government signalling clearly points in this direction. In this base case the conflict is contained to Gaza.

Early signals suggest that Hezbollah and Iran, Hamas' main regional allies, are unwilling to become directly involved in the conflict. The US is also working with regional allies to prevent an escalation of the conflict, including sending two carrier groups to the eastern Mediterranean.

Due to the scale of Hamas' attack on Israel, is it unlikely that it will be politically acceptable for any ground operation into Gaza to end with Hamas still in control of the territory. Depending on the success of Israeli military operations – urban warfare is notoriously difficult – it is possible that the current conflict could continue for many months.

Events in Israel and Gaza are first and foremost a human tragedy. In this note we share our initial thoughts on the geo-



2. Escalation to other Iran-backed actors: 30%

A ground offensive will increase the risks of Hamas' allies, particularly Hezbollah, joining the conflict.

Another factor increasing escalatory risks is the political pressure on Prime Minister Netanyahu to demonstrate the strength of the Israeli military and security apparatus.

The events of last weekend represent a massive intelligence failure. Indeed, as and when the immediate crisis ends, Netanyahu will face serious questions over his leadership. One path to avoiding this will be to demonstrate that after the initial mistake, Israel can comprehensively achieve long-standing security goals.

We therefore put a reasonably high probability on an escalatory scenario in which efforts to contain the conflict fail and other Iran-backed actors, most likely Hezbollah, enter the conflict. Israel might respond with strikes on the infrastructure of Iran-backed actors inside Lebanon and Syria.

Israel would be left fighting on two fronts – in Gaza and on the Israel-Lebanon border, with the Golan Heights also a potential conflict zone. Israel has already acknowledged the risks of this occurring, having ordered the evacuation of a 2km zone on the border with Lebanon.

3. Full-scale Middle East war: 5%

Despite ongoing diplomatic efforts on all sides to avoid a significant deterioration in the region, there remains a small chance that the ground invasion of Gaza triggers a broader destabilisation of the Middle East as multiple actors, including Iran, are pulled into an active conflict.

This scenario could begin with credible evidence emerging that Hamas had assistance from Iran in planning and facilitating the attack on Israel. This could lead to Israeli military strikes on Iran and more international sanctions.

Operating on multiple fronts would slow Israel's military progress, leading to a longer offensive in Gaza. Hamas and its allies could accuse Israel of a de-facto occupation, further inflaming tensions. The humanitarian crisis would deepen, with large population movements likely, further destabilising neighbouring countries as they attempt to cope with the political and economic fallout.

There is no official evidence at this stage to suggest direct Iranian involvement in Hamas' attack on Israel, and multiple diplomatic safeguards would have to be breached for a broader war, limiting the likelihood of this downside scenario.

4. Conflict de-escalates: 5%

Finally, there is at least some chance that the situation de-escalates without a ground invasion. US efforts at securing safe routes for civilian evacuation out of Gaza into Egypt, and for aid to flow into Gaza, could potentially give way to a more lasting ceasefire. Diplomatic outcry at the humanitarian crisis in Gaza would be an important waymark

to this scenario, but internal political dynamics in Israel would militate against it. On balance, de-escalation seems unlikely at this stage.

Implications for the war in Ukraine

NATO has given Ukraine assurances that its support for Israel will not affect its ability to provide ongoing military support to Ukraine.

However, a drawn-out effort to remove Hamas, or escalation in the scope of the conflict, would risk attention being diverted away from Ukraine, as well as military aid being divided between the two countries. The biggest risk for Ukraine is that it simply falls down its allies' priority list, with less time and money being spent on meeting its requests.

The impact of US political divisions

US domestic political divisions are also having an impact. Without a speaker in the House of Representatives, Congress is unable to pass new aid for Ukraine or Israel, with the US government instead relying on existing funding and diplomatic efforts to provide limited support.

Additionally, an ongoing block on approval of military promotions by Senator Tommy Tuberville has left the US without staff members in key positions. The US also does not have an ambassador to Israel at this time. In many instances roles are being undertaken by acting appointees who lack full legal powers. This by no means prevents the US from providing support to Israel but makes coordinating actions more difficult.

Increased geo-political risk premium

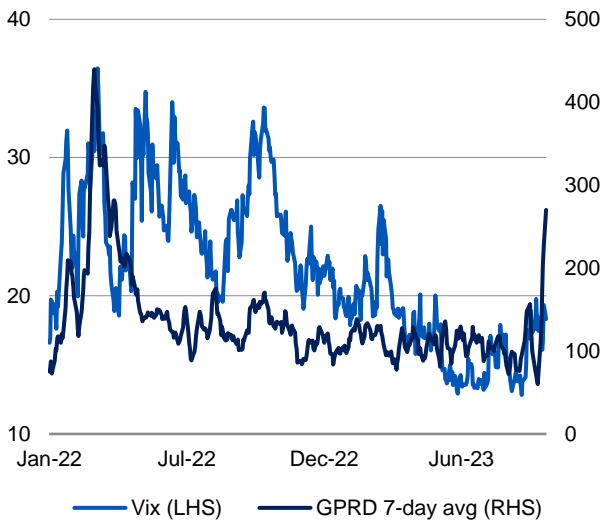
We see two primary transmission channels to the global economy.

The first is through an increase in geopolitical uncertainty in general, which gets reflected in higher risk premia on asset prices and lower business and consumer confidence.

So far, standard news-based measures of geo-political uncertainty have moved higher but remain below Ukraine-invasion highs (see Figure 2). The Vix has moved by less, and remains in relatively untroubled territory. However, if some of the escalatory scenarios we sketched out were to occur, the index could increase much more substantially.



Figure 2: Measures of geopolitical uncertainty have moved higher, although the Vix remains untroubled

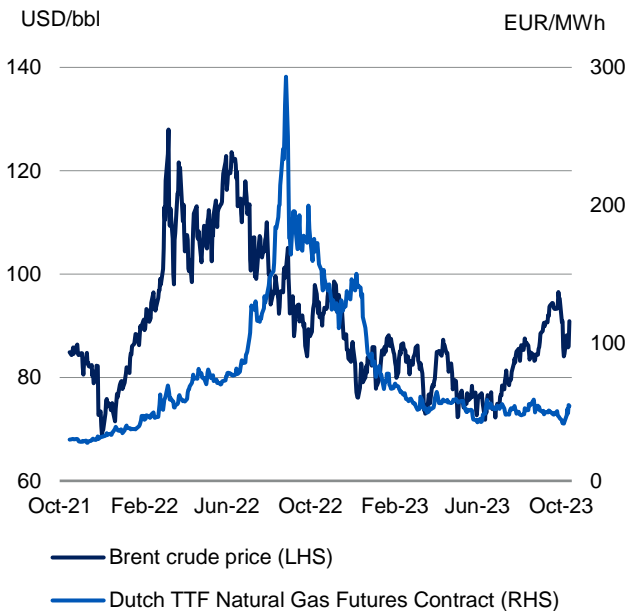


Source: abrdrn, Haver, October 2023.

Direct and indirect energy market impacts

The second channel is through a reduction in energy commodity supply and higher prices, with its attendant spillovers to global inflation and growth. So far, this impact has been relatively small (see Figure 3).

Figure 3: So far at least, the energy price rise pales in comparison to the Russia-Ukraine shock



Source: abrdrn, Haver, October 2023

Israel has become an exporter of natural gas in recent years. The shutdown of the major Chevron-run Tamar gas field due to safety concern constricts supply at a time when firms are still seeking alternatives to Russian pipeline flows, the Baltic Connector between Finland and Estonia is out of action and the European winter is approaching.

The conflict has also raised questions around the Saudi and Iranian oil supply to global markets.

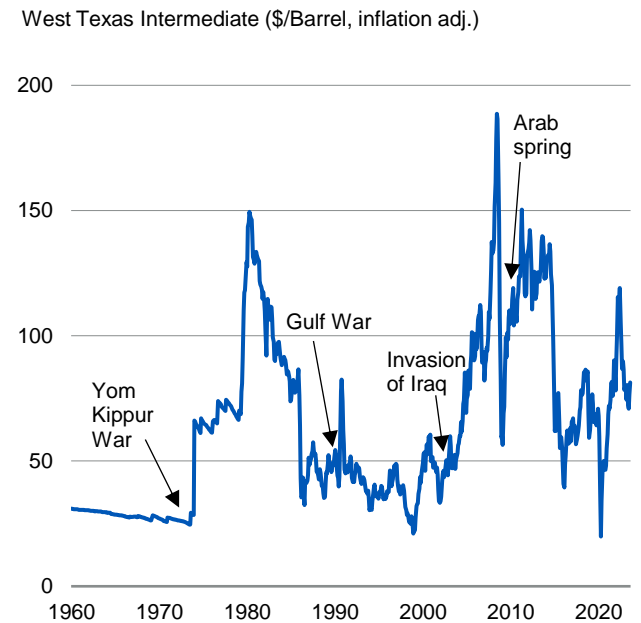
The prospect of a normalisation in Israel-Saudi relations was expected to trigger an increase in Saudi oil supply as an informal quid pro quo of the US-brokered deal. These efforts at normalisation are likely now on indefinite pause, reducing expected future oil supply.

Meanwhile, the policing of Iranian oil sanctions is likely to be more stringent. The US had appeared to be turning a blind eye to sanctioned Iranian oil supply finding its way onto global markets amid inflation concerns. However, this could end, especially if credible evidence of Iranian involvement or foreknowledge of the Hamas attack emerges.

In the more severe escalatory scenarios that we have outlined, global oil supplies may be much more severely impacted. Admittedly OPEC spare capacity is probably sufficient to cover the loss of 1.4 million bpd of Iranian exports should Iran be forced to shut down capacity. But, in contrast to October 1973 – the last time Israel experienced an intelligence failure on this scale – other oil producers are unlikely to cut crude supplies to punish Israel’s international allies.

There would however be a wider risk to the roughly 20% of global flows that pass through the Strait of Hormuz, which would be at risk from Iranian attack. In this severe downside scenario, it might be possible for oil prices to approach the real-terms highs of past oil price shocks, with a peak above \$140 per barrel plausible (see Figure 4).

Figure 4: Conflicts in the Middle East can have varying scale of (real) oil price impacts



Source: abrdrn, Haver, October 2023.



Needless to say, global inflation could rise significantly, and growth would be hit.

Rough rules-of-thumb would suggest that the approximately 50% oil price move we have pencilled in for the worst-case

scenario would knock off 1% of GDP for oil importers (note that the US is a net oil exporter). Meanwhile, a move of this magnitude would add roughly 2% to headline inflation in most economies.

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Figure 1: Israel-Gaza geo-military scenarios

	Description	Indicative probability	Waymarks	Impact
Conflict deescalates	Diplomatic efforts by the US, Qatar and wider allies to contain conflict succeed and wider regional escalation is avoided. Amid an unfolding humanitarian crisis, Israel pulls back from a full ground offensive in Gaza.	5%	<ul style="list-style-type: none"> US-led diplomatic efforts to deter neighbouring countries from directly intervening in the conflict succeed. Promises of economic support convince Egypt to open the Rafah border crossing, allowing Gazans to leave the conflict zone and humanitarian aid to enter. US and Qatari efforts to contain the conflict and de-escalate tensions between Hamas and Israel lead to a hostage release agreement. International pressure to avoid civilian casualties leads Israel to cancel planned ground invasion. 	<ul style="list-style-type: none"> Short-term instability fades to a return to the status quo, though Israeli-Hamas tensions remain heightened for some time. Market disruption is limited, as political crisis dissipates. Oil price dynamics return to pre-attack drivers of supply and demand. Brent stabilises below \$85/bbl.
Contained ground invasion of Gaza	Israel conducts a ground operation in Gaza aimed at removing Hamas and securing hostages. Military action may continue over weeks or months but does not spill over into the wider region.	60%	<ul style="list-style-type: none"> Allies of Israel may provide military support but avoid a direct role in the conflict. The US and EU continue efforts to avoid regional escalation. Allies of Hamas including Hezbollah and Iran maintain rhetorical support but do not directly intervene in the conflict in any significant way. Israel remains focused on removing Hamas from Gaza and does not undertake significant direct action against its regional allies. 	<ul style="list-style-type: none"> Some regional instability as governments across the region respond rhetorically to the conflict and deal with domestic protests. Skirmishes along Israel's borders with Lebanon and Syria are possible but remain limited. Conflict ends when Israel achieves military goals. Oil supply is not directly impacted by the conflict and prices remain within the \$85 - \$90 range seen in the immediate aftermath of the attack.
Escalation to other Iran-backed actors	Israeli and US efforts to deter escalation are not wholly successful. Active conflict broadens to include Hezbollah and other Iran-backed actors.	30%	<ul style="list-style-type: none"> Hezbollah becomes directly involved in the conflict to support its allies following the launch of an Israeli ground operation in Gaza. This opens a second front in the conflict. International conflict mediation and deterrence efforts fail to prevent Hamas' allies from active participation, but Iran continues to avoid a direct role. 	<ul style="list-style-type: none"> Regional tensions rise, leading to greater geopolitical uncertainty. Protests and public unrest are widespread. Israel expands military targets to include infrastructure in Syria and Lebanon. Humanitarian crisis widens, risking deepening regional instability. Concerns over broader supply restrictions from OPEC members drive risk premia. Oil spikes above \$100 and trades in a range of \$90-110.
Full-scale Middle East war	Conflict escalates regional tensions, leading to a broader destabilisation. Iranian regional proxies become actively involved in the conflict, while Israel carries out military strikes against Iran.	5%	<ul style="list-style-type: none"> Credible evidence emerges of Hamas' close allies having direct involvement in the planning or facilitation of its attack on Israel, leading to a military response from the Israeli military. Iranian proxies and Iran itself become directly involved in the conflict, opening up multiple fronts. Israel's ground offensive in Gaza continues for weeks or months, leading to accusations from Hamas' allies that it is carrying out a de-facto occupation of the territory. 	<ul style="list-style-type: none"> Additional sanctions on Iran are likely, alongside tougher policing of current sanctions. Wider regional destabilisation occurs, leading to market disruption and acting as a drag on economies across the region. Large population movements and a deepening of the humanitarian crisis lead to social and economic strain in neighbouring states. Oil exceeds \$140, before recession fears and lower demand expectations drag prices lower.



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AA-011123-170252-33

