

MIDDLE EAST CONFLICT SCENARIOS

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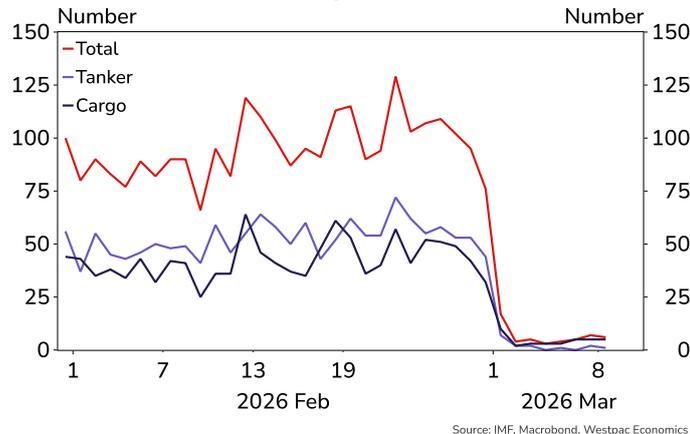
Energy shock, elevated risks ...



Sian Fenner
Head of Business & Industry Economics

The US/Israel–Iran conflict, which began in late February, has disrupted global energy markets with the all-important Strait of Hormuz officially closed due to heightened security risks and surging insurance costs. The Strait typically carries around 25% of global seaborne oil trade and 20% of LNG exports. The [IEA estimates that around 8mb/d](#) of global supply has been disrupted, making this as one of the largest oil supply disruptions on record.

Strait of Hormuz Shipping Chokepoint



Since the start of the conflict Brent crude prices have spiked above US\$100/bbl and while oil prices have since eased to US\$93 after comments from President Trump signalling a desire to avoid a prolonged disruption, volatility remains elevated, with markets still pricing a supply risk premium of around US\$25/bbl. Benchmark gas prices have jumped by more with the Japanese LNG price surging to around US\$16mmbtu, reflecting concerns over LNG supply, particularly from Qatar.

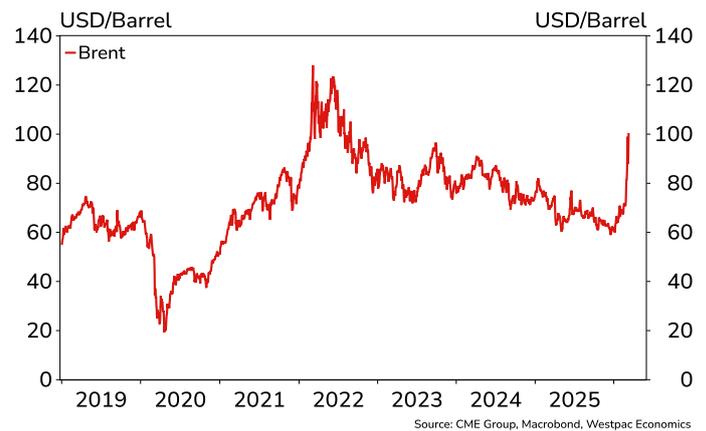
This underscores the ongoing uncertainty over shipping flows through the Strait and the duration of the conflict. Against this backdrop, we outline our baseline and an alternative scenario for energy prices and the broader economic implications using the Oxford Economics Model.

Oils prices to lift to around \$110 in Q2

It is highly uncertain how long the conflict will last and

whether any eventual truce proves durable enough to allow production and shipping to normalise quickly. Our baseline assumes the conflict lasts around one month but that it takes at least a further month for shipping through the Strait of Hormuz to normalise given the risks of sporadic attacks and elevated insurance costs even after hostilities ease.

Crude Oil (Brent)



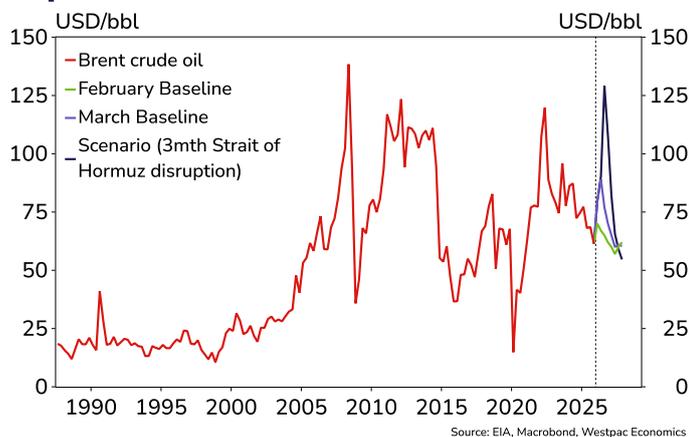
This is expected to reduce global oil supply by over 4mbpd on average in Q2. Only Saudi Arabia and the UAE have operational crude pipelines that can partially bypass the Strait with available capacity at around 1.6-5.5 mbpd. Meanwhile, smaller Gulf producers, including Kuwait, face temporary production 'shut ins' as storage capacity is exhausted. Indeed, UAE and Kuwait have already announced some temporary production 'shut-ins', highlighting that the longer the conflict continues the greater the disruption to global oil supply.

While the current disruption to global oil supply is significant, global oil inventories were ample heading into the current conflict, with world stocks at around 8.2bn barrels, and the IEA has announced plans to release 400m barrels of strategic reserves, although the timing and pace of those releases remain uncertain.

These buffers limit the downside risk to supply but do not eliminate it. Combined with a persistent supply risk premium, this is expected to keep Brent elevated, averaging around US\$90/bbl in Q2, nearly US\$20 above our February Market

... duration is the key uncertainty ...

Oil price scenarios

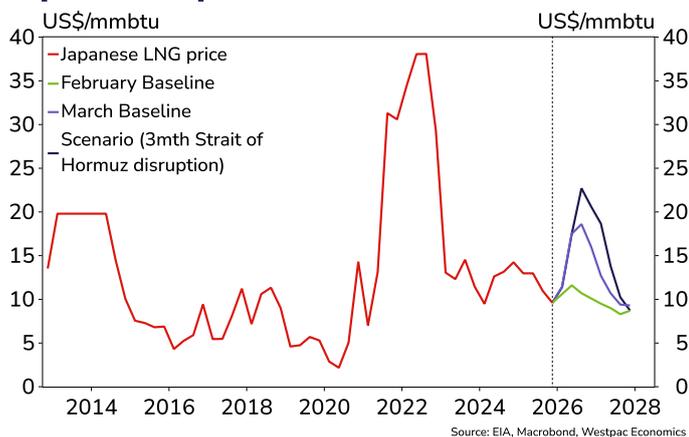


Outlook forecast, with prices expected to climb briefly to around US\$110.

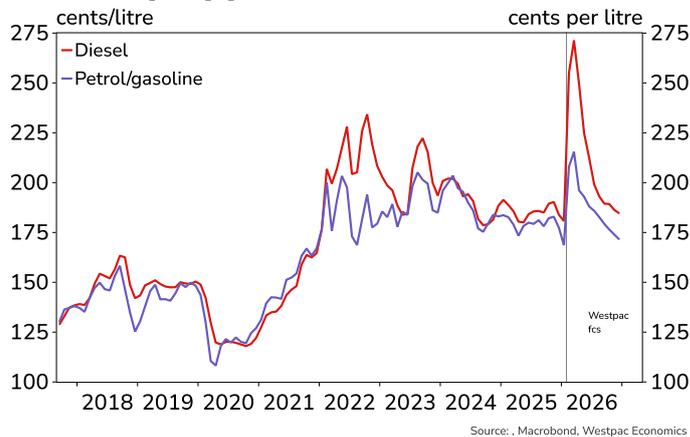
The shock to gas markets is expected to be larger. Qatar, which accounts for around 20-25% of global LNG exports, has no viable alternative route to the Strait, and operations at Ras Laffan, the world's largest LNG facility, have been temporarily suspended. Consistent with the IEA assessment we assume a drop in global LNG supply of over 200mcm/day. As a result, we expect Japanese LNG gas prices to rise to average around US\$19.5mmbtu, nearly US\$8 above our February Market outlook forecasts in Q2.

Both oil and gas prices are expected to ease as the risk premium fades and supply conditions normalise but remain above our February forecasts through the rest of 2026 with prices averaging US\$70/bbl and US\$16mmbtu in Q4. Our baseline assumes that the path for gas and oil prices will converge back towards the pre-conflict path by around mid-2027, with oil prices then drifting modestly lower as supply and demand balances improve.

Japanese LNG price scenarios



Australian pump prices for auto fuel



Impact on growth and inflation

Higher oil prices feed rapidly into headline CPI via fuel and transport costs, and indirectly via energy-intensive products such as fertilisers, freight and manufacturing. Already national petrol prices have risen since the start of the conflict. Singapore refinery margins on Gasoline10, the key benchmark for Australian wholesale petrol and diesel prices, recently increased to around US\$30/bbl, its highest in four years. This suggests petrol and diesel prices are likely to rise by more than the direct pass-through from higher crude oil prices alone. As a result, we expect retail petrol and diesel prices to average around \$2.02/litre and \$2.50/litre respectively in Q2. Fertiliser prices such as Urea are also up sharply and some airlines have already announced price increases due to the rise in jet fuel.

In Australia, we expect the peak impact of higher energy prices on annual headline inflation in Q2, lifting it by around 0.8ppts to 4.6%yr. While inflation is expected to ease thereafter, headline CPI is still likely to be around 0.6ppts higher in Q4 2026 than it would have been otherwise.

The impact on trimmed mean inflation is considerably smaller. However, we do expect some second-round effects from higher energy costs, adding around 0.2ppts to trimmed mean inflation in the second half of 2026.

Based on the Oxford Economics Model, the impact of higher energy prices lowers Australia's 2026 GDP growth by around 0.1ppt as higher inflation lowers household disposable income and spending and weakens investment. These effects are only partially offset by higher coal and LNG prices, which support export incomes.

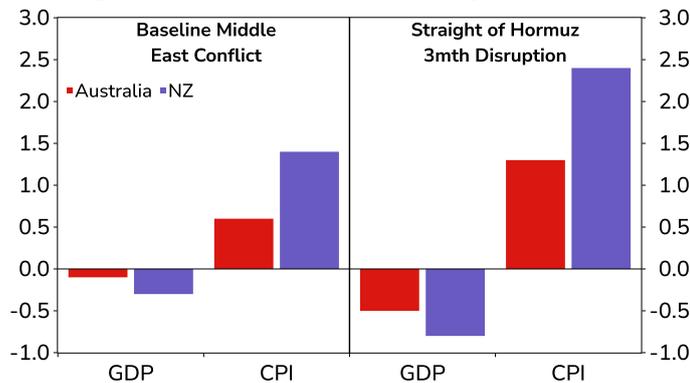
Globally, the model estimates that higher energy prices trim global GDP growth by around 0.1ppt in 2026, with the largest effects concentrated in the Middle East and energy importing regions such as Europe. For Australia and New Zealand, weaker global demand modestly weighs on exports, with

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... adverse scenario sees oil prices at \$130 in Q2

Model estimates of Middle East Conflict impact

Percentage point difference to Q4 2026 yr end growth



Source: ABS, Macrobond, Westpac Economics

lower imports providing only a partial offset.

In New Zealand, the same shock transmits more forcefully. Higher oil prices represent a negative terms of trade and income shock, with no offsetting energy export gains, pushing CPI around 1.5ppts higher at its peak in Q2 and leaving GDP around 0.3ppts lower under comparable assumptions.

Note that all of these estimates reflect the modelled impact of higher energy prices in isolation. Our final forecasts incorporate a broader set of moving parts, which can act in offsetting directions and influence the final economic outcomes.

An alternative scenario amid heightened uncertainty

A key determinant of the economic impact of the conflict is its duration, and there remains a material risk of a more extensive and prolonged disruption than assumed in our baseline. To capture this risk, we have [updated our alternative scenario](#), which assumes the conflict persists for three months with no permanent damage to oil and LNG production and freight facilities.

Under this scenario, oil prices could average US\$130/bbl in Q2, with prices close to, or above US\$200/bbl possible at the peak. Japanese LNG prices would also rise sharply and remain elevated for longer, averaging around US\$20mmbtu in Q4 2026. Such an outcome would trigger a broad surge in energy intensive costs, including transport, freight and logistics, amplifying inflationary pressures across the global economy. A sustained period of elevated energy costs would also increase the likelihood that higher prices spill into wages and broader pricing behaviour, making inflation more persistent.

Under this three month disruption scenario, CPI lifts by around 1.3ppts above our baseline by end 2026 with the Trimmed

Mean remaining above the RBA's 2–3% inflation target range until Q2 2027. A larger and more persistent squeeze on real household incomes lowers growth over the year to Q4 2026 by around 0.5ppts.

In NZ, CPI could be 2.4ppts higher at the peak than our current forecast, with core inflation above the upper part the RBNZ's target band for an extended period and GDP growth around 0.8ppts lower by end-2026.

Central banks have traditionally looked through the first-round inflation effects of temporary supply shocks such as higher energy prices. However, in the post pandemic world central banks may be less willing to dismiss large energy shocks, particularly where there is a risk that inflation expectations could shift higher against a backdrop of existing inflationary pressures.

In Australia, this unwillingness is already reflected in our updated base case, which now sees two further rate hikes in March and May compared to our previous forecast of just one more move in May. The slightly front-loaded tightening may give the RBA a bit more scope to remain on hold later, even if headline inflation rises more sharply under this scenario (noting that this scenario also has a more protracted growth slowdown that will weigh more heavily on inflation once the initial pulse has passed).

A crucial consideration here is the extent to which global energy market disruptions start feeding into domestic electricity and gas prices. As discussed on p6, this channel is expected to be fairly muted, especially compared to the energy shock following Russia's invasion of Ukraine. That reflects both caps on domestic gas prices and other factors that we expect to mute spillover effects from global gas and coal prices to local prices. A more prolonged conflict would clearly challenge these views.

In New Zealand, the policy challenge is more acute. Persistently higher inflation, combined with a lower starting point for interest rates, raises the risk that inflation pressures become more entrenched. Under this scenario, the model estimates, based on a simple Taylor rule, that the RBNZ could raise rates by a further 50bps in 2027 to contain ongoing core inflation pressures.

This scenario assumes no significant damage to oil and LNG production and freight facilities. A permanent loss of supply would prolong the cost to the real economy. It would also add to the risk of a sell-off in financial markets that would not only amplify the negative shock to the global economy but complicate the policy response.

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Corporate Directory

Westpac Economics / Australia

Sydney

Level 19, 275 Kent Street
Sydney NSW 2000
Australia

E: economics@westpac.com.au

Luci Ellis

Chief Economist Westpac Group
E: luci.ellis@westpac.com.au

Matthew Hassan

Head of Australian Macro-Forecasting
E: mhassan@westpac.com.au

Elliot Clarke

Head of International Economics
E: eclarke@westpac.com.au

Sian Fenner

Head of Business and Industry Economics
E: sian.fenner@westpac.com.au

Justin Smirk

Senior Economist
E: jsmirk@westpac.com.au

Pat Bustamante

Senior Economist
E: pat.bustamante@westpac.com.au

Mantas Vanagas

Senior Economist
E: mantas.vanagas@westpac.com.au

Ryan Wells

Economist
E: ryan.wells@westpac.com.au

Illiana Jain

Economist
E: illiana.jain@westpac.com.au

Neha Sharma

Economist
E: neha.sharma1@westpac.com.au

Luka Belobrajdic

Economist
E: luka.belobrajdic@westpac.com.au

Westpac Economics / New Zealand

Auckland

Takutai on the Square
Level 8, 16 Takutai Square
Auckland, New Zealand

E: economics@westpac.co.nz

Kelly Eckhold

Chief Economist NZ
E: kelly.eckhold@westpac.co.nz

Michael Gordon

Senior Economist
E: michael.gordon@westpac.co.nz

Darren Gibbs

Senior Economist
E: darren.gibbs@westpac.co.nz

Satish Ranchhod

Senior Economist
E: satish.ranchhod@westpac.co.nz

Paul Clark

Industry Economist
E: paul.clarke@westpac.co.nz

Westpac Economics / Fiji

Suva

1 Thomson Street
Suva, Fiji

Shamal Chand

Senior Economist
E: shamal.chand@westpac.com.au



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