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[00:00:00] **Rory Johnston:** Normally it costs like two to three bucks to ship a barrel from the Persian Gulf to Northeast Asia. Now that's 10X that volume. Right now, we are seeing that high cost of transit forcing these markets further apart than they would much normally be. We find ourselves kind of now trapped in this horrific balkanized oil market, where it's kind of fragmented and shattered.

[00:00:19] **Nate Hagens:** Well, just like everything in our world, we've got energy as the headline story, but underpinning it is complexity, and what you're saying is there's complexity within the oil and product market itself that could fracture or break.

[00:00:33] **Rory Johnston:** Absolutely. It's fractal complexity all the way down, Nate.

[00:00:41] **Nate Hagens:** Today I am welcoming back oil market researcher Rory Johnston for an update on global oil and importantly refined product supply and the situation, after the Iran war as we head into winter, for the Global North, and we find ourselves in several global conflicts in areas and about energy.

[00:01:13] Before I reintroduce Rory, just a word on the vast standard deviation of the guests that we platform here on TGS and the high standard deviation of humans that follow this show. Two weeks ago we had Indy Johar talking about how the financial runway is headed into a cul-de-sac unless we change the present moment.

[00:01:40] Last week was Robin Wall Kimmerer on the web of life and plants as our teachers, and now we have an oil market analyst. All of these things are part

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of the tapestry of what I perceive to be the more than human predicament, and everyone has their own flavor of what they like to listen to and learn from.

[00:02:03] I think it's all relevant to what humans, individually and collectively, understand and move towards in this fragile historic moment. Yes, this podcast is centered around energy, but also humans' relationship to energy and to the broader world. So I'm interested in all of it. So bringing me back to Rory, who is the founder of Commodity Context.

[00:02:34] He is a lecturer at the University of Toronto School of Global Affairs and Public Policy. He is also the host of the Oil Ground Up podcast. Previously, he led the economics research team in commodities at Scotiabank. He is incredibly knowledgeable and has the pulse of what's really going on behind the narratives in the news, telling us that we now have more exports of oil from the Middle East than we did before the war and the like.

[00:03:12] This was a rapid-fire, lots of data, lots of analysis conversation on the state of global oil markets and what it portends for the future. Please welcome back Rory Johnston. Rory, good to see you. Welcome back.

[00:03:30] **Rory Johnston:** Thanks for having me back, Nate.

[00:03:32] **Nate Hagens:** I'm actually really excited and looking forward to this conversation.

[00:03:36] You know why?

[00:03:37] **Rory Johnston:** Why?

[00:03:38] **Nate Hagens:** Because you know way more than I do on this topic, and I wanna understand what the hell is going on and learn from you. So, you were last

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on the show, I believe, in April. Yep. Which was just a couple months into the Iran war, and a lot has happened since then. A lot has happened in the last 48 hours.

[00:04:03] Today is Thursday, October 22nd, at 9:10 in the morning Central.

Because I think we, in conversations like this, we always now have to timestamp things 'cause things– Yeah ... move so quickly. So I'll start by asking you to give us a quick update on the current state of conflict surrounding the Strait of Hormuz, especially what we're seeing in terms of oil exports coming out of the region.

[00:04:31] Just give us an aerial view of what's going on.

[00:04:34] **Rory Johnston:** Yeah, so we'll start quickly with what's happening now before doing the rewind and kinda catching up on– Okay. Please ... where we've been since we last spoke, kind of at the peak of the crisis in early April, I believe. So the status right now is that the conflict and the disruption through Hormuz is in this bizarre kind of middling no man's land, where exports of particularly crude oil, non-Iranian crude oil specifically, have briefly recovered over the past couple weeks, and particularly through the end of September, to pre-war levels.

[00:05:07] All the data indicates that we are kind of getting those volumes back through, but one, that is extraordinarily precarious, and immediately after we hit these levels, we saw Iran dramatically re-escalate its attacks to, so far, their actually largest and heaviest level of the war, even heavier than we saw in March and April.

[00:05:26] This has pulled back those volumes, I think predictably. And the other piece that I wanna stress here, and we'll get into, like, really the nitty-gritty of all of this, but the other piece here is that the cost of those barrels currently getting through is astronomically high. Normally, it costs a couple dollars a barrel to ship a barrel of crude out of the Persian Gulf towards Asia.

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[00:05:46] Now you're looking at somewhere between \$20 and \$30 a barrel, 10X that normal level because of the extraordinary, you know, risk of being struck in war insurance, the complications of this dark transit system that we'll talk about. But just in total, we're at this weird point where the market's recovered, the deficit on paper is shrinking, but the accumulated prior surplus, the stocks that we've drawn down over this period, have come down considerably as well.

[00:06:14] So even a smaller deficit today is as or even more concerning to the oil market than a large deficit with high inventories was back in March.

[00:06:25] **Nate Hagens:** So what you're saying is, well, we have a stock in the ground of oil, and reserves, and there's a flow rate on how that comes out, and that we haven't talked about yet, but that's part of it.

[00:06:40] Yep. Then we have a stock of oil above the ground in, like, storage and the Strategic Petroleum Reserve and on tankers in the ocean. That's been drawn down a lot.

[00:06:52] **Rory Johnston:** Yeah.

[00:06:52] **Nate Hagens:** And then we have the daily flows of the production that are going around the world, and you're saying that is mostly recovered to the pre-war levels, but not quite.

[00:07:06] So that's an aerial view of the circumstance, yes?

[00:07:11] **Rory Johnston:** Correct. And just to kind of put it in perspective, 'cause I think stocks are accumulated flows. So the accumulated total volume of oil production that we've lost thus far this year in the Middle East, kind of what we would've expected them to produce versus what they actually produced, is over two billion barrels.

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[00:07:31] Now, not all of that has come out of stocks, 'cause again, we are going to have an oversupply this year. I was expecting prices to fall this year because of the oversupply. So some of that was absorbed by the oversupply, but overall, we lost two-plus billion barrels of what we were supposed to have this year, which is by far the largest shock in the history of the market.

[00:07:48] **Nate Hagens:** You said that we're getting a majority of the oil, but the cost of shipping is 20 to \$30 more. First of all, I will say that in the backdrop of what oil does for society, that 20 to \$30 is really still not much for the bargain we get from this stuff that's indistinguishable from magic on human timescales.

[00:08:18] But who's bearing that cost, the \$20 to \$30?

[00:08:22] **Rory Johnston:** It's a great question, and the answer is kind of everyone bearing the cost. But really the kind of primary burden, particularly for the Middle Eastern exporters, is falling on the exporters themselves. So one of the countries that was fastest to respond and recover from the Hormuz shock, which is actually surprising 'cause this actually bucked my initial expectation, was Iraq.

[00:08:43] We didn't think Iraq would be one of the fastest to respond 'cause it doesn't have the same financial and technical resources that, say, the Saudis have with Aramco. You know, Iraq has less state capacity, less money. It was predictable and more challenging geology. We thought they were going to recover more slowly.

[00:09:00] But what they proved to be was the most willing to barter and discount. So what you've seen is, as an example, I think it was September, the Iraqis discounted their average barrel for a shipper that was willing to come into the Gulf through Hormuz, risk that, and load at Basra, which is in southeastern Iraq.

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[00:09:20] They were getting something like \$37 per barrel discounts on that loading versus whatever the Dubai or Brent benchmark they were using. And just to put in perspective here, so that's like, let's say, on that day, a third or more discount on the kind of headline kind of barrel you were going to be paying for.

[00:09:38] Commodity traders, so like the people that have really moved this stuff around, the, you know, Trafiguras, the Vitols, the Glencores, et cetera, the people that, you know, are the swashbucklers of the global commodity market. They normally make their huge volumes of money with, you know, margins of a couple, like, 10, 20, 30 cents a barrel or maybe a buck a barrel for an extremely good trade.

[00:10:02] They have huge margins to work with here if you're talking about \$37 a barrel. So you can pay that exorbitantly high wartime insurance to insure your tanker coming out of Hormuz. You can deal with the fact that the shipping rates are 10X what they normally are. You have to kind of do all these ship-to-ship transfers and all these additional logistics.

[00:10:21] All of this costs time, costs money, and essentially right now, the Gulf exporters are the ones that are primarily, kind of, bearing the brunt of that cost.

[00:10:32] **Nate Hagens:** If the war ended tomorrow, and production and export flows returned more to pre-February 26 baseline, would this insurance transit shipping premium still remain, do you expect?

[00:10:50] **Rory Johnston:** It would drop quickly, at least on the insurance side. I don't think it would come back to pre-war levels anytime soon because obviously we've kind of popped that bubble. We've exposed people to the potential of just how risky this can get. And then shipping, I think you're... A lot of what's happened is the kind of emergence of the shadow and dark shuttle trade that we'll talk

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about more, that's kind of really tied up more and more shipping assets for the same given barrel flow.

[00:11:15] So you're stretching the same, you know, capacity to get the same thing done. And that I think would heal, but over time, probably a couple of months. Same as, you know, when we're talking about what the effect on global crude oil prices would be. I think that if this ended and if we return to the pre-war norm, we would have a surplus, so that would put downward pressure on prices.

[00:11:35] But before this war, I'd expected this year for Brent crude prices to fall potentially as low as fifty dollars a barrel or lower in order to force that kind of supply rationalization we needed. But that was after a year of surplus going into 2026 and the accumulation of large stockpiles of inventory that was kind of weighing on prices.

[00:11:56] We've eradicated, we've erased all of that surplus of stocks. So I think that while you would put downward pressure, you know, next year in 2027, you would likely need to rebuild all those inventories back to those levels where prices were under pressure again.

[00:12:10] **Nate Hagens:** And probably higher levels, 'cause now people are aware of the existential...

[00:12:17] I mean, you're in Canada, I'm in the USA, we have a lot of oil production. But if you look at Pakistan and, you know, India and places like that, they're really suffering right now with lack of access to diesel and natural gas. And so I think the world is going to want larger stockpiles of this stuff going forward.

[00:12:40] **Rory Johnston:** Absolutely. I think, you know, there are a lot of countries, I think India in particular, a country that didn't have a major strategic petroleum reserve of crude or refined products, and they got hit with crude, and

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they got hit even more acutely by the shortfall of LPG, which is used as cooking fuel in India.

[00:12:55] So you've already seen countries kind of commit to building larger strategic stockpiles on the other hand of this, often in partnership with the Gulf exporters, because the importers want the import cover, and the exporters, in this case with India, it's ADNOC from the Emirates, they want forward-deployed barrels, so if Hormuz ever got blocked again, they could keep selling out of those stockpiles and keep their kind of customers happy and, more importantly for them, the flow of funds back into their country alive.

[00:13:20] **Nate Hagens:** So what are some of the implications of the shipping rate stuff that you outlined?

[00:13:26] **Rory Johnston:** Yeah. So I think, again, we mentioned, you know, I was mentioning earlier that normally it costs, like, two to three bucks to ship a barrel from the Persian Gulf to Northeast Asia. Now that's 10X that volume. Shipping is really important in this industry.

[00:13:38] It essentially connects... It's always a pedantic oil analyst that'll say there is no global oil market. There's only regional benchmarks and all this stuff. But once you get to tidewater, once you get on a tanker in the ocean, the cost of shipping is so low that normally it doesn't really matter, and you could generally talk about a global oil market.

[00:13:55] So unless you're a Western Canadian oil producer stuck behind insufficient pipelines, it doesn't really matter. Right now it matters tremendously because there are still truly regional pockets of supply surplus and supply deficit, and transportation tankers bridge those pockets and kind of solve and arbitrage these inefficiencies and these balances.

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[00:14:17] Right now, we are seeing that high cost of transit forcing these markets further apart than they would much normally be. Exporting regions like the US Gulf Coast are seeing very large discounts, whereas importing regions like the North Sea are seeing all-time high physical premiums. So I think it's the North Sea's all-time high physical delivered premium, as an importing region.

[00:14:38] West Africa, which is a major exporting region to Asia, it's seeing the largest physical discounts in history to major benchmarks. And this is because both sides are needing to kind of close and pay for a piece of that bridge that's now extraordinarily expensive. The most important, I think, you know, two benchmarks in the oil market are WTI and Brent.

[00:14:58] And even more particularly over the past couple years, as North Sea production was declining, they actually started adding WTI directly into the Brent benchmark in the North Sea, and that shipped from the US Gulf Coast. Now, the difference between a barrel of WTI at the US Gulf Coast and a barrel of Dated Brent, the physical benchmark in the North Sea, recently in early October, because of these shipping rates, 'cause again, shipping needs to close that gap, that blew out to the widest point on record ever in history of about more than \$40 a barrel.

[00:15:29] Which, just for reference, is a larger spread than the spread that occurred on April 20th, 2020, when WTI actually traded negative \$37 a barrel. So we have a larger, larger discount or a larger spread earlier this month than when WTI literally traded negative.

[00:15:46] **Nate Hagens:** Wow. And that also happened the same day that diesel crack spread spiked, like, over \$10 on that day.

[00:15:54] **Rory Johnston:** Around that time, yeah. And I think all of this is playing together. I talk about how, relative to a normal global oil market, we find ourselves

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kind of now trapped in this horrific balkanized oil market where it's kind of fragmented and shattered. So everything else is taking that much harder to kind of solve.

[00:16:10] **Nate Hagens:** Well, just like everything in our world, we've got energy as the headline story, but underpinning it is complexity. And what you're saying is there's complexity within the oil and product market itself that could fracture or break.

[00:16:25] **Rory Johnston:** Absolutely. It's fractal complexity all the way down, Nate.

[00:16:29] **Nate Hagens:** So I know you're an oil guy, and your opening statement about flows is oil-based.

[00:16:37] But what... Can you briefly tell us what's happening with respect to natural gas flows in the Strait of Hormuz relative to pre-war?

[00:16:44] **Rory Johnston:** Yeah. So again, I'm not as... I do not follow the gas market as closely as I used to when I covered this at Scotiabank. But generally, LNG has kind of followed a similar trajectory to refined products.

[00:16:56] So what we've talked about thus far is the recovery in crude oil flows specifically. Now, there's a reason that crude oil has recovered more easily than other stuff from refined products to LNG to bulk, you know, fertilizer or anything else, is that you have both these rerouting pipelines, which are an important part of how we survived this shock with the East-West Pipeline to the Saudi Red Sea and the ADCOP pipeline through the Emirates to the Gulf of Oman.

[00:17:21] Those are crude-only pipelines. So you're only shipping crude there. So when we talk about this recovery, it's crude only, and that's an important piece.

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Refined products are still less than half of their pre-war levels. And natural gas, LNG shipments are also, you know, still well below their pre-war levels. So that is further contributing to tighter prices and on top of the actual limit of the flow of LNG through the Strait of Hormuz because, again, if ships are getting hit, you really don't want an LNG tanker hit.

[00:17:50] That's obviously a particularly worrying, kind of instance. And on top of this, you also have the fact that the Ras Laffan LNG facility in Qatar, upwards of twenty percent of their total capacity was one of the major energy infrastructure hits by Iran in March, and that is gonna be offline for, you know, for probably years.

[00:18:12] Yeah. So you do have a structural loss there as well, in addition to this ongoing logistical tightness of LNG supplies out of the Gulf.

[00:18:18] **Nate Hagens:** So we had roughly twenty million, twenty percent, of the world's oil, and I often say about a third of the world's purchasable oil came through– Yeah ... the Straits pre-war.

[00:18:32] But you mentioned products. So twenty million barrels of oil, how many refined products were there pre-war? And you said we're down to about half of that now.

[00:18:43] **Rory Johnston:** Yeah. So prior to the war, we had between twenty and twenty-one million barrels of total petroleum leaving– Okay ... Hormuz. Of that, basically fifteen million was crude and five million was products.

[00:18:56] Okay. So that twenty million number is total petroleum– Got it ... all put together. Yeah. And I think the important thing is all of that.. 'Cause you're like, "Oh, we've only lost crude, or we only lost product," or whatever. The product

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trade is also crude upstream, right? These are not barrels that are imported or refined.

[00:19:11] This is their own crude production that's being transformed and shipped out. And right now, you know, a bigger problem, even tighter than the crude oil market, is the refined products market. So we also really want not just the crude flow, we need the product flow back as well.

[00:19:25] **Nate Hagens:** And we're gonna get to that.

[00:19:28] But back in April and back when this first happened, there were a lot of people looking at second-, third-, nth-order risks coming from the Strait shutdown. And we talked a lot about ammonia- Yeah ... fertilizer and sulfur, and other things. Is there anything on your radar there that is not oil but might be important in coming months?

[00:19:57] **Rory Johnston:** I would say generally, unfortunately, all of my time, all of my bandwidth has been absorbed by oil- Okay. Okay ... over the past six, eight months. But I think all of that stuff is still, you know, that's all still a crisis as well. Yeah. There are other analysts that are much better placed than I am to speak about those.

[00:20:11] **Nate Hagens:** There's a time lag on all this stuff.

[00:20:13] **Rory Johnston:** Exactly, and again, I think that when we hear about the recovery of crude oil, 'cause again, there were a bunch of headlines earlier this week that crude oil, you know, production or exports out of the Middle East recovered to pre-war levels, excluding Iran.

[00:20:25] Which again, is an important caveat there that Iranian oil barrels are in fact oil barrels, so I think they matter, too. But given the framing, it makes sense

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to kind of say, okay, ex-Iran, the recovery in the Gulf flows. But I think that's framing some of the narrative here, that, you know, oh, we're over, it's back to normal.

[00:20:42] But that's just– Yeah ... crude oil.

[00:20:44] **Nate Hagens:** Yeah.

[00:20:44] **Rory Johnston:** LNG is not, you know, fertilizer is not. All of this other stuff is still well behind crude oil in that recovery kind of timeline. Crude oil has just been the thing that's obviously been prioritized by the Gulf producers and by CENTCOM in terms of its convoy operations.

[00:20:59] **Nate Hagens:** You could use the word framing. You could also use the word spinning.

[00:21:04] **Rory Johnston:** Spinning, yeah. It's less charitable, you know– Yeah ... word for the framing, but I like to give people a little bit of slack.

[00:21:12] **Nate Hagens:** So seven months out, are you getting enough sleep, by the way? You look great, but I have to imagine this is one of the busiest times of your life.

[00:21:22] **Rory Johnston:** Definitely the busiest time of my career by far. Yeah. It's been great for business. It's been terrible for sleep– ... and any other kind of human pursuit, but it's been interesting, and I think I and other analysts in this market have learned probably as much in these past eight months about how the market acts and how the market can act as we had in the prior kind of five years.

[00:21:44] At least since COVID. These big shocks are such interesting natural experiments in how these systems will work, and I think as, obviously, a lot of stuff we talked about that I thought was gonna happen in April didn't come to pass,

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and I think we've learned a lot of important lessons since then as to why my initial calls for upwards of \$200 a barrel crude never came true.

[00:22:06] **Nate Hagens:** But you did call for effectively the same in diesel, which is kind of coming true.

[00:22:10] **Rory Johnston:** It is. It is. So diesel prices at the end of September hit just shy of \$230 a barrel equivalent, and even back in March and April when I talked about \$200 oil, the thing I said at the time was that I wasn't super confident on whether or not that would be crude specifically or inclusive of the refined product crack.

[00:22:31] Because the reason that I thought we were gonna need \$150, \$200 a barrel oil was that we've seen 130, 120, \$130 oil before, and it managed to destroy, you know, one to two million barrels a day of oil supply or of oil demand rather. In this crisis, an unmitigated, you know, shock of Hormuz, you know, supply loss, again, even including the rerouting pipelines, even including the SPR release, but not including China, which we're gonna get to in a big second here.

[00:23:00] But all of that, we still would've needed to destroy something like six or eight million barrels a day of demand. That's where \$200 came from. We knew that 130 wouldn't do it. Yeah. We needed way higher. Now these refined products, it's not crude oil that drives demand destruction, it's the refined products, and that's what's trying to do the heavy lifting right now, particularly in these middle distillates like diesel, gasoil, and jet fuel.

[00:23:20] **Nate Hagens:** We're gonna get to that, too. So I also admit that if you would've told me it... Well, first of all, just the stuff that's happened in the last week with ships being blown up and things like that. Any time in the past decade, if any one of the events that happened in the last few weeks had happened, oil would've been up \$10 a barrel, just on that news, and now we're kinda used to it.

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[00:23:47] I am still quite shocked at, I guess, the resilience of the global economic superorganism on how we could Rube Goldberg machine our way out of flows and finance and geopolitical arrangements so that seven months on, the war is still going strong, and we've had this much resilience. So I'll flip that to you.

[00:24:13] What are your big surprises as you've watched this conflict unfold this summer and into the fall?

[00:24:20] **Rory Johnston:** Yeah. So I think there's three things I'd like to focus on. One would be China's gargantuan, what I call the Beijing swing, the collapse of their imports. The second, I think, is the role played by the fact that we entered this year with a big surplus of supply, and the expectation is still the other side of this.

[00:24:38] We're still going to have a surplus of supply, which is rare in the market. And the third piece of this is the role of the White House, and specifically Donald Trump's jawboning of the price, which injected a huge amount of volatility to the upside that I think has affected things.

[00:24:52] **Nate Hagens:** On the first two points, said differently, if there was going to be a war in the Middle East that muzzled the global flows of the hydrocarbon hemoglobin, this year would've been about the best historical time for it to happen.

[00:25:11] **Rory Johnston:** Correct. Yeah. Never before in history was the oil market as prepared, as kind of steeled for this moment as now. And again, I think it was even more prepared and more steeled than I and many other analysts expected going into the year. So let's talk about it 'cause let's start with China 'cause I think that's the big thing, and I was just in DC a couple weeks ago presenting all about China and the Beijing swing.

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[00:25:32] Got a lot of interesting feedback, and I was in Hong Kong the week before that, and I thought surely people in Hong Kong would know more about how this happened or why it happened, and the answer's no. It's the biggest... It's still the biggest mystery in the oil market, so let's talk about it because I think it's really fascinating.

[00:25:47] So the Beijing swing, as I call it, is essentially the fact that between the quarter before, so the three months average prior to the war, December to February, and the bottom in June and July, China cut crude oil imports by about five and a half million barrels a day. And I think we've got a chart here that shows this relative to other Asian importers as well.

[00:26:10] And this is insane. Like, this is something that we've never seen before. This is forty-five percent of China's pre-war crude oil imports. And again, at the beginning, we didn't think much of it. At the beginning, Chinese imports were falling. All Asian imports of crude oil were falling, which made sense. We lost a lot of oil out of the Middle East.

[00:26:29] Most of Asia's imports come from the Middle East. It was not a surprise. In fact, it was an accounting identity, right? We needed imports to fall. But then around May, things got really strange, which is that all of a sudden, Chinese imports of crude oil kept falling steeper still, and the rest of Asia's imports rebounded sharply to pre-war levels and actually even above them.

[00:26:54] So why did Beijing, and how did Beijing shoulder this massive kind of contraction?

[00:27:01] **Nate Hagens:** To win friends and influence countries?

[00:27:04] **Rory Johnston:** I think it's two questions. The first question is how they managed this, and the second question is why, and I think they kind of feed each

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other a little bit. So on the way, I split the question in two chunks, which is crude oil and refined products.

[00:27:16] On crude oil, about half of that was explained by cuts to refining runs. Now, that makes sense, because actually one of the other things that happened during this period is China tried to, again, inoculate itself against the energy shock, as they capped refined product prices in China. So while in early April, right around the time we last spoke, global wholesale diesel prices had roughly doubled.

[00:27:41] Beijing's guided diesel price was only up thirty percent. So this cap on domestic prices basically meant they also capped exports because that price disparity would've basically incentivized a huge outflow of products. But when you didn't have the export flow and you still had high crude prices and low domestic product prices, refinery margins collapsed to the low, like, hugely negative levels, the lowest levels in history in China.

[00:28:05] This predictably contracted import demand for crude oil. At the same time, we knew that China was building surplus strategic stocks going into this war. There's a big debate about how much. It's probably between five hundred thousand barrels a day and a million barrels a day. The larger that number, the more bearish it is for the oil market 'cause it means they don't necessarily need to recover to that level in order to fully kind of recoup their market.

[00:28:30] But at the end of the day, the numbers are too big to be explained by any one of these things. And what we likely saw was that in addition to everything else, we likely saw large undisclosed SPR releases of crude from China as well. And then when we go downstream to the products, how the heck did China suddenly deal with three million barrels a day less, you know, refined products coursing through their economy?

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[00:28:54] This is a larger apparent contraction in demand in China than we saw during the COVID Zero lockdowns in early 2022, when literally all of China was, like, locked in apartment buildings. It seems unlikely that you had the same actual destruction of consumption then. So what was going on? I think in addition, very simply, I think in addition to the crude inventory releases, we've also seen strategic product, refined product releases from China as well.

[00:29:21] Now, I wanna stress here, there is no evidence. There is no confirmation of these releases. This remains a point of heavy debate among analysts. But I think that there's another chart I shared, which was apparent diesel demand. And again, apparent is an important word here because China doesn't publish official demand monthly data, so we kind of piece it together by what appears to be disappearing in the economy, refinery production, net trade, et cetera.

[00:29:48] When you look at the gap between diesel apparent consumption and road freight, which accounts for about seventy percent of Chinese diesel consumption, the apparent diesel consumption was down about twenty percent this summer year over year, whereas road freight was up three and a half percent.

[00:30:07] So that seems weird. I think that is unexplainable without these additional volumes coming into the market, even factoring for increased penetration of natural gas in trucking, increased penetration of electrification in trucking. All of this is happening, but these are not enough to explain at this moment, which goes back to this, it seems like China is doing well beyond what it necessarily needs to keep this going.

[00:30:32] So then you get to this question of why. And I think there's two big explanations, and they are potentially aligned, potentially in conflict at some points. But I think the first one is they wanted to protect their own economy. They wanted to maintain these price caps. They wanted to kind of inoculate Chinese society from this US war in the Middle East.

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[00:30:54] But I think, again, I think they did more than necessary to achieve that goal, which seems almost altruistic. But I don't think that we should think of Beijing as an altruistic power. So the question is, what did it get out of it? And I think the answer comes to export markets for their, you know, merchandise and manufactured exports that they were trying...

[00:31:15] Basically, historically, China had always leaned on the pedal of real estate and construction activity in order to reflate their economy. We saw this in 2016. We saw this in 2008. But over the past half decade has basically been a broken market. Chinese real estate is beleaguered.

[00:31:34] You know, activity's been declining every year for like four or five years. Not the area that Beijing can re-accelerate in a crisis like this. So exports today are even more important to China than they were, say, in 2022 during the last fuel crisis. At the same time, Trump 2.0 and the renewed trade war is pushing Beijing to diversify away from the US market, and the only two other markets that are really comparable in size and purchasing power are Asia and Europe, the two regions that were gonna get hit hardest economically by an unmitigated, you know, Hormuz shock.

[00:32:06] So at the end of the day, I think part of what they did was essentially backstop their own export markets to preserve that economic vitality. But again, these are theories. And there are many theories out there, but I think these are the theories that best fit the available data.

[00:32:23] **Nate Hagens:** I will make a prediction, and it's not what you might expect.

[00:32:28] Of everything you just said, the thing that kinda shouted at me was your use of the word. Apparently, because we don't know. I think unfortunately for people like you, your job is likely to get harder in the coming decade, as I think

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we're gonna have a lot more of that apparent in the energy data around the world because it's gonna be tied to national security.

[00:32:55] And, you know, China is kind of a half capitalist, half command economy, and there's an advantage to people in the world not knowing how much oil they have or where it's stored or how much product, et cetera. And even in the United States, the Energy Information Agency is not as robust and detailed with their reports as they once were.

[00:33:22] Agreed. So I actually think this trend will continue, and especially as oil and energy become recognized as underpinning our entire financial system, I expect that to continue.

[00:33:37] **Rory Johnston:** I agree. I think even since I started in this industry in kind of, you know, the early twenty-teens, I kinda think the late, you know, the early two thousands and that early twenty-teens period was probably the high-water mark for government data transparency.

[00:33:52] So many of the sources that I had used historically, you know, they've disappeared. And then you noted that the Energy Information Administration, the kind of data component of the EIA, that I think you have seen gradually and then, under Trump 2.0, aggressively kind of defunded. So you're seeing fewer and fewer people.

[00:34:13] Some of the best analysts that I used to speak with there have moved on to other areas. It's a tragedy. I think that this is the value, the kind of multiplier value you can get off this public data. And again, a lot of this data can only be collected and distributed by the government.

[00:34:29] So there's been lots of these alternative data providers, tanker tracking, satellite analysis, that have added invaluable additional detail and

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granularity to our understanding of these markets. But at the end of the day, most of this can't be seen by satellite, and you need the survey authority of the government in order to actually get this data.

[00:34:48] And that, I think, is what we're slowly sacrificing because the EIA, for instance, has canceled many of their kinds of critical surveys. And we're poorer without that data.

[00:34:58] **Nate Hagens:** Not to mention all the scientific and environmental data that's also being–

[00:35:03] **Rory Johnston:** Also that ...

[00:35:04] **Nate Hagens:** truncated. Yeah. So let's move to the US 'cause you said something earlier that I didn't fully understand.

[00:35:10] Last week on your Commodity Context, you reported that the US commercial petroleum stocks fell by over thirteen million barrels. And you pointed out that crude supplies are falling at a time when they typically should be building. Can you briefly explain what products are primarily being affected by this, and why would we normally see the stocks of these things building at this time of year?

[00:35:36] **Rory Johnston:** Yeah. So normally the oil market, a lot of what you'll see in oil analyst charts are these seasonality charts. So you've got your line of this year, the X-axis is essentially kind of the months or weeks of the year. And then you've got this year, last year, kind of five-year average, five-year high low, right?

[00:35:52] Kinda gives you a sense of how this typically emerges. Because crude oil storage is a pretty clear seasonal pattern. You tend to get kind of a drawdown

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through the heavy demand season of the summer. You have, you know, a build early in the year. You have a draw... You know, you begin building around this time of year when refineries are typically in maintenance.

[00:36:14] But one of the weird things about this year is that all of our seasonal patterns are all distorted because, for instance, refineries aren't going into maintenance as aggressively as they normally do because with, you know, refinery profitability at all-time highs, if you can keep your refinery on for an extra month, you could make almost a year's worth of profit off of that one month of refining.

[00:36:33] So everyone is delaying maintenance as much as they humanly can, which makes sense, and we need it in this market. The downside is that, you know, delayed maintenance is pretty important. So the more you delay maintenance, the higher probability you have of unplanned kinds of losses or downtime in these refineries, which the market is particularly kind of vulnerable and fragile to right now.

[00:36:58] **Nate Hagens:** So you mentioned that the draw was over 13 million barrels. How do you anticipate that, as a trend, might affect prices for petroleum products this winter? And are you worried about supply availability for any countries in particular through the cold months, asterisk, through the strongest Super El Niño we've had?

[00:37:22] **Rory Johnston:** Yeah. And honestly, that Super El Niño might come in handy. It might be one of the only upsides of the Super El Niño this year– Yeah ... is a little bit of a warmer winter when we're–

[00:37:30] **Nate Hagens:** Especially for Europe, yeah ...

[00:37:30] **Rory Johnston:** Yeah, when we're crucially low on all of our heating fuels. So when you look at the product level, we're basically below the five-year

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trailing low for this time of the year for crude, gasoline, diesel, basically all the major fuels.

[00:37:47] The only major fuel that's a little bit higher is actually jet fuel. Ironically, early in the war, we thought jet fuel was gonna be the tightest because that's where the clearest kind of bottleneck was. What we've actually seen is that refineries were actually generally able to switch towards their yields.

[00:38:07] And then you saw upwards of a 1% yield increase, which sounds like little, but it's actually a crazy high volume– Yeah ... for jet fuel in the US, while at the same time you saw basically a 1% loss of, you know, a sacrifice of gasoline and diesel as that kind of blended up. Yeah ... that ended up keeping, ironically again, you know, jet fuel stocks the highest of all the major products, along with natural gas liquids like propane.

[00:38:31] But everything else is really tight.

[00:38:34] **Nate Hagens:** Tiny asterisk there. We can do that in the US because our oil is perfect to make gasoline, so if we can stretch a little bit, 1%, there, that's no big deal. It wouldn't have worked if we had to trade gasoline to make jet fuel.

[00:38:51] **Rory Johnston:** Yes. Correct. Yeah. And again, when we're talking about, like, the shortages and availability of this stuff, I think as we talked about in April as well, I don't expect, unless governments start messing with trade, which we'll get to as the potential risk.

[00:39:05] But unless governments start messing with trade and policy, I do not expect that North America, Europe, or even wealthy Asia will face outright physical shortages.

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[00:39:15] **Nate Hagens:** Well, that's assuming there's no attack on Fujairah in the UAE or something else that blows up.

[00:39:24] **Rory Johnston:** Yes. Well, and I think that even in a case where we re-end in a deeper deficit.

[00:39:28] I think my point is that advanced economies will be able to pay more for these barrels– Yeah ... and incentivize those barrels to those countries. Yeah, I think what we've already started to see, we saw it in Sri Lanka, we've seen, you know, reports in Indonesia. A lot of poorer, you know, emerging market countries, particularly in Asia, are in a much tighter bind right now where, because of the combined high cost of crude, high cost of products, and these really high shipping rates that we've mentioned, they increasingly cannot compete.

[00:39:56] Their consumers cannot compete for the attraction of those barrels to their shores. So demand destruction needs to be borne somewhere, and again, the unfortunate reality of global capitalist trade is that it will be borne by the poorest members of society.

[00:40:07] **Nate Hagens:** This is something I talked about in one of my Franklys in February, right when this happened.

[00:40:12] Do you have any specific stories in your travels or in your research on how this is affecting some of those countries?

[00:40:20] **Rory Johnston:** It's hard to get a lot of specific color other than long gas lines, you know, clear signs of scarcity. Governments, you know, are still pressing hard on all of these, you know, forced work from home or, you know, only odd or even numbers, you know, cars in their inner cities, you know, depending on the day of week.

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[00:40:40] All that stuff is happening, but it's really hard to tell. And what we can see in data is that it doesn't appear yet that we've seen major losses of demand anywhere yet. Most of what we're seeing is still being drawn down from inventories, which are getting extremely low. The main areas that we saw outright loss of consumption reported were largely on the LPG.

[00:41:04] So this is your propane, butane, et cetera, particularly in India as an example. India, which uses upwards of between half and a third of total oil goes towards cooking fuels and LPG. That has taken a massive backseat, and we have seen reports about people returning to burning wood or coal– Mm–hmm.

[00:41:21] Mm–hmm ... or in the extreme cases, animal dung in, you know, homes, which is, you know, as many, you know, humanitarian activists have pointed to over the years is like a major sign of, you know, lung disease and kind of, you know, particulate matter inhalation in these countries. That's a huge problem.

[00:41:37] More broadly, we've seen kind of, you know, some of the losses in Asia, particularly early in the war, LPG and naphtha, which is a type of light oil product that typically goes into petrochemical refining, but even that's generally recovered. And we are seeing demand remain shockingly resilient, at least apparently outside of China.

[00:41:57] Relative to what, again, with these prices, we would have expected even more.

[00:42:00] **Nate Hagens:** The last I looked was a week or two ago, but it seems like many of the coal plants in India are running out of coal and are using emergency reserves, and there's not enough coal, which contributes to some of these issues.

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[00:42:20] **Rory Johnston:** Yeah, I think all this whole system, everything, and it's not just products, it's not just...

[00:42:26] Like, everything, every energy product, every commodity is facing these same constraints. Again, what's interesting is, like, we're talking about diesel. Like, diesel's a cost structure in oil mining. It's a cost structure– Yeah ... in shipping fuel. All of this kind of percolates out, and basically everything is feeling the pain.

[00:42:45] Again, I think these products are still the epicenter of that. Yeah. But more broadly, you know, everything's feeling the pain, which is making diversification and substitution that much harder.

[00:42:54] **Nate Hagens:** So let's move to diesel and the other products. So I've had several guests on the show discuss trends in crack spreads before, but I don't think I've had anyone explicitly define crack spreads.

[00:43:10] So for those listening who might be unfamiliar, maybe you could give a crack spread 101 and why analysts keep a close eye on that, especially when it comes to diesel.

[00:43:19] **Rory Johnston:** I'd love to. So I actually have a chart here, refined product prices and crack spread overview, which I think breaks it down in a helpful way.

[00:43:27] And my favorite thing, and one thing I will say up front, one of my favorite things about being an oil analyst is the innate kind of immediate snicker that I always get anytime I mention the term crack spread. 'Cause it is a funny word. But I think it's appreciated. Like, why do we use that word?

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[00:43:40] Because I think it is actually really illustrative. As you well know, Nate, an oil refinery is basically a big chemistry set, and oil, or hydrocarbons generally, are long chains of hydrogen and carbon atoms. The longer the chain, the denser or, quote, heavier is the oil or the product. So gasoline, relatively light, very short hydrocarbon chains.

[00:44:04] Heavy sulfur fuel oil, asphalt, you know, most crude oils, longer hydrocarbon chains. When we talk about cracking, we literally mean breaking those hydrocarbon chains apart into shorter and shorter elements to these other products. So we do that through a series of, you know, heat to crack them apart and then chemical catalysts.

[00:44:24] So really what a crack spread is, very simply, is a quick heuristic, a quick rule of thumb comparing the value of a barrel of a given refined product, so let's say diesel, and the crude oil that would go into producing it. Now, a refinery cannot transform one barrel of crude oil into one barrel of diesel.

[00:44:42] Unfortunately, that's not how it works. It'd be very handy in this particular moment. It creates these kinds of fractionations or this rainbow of different products.

[00:44:49] **Nate Hagens:** By physics, you just couldn't do it one to one. You have to do it—

[00:44:52] **Rory Johnston:** Exactly. Yeah. It's physics, it's chemistry. I mean, the initial stage of an oil refinery is the distillation tower.

[00:44:57] Yeah. So you basically put crude oil in, you heat it, it rises into all these other elements, and then you basically get a very natural split. You get like that super gunky, you know, residue and asphalt at the bottom. You get really light propane at the top, but just below that's gasoline.

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[00:45:12] But this is kind of how it works. Now, because of this, the actual refinery profitability at the end of the day is essentially a weighted average of all of those crack spreads based on what you're actually producing, netted for other costs. Now, in that chart I mentioned, you can kinda see on the left-hand side, you've got what I call flat prices, which is basically just, you know, the price of a barrel of diesel.

[00:45:36] So in New York Harbor in late September, this is a three-region average, so it's Europe, US, and Asia, so it's a little bit different from the high numbers I'm talking about. But in New York Harbor specifically, we saw the flat price of diesel for futures rise to, I think it was \$227 a barrel, which was the highest level in history. When we talk about the crack spread, that was at that time more than double the price of crude oil.

[00:46:02] So the crack spread on that day was around \$120 a barrel. For reference, as you can kinda see here in this longer-term chart on the right-hand side, which compares those flat prices to their crack spreads, the normal kind of long-term norm for diesel crack spreads is around \$20 a barrel. So we're currently around five times that level, and recently hit about six times that level.

[00:46:24] And I think that highlights the fact of just how scarce this particular product is. 'Cause I think at the end of the day, it's important to remember that while obviously, crude and gasoline and diesel and jet fuel are all related, at the end of the day, they are fundamentally, you know, distinct commodities, each with their own supply and demand curves underlying them.

[00:46:44] **Nate Hagens:** I'll point out a couple more things that we've summarized in the past. If we suddenly had every car in the world be an electric car, we wouldn't remove the same amount of gasoline that was used in internal combustion engines as those barrels of oil removed from the system. Yeah.

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[00:47:06] Because every barrel of oil has demand for different things, like you just described. Gasoline is 40% of a barrel. Diesel is what? 20%– Yeah ... –ish. Give or take. So, and all these other things, jet fuel. So unless we could do massive refinery switches, we would still need around the same amount of barrels of oil, point number one.

[00:47:27] Point number two, diesel really is what powers the world. Yes. So diesel is a hella important product because of its energy and power density and use in tractors and machinery and such. So Rory, what is the current state of diesel prices? How have refineries been responding to shortages in the last month?

[00:47:49] And you were quite worried about this in April. What do you think now?

[00:47:54] **Rory Johnston:** Yeah. So overall, diesel is still the epicenter of our current crisis, and as you noted, diesel's in pretty well everything. So whether that's groceries, your Amazon delivery, everything comes on a truck. I always joke that, like, even if you bought an EV to kind of get around high gasoline prices, that EV was delivered to you likely on a flatbed powered by diesel.

[00:48:13] That's just the way this world works.

[00:48:15] **Nate Hagens:** Well, and the EV is made from other products in the oil that–

[00:48:17] **Rory Johnston:** And the EV is made from... and the lithium and cobalt are mined using diesel and–

[00:48:22] **Nate Hagens:** And the asphalt that it drives on is made from–

[00:48:25] **Rory Johnston:** Asphalt. Yeah ...yeah. All of this is diesel at the end of the day. Right.

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[00:48:27] So basically, the actual loss, we are now, depending on the month you're looking at, we are talking about roughly one to one and a half million barrels of diesel supply or exports lost from the market. Out of a normal market of, say, 25 to 30 million barrels. That's roughly how much the overall consumption of diesel is in the world. So that's a pretty big shock.

[00:48:49] It doesn't sound like that much, but when you're talking about, like, that would be the equivalent of, like, a five-plus million barrel a day deficit in the overall oil market if you scale it up. In terms of what's driving that, now, obviously, we are in an election year. We are less than... We are only a couple weeks out from the US midterm elections.

[00:49:04] The White House has really tried, and President Trump has really tried to blame the entirety of this diesel crisis on Russia and Ukraine. But the first thing I want to say, while that is contributing, I want to say that is part of it, but the primary driver is still obviously the Iran war and the broader Middle Eastern security crisis.

[00:49:22] **Nate Hagens:** If you were a US citizen instead of a Canadian citizen, would you have said that as confidently as you just did?

[00:49:30] **Rory Johnston:** I do. I would- ... and I said it when I was in DC to members of the US government, and I was just hoping I didn't get deported along the way. Thankfully, I didn't.

[00:49:40] **Nate Hagens:** I mean, I was being flip, but not entirely flip.

[00:49:42] Keep going.

[00:49:43] **Rory Johnston:** Yeah. So basically, that... So Trump has tried to blame this entirely there. I would say roughly, we're talking about 60/40 is Iran war

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versus the crisis, and Ukraine's attacks against Russian refineries. Yeah. So in total, there's a couple things that are going on here in the Middle East.

[00:50:01] We'll start there. Part of this is driven by the actual structure of the trade and rerouting. And we talked about this a little bit earlier. All the pipelines are crude oil. All of this dark transit trade that essentially facilitated this. This is ship-to-ship transfers through Hormuz to ships waiting in the Gulf of Oman, and all of this kind of clandestine activity.

[00:50:21] And the high cost of insurance and everything else naturally leans towards economics of the largest category of tankers. VLCCs, very large crude carriers, carry two million barrels of typically crude oil. Refined product ships or clean product tankers will also face very high insurance costs, but they are smaller, so you can spread that cost along a fewer number of barrels, so it's more expensive per barrel.

[00:50:45] I think that is part of what has also just prioritized crude over those refined products. On top of that, we have also had various damage to refineries in the Middle East. Now, early in the war in March and April, you had attacks from Iran directly against refineries in Saudi Arabia, the UAE, and I think most notably Kuwait, which is the region's typically one of its largest diesel exporters.

[00:51:10] And on top of that, more recently, you have seen the Houthis in the Red Sea dramatically escalate their attacks against Saudi oil infrastructure, and most of Saudi Arabia's oil refineries are actually on the Red Sea coast in the west 'cause that's where most of the Saudi population is. So overall, we've probably lost seven hundred and fifty thousand to a million barrels a day of diesel exports from the Middle East.

[00:51:31] On top of that, we have also seen an acute loss of Russian diesel exports. Now, no one likes Russian diesel exports, obviously, particularly at this

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moment. Like, I don't think we're gonna shed a tear for it. But they are typically the world's second-largest diesel and gasoil exporter, typically exporting between roughly nine hundred thousand, but let's say for easy math, a million barrels a day of diesel compared to the US's maybe one point one, one point two.

[00:51:59] US is the largest exporter. Russia was number two. Because of these attacks that Ukraine has begun mounting against Russia's, you know, ports, pipelines, tankers, export terminals, but also most notably refineries, you've seen upwards of half of Russia's refinery fleet offline at various points this year, which has caused an acute domestic supply crisis of diesel and prompted Moscow to ban the export of gasoline, then jet fuel, then ultimately diesel.

[00:52:28] Russian diesel exports fell from, again, around 900,000 barrels a day to barely more than 100,000 barrels a day. So you've lost a huge chunk of this as well at the point where the world is least capable of absorbing that supply hit.

[00:52:41] **Nate Hagens:** When you were at a Wall Street bank as an oil and commodity analyst—

[00:52:48] **Rory Johnston:** Bay Street, I'll say.

[00:52:49] **Nate Hagens:** Yeah. But back then, ancient history, if you would've just imagined the story that you're telling right now, it would've been like a fricking Twilight Zone story, almost unimaginable, and everything is just all happening all at once.

[00:53:05] **Rory Johnston:** Correct. Well, it's... I always like to say, like, I would have loved...

[00:53:07] I have this, like... My ultimate bucket list is, like, just peacing out for a while and doing a PhD. And there are, like, a dozen—

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[00:53:14] **Nate Hagens:** I don't recommend it, but you go ahead.

[00:53:15] **Rory Johnston:** I mean, every person with a PhD has told me this, for the record. Yeah. But there are, like, a dozen topics this year that I would love to just squirrel away with for, like, a half decade and research.

[00:53:26] **Nate Hagens:** Yeah.

[00:53:26] **Rory Johnston:** And there's so much, we're basically forced to basically jump from topic to topic.

[00:53:30] **Nate Hagens:** Yeah.

[00:53:30] **Rory Johnston:** And any year, this would be the biggest thing we were talking about. Yeah. Obviously now, I think, you know, when we're talking about diesel and we're talking about Russia, the most recent development in this, you know, chaotic environment is that, you know, was it two Fridays ago, Donald Trump announced on Truth Social that he had signed some kind of diesel deal with President Putin that would probably, as he was telling it, help save us from this crisis and help save, you know, US farmers ahead of the midterms.

[00:54:01] But very importantly, the numbers kind of... I kind of said at the beginning, like, this is a nothing burger. I was very proud I got nothing from the burger printed in Reuters. But I think the overall message here, like, the pledge that Putin made was five hundred thousand tons of diesel in November, which sounds like a lot.

[00:54:18] You know, half a million tons, that's so much diesel. It's only a hundred and twenty-five thousand barrels a day of diesel, which as we noted, is basically what Russia's exporting right now, and roughly a tenth of what it normally exports.

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So this is really a nothing burger in terms of volume. And in exchange, Trump actually dropped sanctions on Russian diesel for six months through April 7th.

[00:54:42] So, you know, the Kremlin got a lot out of this deal and a lot of kind of fanfare, and it really hasn't actually had to do much.

[00:54:49] **Nate Hagens:** I didn't anticipate asking you this, especially because you're probably not an expert and you don't live here, but I live here, and I'm not an expert. If there is a blue sweep in a couple weeks in the election, have you gamed out what that means for oil and products potentially, with respect to the Iran war and maybe our stance vis-à-vis Iran and Russia might change?

[00:55:17] I don't know, and I don't think anyone knows, but have you thought about that?

[00:55:21] **Rory Johnston:** I've thought about it a lot. I also do not know a firm answer. Yeah. 'Cause I think you can look at it two ways. I think, like, the two obvious camps here are that, let's say, Dems sweep both chambers. All of a sudden, Trump gets tied up in two years of congressional hearings.

[00:55:38] Maybe that slows him down. Maybe the Congress can take money away from the Pentagon, you know, kind of starve out the war that way. I think that's one way it can go. The other way I think it's even more concerning, however, which is all of a sudden you have Congress calling for Trump to come in for hearings, trying to defund the Pentagon, prompt some kind of constitutional crisis, and Trump, in an attempt to distract from domestic chaos, re-escalates the war alongside Israel in the Middle East, and then basically tries to go for some kind of rally-around-the-flag function.

[00:56:10] I can see both scenarios occurring, and they obviously mean very different things for the world.

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[00:56:14] **Nate Hagens:** So there's a lot of focus on the oil and products that are missing from the Middle East, and as you mentioned earlier, it's important how much production is offline or not being exported from the country of Iran itself.

[00:56:29] **Rory Johnston:** Yeah.

[00:56:30] **Nate Hagens:** Briefly, let me ask you that. What's the current state of Iranian crude production and exports?

[00:56:35] **Rory Johnston:** The Iranian crude production is basically back to near its lowest level since the 1980s. Basically, it is exporting almost no oil. You know, prior to the war and even as recently as, let's say April, Iran was exporting around two million barrels a day of crude and products through the Strait.

[00:56:57] That puts their total overall production in the ballpark of, say, four million barrels a day, 'cause they consume around two million barrels a day domestically. That has, you know, following the imposition of the US blockade, that has proven pretty effective at kind of blocking that. Now, there are reports that there are smidgens of, let's say, LPG getting commingled with other tankers in those Gulf of Oman ship-to-ship transfers.

[00:57:19] But in terms of any material volume of, say, crude oil, that seems to largely have been cut down. Obviously, this is what the White House and the Pentagon are betting on. They think that this is a stranglehold on Tehran, is bankrupting them rapidly, and that they think they're gonna win the game of, I've been calling it kind of like siege chicken, where each side is besieging the other, and they both think they're gonna win out.

[00:57:44] **Nate Hagens:** Yeah, I have a bunch of follow-up questions, but here's something that I thought of while you were speaking.

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[00:57:53] In the current world, other countries couldn't do that to the US because we could just print our money, and our money is the world's reserve currency. Iran can certainly print their own money, but they can't buy stuff with it in the international market. So there is definitely logic there.

[00:58:14] So if the war ended or the US blockade were lifted today, how quickly do you think Iranian production could recover?

[00:58:24] **Rory Johnston:** I think pretty quickly. I think you'd probably get back up to pre-war levels within a couple months.

[00:58:29] **Nate Hagens:** And is it the same with Iraq? And I know I asked you this in our first conversation, and you said you weren't an expert, but is there, in this region, a risk of shut-in production, and we don't know how much will come back online once the white flags are up?

[00:58:51] **Rory Johnston:** I'm generally a shorter of the kind of reserve damage thesis, mostly 'cause I've heard them a lot over the past 15 years. And almost always, you know, after a month, things start going again. I think Iraq is a great example. Iraq is basically almost back to pre-war production levels, and is able to do that not because of its reserve expertise, just because the economics of those discounts facilitated the loadings.

[00:59:16] Mm-hmm ... The final thing I will say, just in terms of this question of Iran's domestic economy, one thing that's really interesting, I actually ran into... Again, you never know who you're gonna meet, or who you're gonna talk to. And I ended up meeting an economic analyst at my son's birthday party, one of the other dads there, and he had just come back from Tehran.

[00:59:32] And he was talking about some of the... He had done a bunch of economic surveys about how people are dealing with this. And I found some of

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the answers fascinating. One, the inflation is very real. Like, we're talking 100-plus percent annualized inflation. Obviously, that's happening, mostly driven by the depreciation of the rial.

[00:59:51] But he was saying that it's not like people are acting like it's hyperinflation. It's not like there's the wheelbarrows of, like, Weimar Republic for bread. Also that there didn't seem to be a huge shortage of goods within the actual Iranian economy, and that, basically, it had turned autarkic.

[01:00:08] Iran's a massive economy, like 80-plus million people, a huge diversity in that skill set, and they've started producing many more things domestically that on a pure comparative advantage basis they would have no business producing. But given they're cut off from world trade, they've kind of become self-sufficient.

[01:00:24] And the final thing that I thought was really interesting here in terms of an economic stimulus that kinda countered some of this US pressure is that historically, the top, like, 20% of the Iranian income strata would often have spent a lot of their money outside of Iran, in Europe, in the Gulf, in Moscow.

[01:00:40] Now all that money has been trapped in Iran, and it's now recycling through the economy, which has provided a little bit of this uplift. So again, it's really, aside from the rial, which is, like, an easy thing to, like, look at and say, "Yeah, that's depreciating or inflation or whatever," it's really hard to get a true picture of what's happening in Iran's economy, which is always tricky, but, like, particularly important right now 'cause it kinda tells us who's winning out on that.

[01:01:05] Again, for Trump, we can just look at the price of oil on the screen or the price of diesel at US pumps and say, "That's your metric for pain." It's much harder to get an accurate read on how Tehran is managing this economic kind of pain on its own end.

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[01:01:19] **Nate Hagens:** I would've thought there would've been more economic pain in the US with \$100 oil and effectively \$200 diesel by now.

[01:01:27] **Rory Johnston:** Yeah, I think, and again, I think one thing this has shown, not only is the oil market more resilient, but global economies are much more resilient to high oil prices than they once were. I think, like, it's no secret right now that obviously global equity markets, like the US S&P 500, is primarily now an AI index in terms of its actual gain.

[01:01:45] **Nate Hagens:** And only a few companies even.

[01:01:47] **Rory Johnston:** Exactly. But yeah. And I think there's an open question, like, what would this have looked like, again, back to this question of it was the perfect year–

[01:01:55] **Nate Hagens:** I know ...

[01:01:55] **Rory Johnston:** for this to happen.

[01:01:56] **Nate Hagens:** We can add AI to the mix of–

[01:01:57] **Rory Johnston:** And AI, right? Like, not only did we have a surplus, we had high inventories, we had electrification drive, and we had an equity index that seems kind of completely immune to, like, the old economy weight being kind of exerted on.

[01:02:11] How long that lasts remains an open question.

[01:02:14] **Nate Hagens:** Except some Wall Street firms are starting to say the quiet part out loud that the whole thing is also a bet on energy.

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[01:02:22] **Rory Johnston:** Yes. Which I think, again, I think all of this, eventually the old economy does eventually seek its revenge, right? But, like, I think that a lot of this other stuff is much bigger, much flashier, and I think much more compelling than...

[01:02:37] I mean, I always laugh, like, the people that are the least or the most tired about hearing about the Iran war are basically anyone that's long tech, right? They don't want this. Yeah. They don't want inflation. They don't want the Fed to raise interest rates. They want cheap debt so they can afford a massive– Yeah

[01:02:54] trillion-dollar build-out of data centers and everything else, and higher interest rates and higher inflation really kind of stymies that entire plan.

[01:03:02] **Nate Hagens:** Yeah. No, I agree with that. So, briefly, let's move to Iraq, who holds, I believe, the fifth-largest proven oil reserves in the world, and borders Iran and Saudi Arabia.

[01:03:15] What type of role is Iraq playing, both in the physical conflict of the Strait and in the volatility of oil and product supplies?

[01:03:24] **Rory Johnston:** Iraq's interesting just because it's managed so aggressively to recover, and again, through these massive discounts. On top of that, you've seen massive convoys of trucks. They've been trucking huge amounts of oil, like 100,000 or 200,000 barrels a day, which is a lot to be trucking across the country.

[01:03:41] They've been trucking it west to Syria and actually exporting it through the Mediterranean. So again, you can shoulder that when you're talking about \$37 a barrel discounts for loadings in the Gulf. You can make a lot of other logistics work. So I think the main story of Iraq through this has been just how impressive it's been with that production recovery.

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[01:04:00] The other piece of this is that you still do have these, you know, Shiite Iraqi militias that are heavily aligned with Iran, and, you know, last month when the East-West Pipeline went down in Saudi Arabia, a lot of people thought it was the Houthis from Yemen that actually took that pipeline down because they were the ones doing all the damage to the Red Sea west coast infrastructure.

[01:04:23] But all indications are actually that it was an attack launched from southern Iraq from these more Iranian proxies, which, again, rather than the dotted line of the Houthis, it was much more of a straight-line connection, that this was an Iranian attack on the East-West Pipeline. So it's both interesting from a commercial point of view and also from a geopolitical staging ground.

[01:04:43] **Nate Hagens:** What do you think the chances are, as all this real-time game of Risk unfolds, that new alliances within the Gulf Coast countries themselves emerge from this because the US is not the guarantor of safe transit and safety and military bases that was once assumed. And in that speculation, what would the implications for oil and products be?

[01:05:15] **Rory Johnston:** It's a great question. I think that obviously a post-Carter Doctrine Middle East is something that can have a lot of variability and volatility to it. So I think one of the most marked and kind of noticeable divergences through this conflict has been the behavior of the UAE versus the behavior of Saudi Arabia.

[01:05:38] The UAE proved to be one of the most aggressive, arguably the most aggressive participants through this entire war. It joined in attacks against Iran. It also reportedly paid Iran some kind of funds early in the war for potentially some kind of defense. Like, it's been doing everything. It's not been pulling punches.

[01:05:55] It's been trying everything, seeing what sticks. It was the one that pioneered this dark transit system through these Gulf of Oman ship transfers and

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all this stuff. Like, they've been kind to the people at the front, whereas Saudi Arabia has said far less, typically the most vocal within the region, particularly through OPEC, but saying very little through this.

[01:06:18] Now you've seen this major drive for various countries to either expand these current rerouting pipelines or build entirely new ones. You've seen a flurry, probably a half dozen or more different pipeline proposals that would all have this concerted strategic purpose of routing around Iran. So I think there is some degree of kind of Gulf monarchical kind of camaraderie going on here.

[01:06:42] But at the same time, you're seeing divergence in the individual strategies of the countries. So I think they're all cooperating, and they all wanna figure out a way to kind of inoculate themselves from the Iranian risk and from the dependence on the Strait of Hormuz. But it's difficult.

[01:06:57] So you're seeing all of these pipelines, and I think there's other ones that could potentially go to, you know, down through Oman directly to the Arabian Sea. 'Cause right now, obviously, the East-West Pipeline puts them out in the Red Sea, which is great except for the Houthis in the Bab el-Mandeb Strait.

[01:07:12] So all of this stuff, you know, you go to one region, and you pop up another whack-a-mole.

[01:07:16] **Nate Hagens:** I think that's right, what you just said. I was more curious, not because they're insulating themselves against the Iranian risk, but against the USA risk. Ah. Like, how do they change their relationship with the US?

[01:07:29] **Rory Johnston:** Well, I definitely think that there's less favors, kind of less deference.

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[01:07:33] I think that once upon a time, and I think the UAE was actually kind of at the front of this as well, that it was the country that received more than all the other strikes across the GCC combined, the UAE kind of received. And you had, like, early on, you know, like, drones hitting the Palm Dubai, like the very, very famous ritzy hotel, like things that were really popping that bubble of the kind of safety and security that Dubai in particular had always tried to project in the region.

[01:08:03] They, I think, jumped ahead. So they've been working with the Israelis. They've been working with, you know, the Ukrainians. They've been working with everyone to try and figure out ways to defend against drones, to restock their arsenals. They're no longer dependent on the United States.

[01:08:17] So I think you're seeing a lot... I think once upon a time, the Middle East was always, particularly the Gulf states, were always this, it was oil, and it was this dotted line to the US military-industrial complex and this kind of tightest, you know, allies in the region. I think they are now seeing that the security umbrella didn't really get them much in terms of actual security when it really mattered.

[01:08:38] So I think they are now going to be trying to be much more self-sufficient in protecting themselves and diversifying their ally networks to kind of support, particularly when there's a deeply unhelpful person in the White House.

[01:08:50] **Nate Hagens:** So I agree with that, and your last two sentences are why I think today's prices, barring a recession or a depression, will be the floor for the future because if there's any sea change in geopolitics and where the spice flows, it used to flow east, and now I think it's gonna largely or more so flow west, and that will change the prices of the things that you work on.

[01:09:25] What do you think about that?

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[01:09:26] **Rory Johnston:** Yeah, I think that I always have trouble with, like, the idea of a floor because at the end of the day, cash-settled commodities will always have an aggressive overreaction function at various– Yeah ... points of–

[01:09:38] **Nate Hagens:** True ...

[01:09:38] **Rory Johnston:** over or under supply.

[01:09:39] **Nate Hagens:** There was a lot of peace built into the historical term structure of oil.

[01:09:45] **Rory Johnston:** Yes, I would agree there. I think, again, I think one of the things that we haven't talked about so much, one of the other things that was my big surprise in this, I only got through that first one on China, was how patient and resilient markets have been despite these low inventory levels. And I think two things explain this.

[01:10:01] One is the fact that we entered this crisis with a very large surplus, very high inventories, and an expectation, an almost consensus expectation that as soon as this ends, we are going to go back into a period of not just mild, but acute surplus.

[01:10:17] **Nate Hagens:** Yeah.

[01:10:18] **Rory Johnston:** Every other period that I can think of through all of the rest of the history of the oil market, whether that be 2008 or the, you know, early 2010s or even 2022, where you had a big deficit emerge, inventories were low, and the market collectively was like, "Oh God, how do we ever get out of this?"

[01:10:36] It's always easy to talk about in hindsight how we got out, but at the time, in the moment, everyone's like, "There's no future surplus. Like, we're

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screwed." Now, it's this feeling of actually, maybe these low inventory levels are good because we're gonna need all that inventory space on the other side of this.

[01:10:51] But I think that's been the theme heavily over the first six months. I think what we've started to see over the last month or two, is that as participants, 'cause again, this rise in flows through Hormuz, one element of it is that it's bearish because it's more oil, obviously.

[01:11:08] But on a bullish factor, I think all of these countries are trying to figure out ways to deal and make this status quo somewhat sustainable for them. And it's not fully sustainable for anyone. So, you know, the belly of the futures curves are also beginning to rise now much more notably as the market begins to hedge this into next year and even into 2028.

[01:11:29] **Nate Hagens:** Well, let's briefly talk about that: the almost doubling of crude prices and almost tripling of product prices since before the crisis.

[01:11:40] **Rory Johnston:** Yeah.

[01:11:41] **Nate Hagens:** Is that changing the rig counts in the USA, and can you briefly tell me what has happened to US crude production this year?

[01:11:49] **Rory Johnston:** Yeah. So going into this year, again, I expected a heavy surplus.

[01:11:53] I expected prices of \$50 Brent or lower, for WTI below 50. That would, in my expectation, have peaked out US shale crude production growth this year, and we were going to begin declining. That was actually baked into the EIA's Short-Term Energy Outlook. So the formal energy department outlook for US crude production was that it would contract with prices, you know, 60, 50 or 40, right?

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[01:12:17] What we've seen is that we haven't seen this kind of shocking, resurgent drill, baby, drill phenomenon, like obviously the president would like to see. But what we have seen is that you haven't seen that contraction. So relative to by this time in the year, I would've expected US production to be declining.

[01:12:36] We are still steadily rising, not gangbusters, but rising, and we keep hitting new fresh all-time high crude production in the monthly numbers. I think that is something that's going to continue so long as prices are where they're at. I do think, and people are like, "Rory, you know, you can't have oil below 50 or whatever because shale doesn't break even then, and shale would contract."

[01:12:58] But that's actually kind of the point, right? We actually are going to have a surplus. This surplus, again, just to rewind very briefly, I still think is fundamentally OPEC's fault, right? OPEC unsustainably attempted to keep the price high by cutting back huge volumes of production between 2022 and 2024.

[01:13:17] And those, basically the unwind of that cut is what put us into this glut situation in the first place. And I think that's the situation, is that we are going to need lower prices to rationalize supply and/or juice demand. And that's the only sustainable way this market will solve over time. And this crisis has happened right in the middle of that necessary rationalization, and actually pushed it out even further because during this period, non-OPEC production has continued to grow.

[01:13:42] The UAE has left OPEC and is actually now pumping full out, and all the while, demand growth, while not cratering, is not growing this year. So any surplus next year is gonna be even larger than the one I would've expected this year.

[01:13:56] **Nate Hagens:** This interview is like cell division mitosis, 'cause every question I ask you, I then have two more after your answer.

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[01:14:02] So the two here, number one, is OPEC relevant, and will it be relevant in the future?

[01:14:08] **Rory Johnston:** Yes and yes, but it's precarious. I think that the loss of the UAE earlier this year when it decided to quit, and it's now pumping full out, and it's seemingly succeeding at that, was the largest loss to the producer group in its history.

[01:14:24] While Iraq technically produced a little bit more crude oil, the UAE's spare capacity, which is the main currency in OPEC, was much, much larger, and it was much more politically important. So while we've lost, you know, Indonesia, Angola, Qatar, these were all losses cumulatively, but nothing...

[01:14:41] All of those combined didn't amount to the loss of the UAE. So that's a big hit. Even more importantly, I think that Saudi Arabia, what we saw going into this, had turned a bit hawkish, a bit bullish on oil. Historically, before MBS took over and before the kind of change in Riyadh, the kingdom had always been the kind of relative dove within OPEC.

[01:15:03] It wanted low prices, it wanted a stable economy. That seemed to shift, and now they seem to have more of a bullish bias. They want to cut more to keep prices high. The challenge now is that all members, particularly Iraq, this is where Iraq comes back into the picture, want to produce all out to make up for the loss this year.

[01:15:24] They have a huge fiscal burden, a huge fiscal hole to plug. So I think that Saudi Arabia is going to want to cut and maintain slightly tighter markets all else equal, but I don't think it's going to be able to get OPEC broadly consensus on this. And by trying to force the matter could actually prompt Iraq's exit.

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[01:15:43] And I think if Iraq leaves, I think OPEC is pretty dead. But I don't think that's the base case yet. And I think that Saudi Arabia can still handle this. But I think that's the dilemma Saudi Arabia now finds itself in. So I think what's going to happen is I think you might have OPEC that remains as this kind of forum for consensus building.

[01:15:59] But I expect that Saudi Arabia might be doing a little bit more unilateral cutting in the new year.

[01:16:02] **Nate Hagens:** So the flip side to that question is a strange question. You and I understand that energy is the floor of the economy and technology might be the ceiling or probably ecology is really the ceiling and that our culture is energy blind because we basically have increasing supplies through our entire lives and we kind of miss that huge support of our system.

[01:16:35] In the United States, we long ago peaked in the conventional crude, then we added the crude from the North Slope in Alaska, which is separated by your country, and we went under the oceans to extract the Gulf of Mexico, and now we're extracting shale oil. And most of the shale oil regions have peaked except for the Permian– Yep

[01:17:00] and we're high-grading the rest. So if we're a wise culture, which arguably we're more clever than wise, given this backdrop, wouldn't it make sense to keep our remaining oil in the ground and buy other people's oil with this backdrop? Why are we so proud that we're draining what we have left faster?

[01:17:27] I don't know. Do you have any thoughts on that?

[01:17:29] **Rory Johnston:** Well, I... All I'll say is that's actually what I expect to happen. I think that– Really? ... I am not what I'd call a geologic fatalist of shale's trajectory, but I'm very much an economic one. That–

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[01:17:40] **Nate Hagens:** Mm-hmm ...

[01:17:40] **Rory Johnston:** the days of, you know, a million barrels a day plus of US crude production growth with crude at \$65 a barrel, those are behind us.

[01:17:50] **Nate Hagens:** Yeah.

[01:17:50] **Rory Johnston:** But I think in a moment when you have triple-digit oil prices, yeah, US shale's gonna grow. But when you have \$50, I think it's gonna plateau and decline, and I think that what we're gonna need on the other side of this eventually, once we've restocked and everything else, so, like, the timelines here are very wide, but I think that eventually you're going to need lower prices, and then US shale will contract and you'll buy it from everyone else again, like Canada.

[01:18:11] **Nate Hagens:** But here's the flip side of that argument, which back in the day, I called the biophysical gauntlet. Yes, if we have triple-digit oil, that's good for oil drillers and producers- Yeah ... 'cause they can make money, assuming the rest of the economy can keep up with them. And \$100, as you said earlier, at some point, \$130 plus, there's demand destruction.

[01:18:37] So what's good for oil producers is not good for little Johnny who wants GI Joe with the kung fu grip.

[01:18:45] **Rory Johnston:** No. And I think I should say here that I think that while we're going to have periods back in that triple-digit oil price, I do generally believe that there is more supply available than demand.

[01:19:04] That eventually, once these wars stop, and again, I think there's a world where you say, like, this never stops, that this is the new status quo of this deeply

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uncertain political, geopolitical reality. That I think is more complicated because then the actual location of those reserves matters a lot more.

[01:19:22] But if we can go back to a world of even, you know, 10 months ago, I think the direction of travel is towards weaker prices. And I actually think that the economy could survive \$100 a barrel oil if not for the \$100 cracks put on diesel. But I do think that unfortunately, I think the supply and demand is just gonna really tell the story there.

[01:19:43] **Nate Hagens:** I don't wanna add another complicating factor to this- ... but I'll just mention it, which is how much of our current... There's supply and there's demand, and there's affordability, and the affordability wedge has been supplemented by credit. Yes. Not only in the oil patch, but, I mean, in the AI patch, for sure in our entire culture.

[01:20:02] So personally, I think we're closer to a 2020 event of negative oil prices than we are a super spike just because of this credit, pin-breaking-a-balloon sort of thing. We'll see. I mean, we don't know what's gonna happen, but I think that a 2020 to 2009 redux is highly possible, I think.

[01:20:27] **Rory Johnston:** Here's the thing. I think that, like, in a scenario where, let's say, this ended abruptly, and then we basically had a big surplus for a year, and we entered 2028 with everything restocked kind of where we were entering this year. Yeah, I think that you can... There's nothing that stops oil from necessarily going negative, aside from those kinds of, you know, supply cuts or whatever else.

[01:20:48] I think at that moment, the Saudis would likely try to do something or China would start buying a bunch of oil for its SPR. I think this is the thing. We've seen these weird, you know, swing balances in here that we hadn't seen in, say, a decade ago of oil.

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[01:21:02] **Nate Hagens:** But isn't it just such a bizarre sentence that we both agree how central oil is to our modern world and the fact that it could go negative in price?

[01:21:14] Like, it's just so surreal because we can create so many more monetary and digital claims on reality than there is the underlying reality. It's just bizarro to me.

[01:21:26] **Rory Johnston:** I agree. I think it's like, you know, it always comes back to that you can't print molecules. That's right ... You know, I think there's truth in that.

[01:21:32] But on the flip side, you also can't just, like, get rid of molecules if you have too many of them, right? I think on the other side– That's right ... you know, there's a physical inertia to this stuff that I think... I mean, even when we're talking about the shipping crisis. Like, all of this stuff is, like, the oldest school problem in all of economics, and yet it still bedevils us, having the right ships in the right place at the right time.

[01:21:54] Yeah. This is stuff that, like, Christopher Columbus and, like, you know, the East India Company had trouble with, and we're still struggling with it in the era of, like, satellites and artificial intelligence.

[01:22:05] **Nate Hagens:** Yeah. So I know a lot more than I did a year ago. I'm also quite humbled by what I discovered I don't know, and this Iran war is just one of the things I'm tracking.

[01:22:19] And what a horribly and fascinatingly complex world we live in. You've mentioned the dark transit system several times, and each time I start to say those words, I can't help but say the dark triad system because that's been on my– ... in my mind. But there's so much information coming out, Rory, every day

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about this war and oil markets and Hormuz transit counts that get revised upward as the dark transit surface.

[01:22:46] How do you, in your full-time job on this, keep up to date with what's happening while also having some sort of filter to signal out the noise? So what are the metrics that you're monitoring and looking at most days?

[01:23:04] **Rory Johnston:** I follow Hormuz transits. I update it every day or every couple days, just to kind of see how things are evolving.

[01:23:10] I think what we've seen there is that things peaked in late September, then you had this massive spike in attacks, and things have pulled back. But again, as you noted, this stuff has lagged and tends to be revised higher. I think one of the interesting things about this, again, I think there's been an abnormal amount of kind of general market and macroeconomic focus on the oil market.

[01:23:30] As you well know, Nate, this is not an industry that works on real-time data. This is an industry that has historically, we've all spent all of our energy debating two-month lag monthly average, you know- Yeah ... you know, totals. So the fact that we are fretting about, like, oh, the data's revised from today versus a week from now, like, that's almost laughable.

[01:23:49] But unfortunately, that's the world, that's the reality we face. So right now, basically you get a kind of a count. Now, I use data from Kpler, but other providers are out there. But these are ship trackers, and they use a whole bunch of assessments. They look at the AIS, the satellite transponders, but that's what turns off during these dark transits, so that obviously Iran can't see them and hit them.

[01:24:10] So they kind of figure out, like, where these things disappear, where they reappear. They try to reconstruct the voyages. They use satellite imagery to

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kind of add. They have onshore spotters or at the actual port. So there's this cornucopia of data that people are trying to wrap into these products, and then analysts like myself are trying to interpret.

[01:24:28] I think the one thing that you see time and time again is that in this market, obviously, whether you have a market bias, like you're bullish or bearish on oil or equity markets, or I think particularly in this crisis, whether or not you are, you know, on the take or kind of a supporter of the IRGC or the White House or Israel.

[01:24:46] Like, there's a huge amount of political confirmation bias and not the framing, but, like, the slant of this. There's a lot of that. Spin. Yeah. So I think be very careful when you're looking at this market. Find indicators and people that you trust over time. Like, I spent a good chunk of the early war being told that I was, like, an agent of the IRGC because I was like, "The flows through Hormuz are really low, and that's a big problem."

[01:25:12] **Nate Hagens:** Amazing. Not surprising, but amazing.

[01:25:15] **Rory Johnston:** Right? And then over the last month, I've been told that I'm, like, on the payroll of the CIA because I have said that Hormuz flows have risen back, and that's shocking and amazing. But again, I just follow the data. So it really... I think it's a nice bellwether of the sentiment of the market where, like, I just follow the data that keeps changing and surprising me along the way.

[01:25:35] I wish it was simpler. I wish it made more sense and confirmed whatever political biases I have in this. But unfortunately it doesn't conform to that, and I think that... So just find a nice stable way of following this and track over time. So I've got a couple charts here. So I've got the Hormuz tracker.

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[01:25:50] I also have one that tracks the recent rise in shipping attacks between the Gulf and the Gulf of Oman and Hormuz. And then we... I mean, all the stuff we talked about, the Red Sea, like, all of this stuff is there, and I think you're gonna attach some of this as an appendix.

[01:26:03] **Nate Hagens:** Yeah. I will attach, in the supplemental show notes, the PDF that you sent me, which is very helpful.

[01:26:10] There's no way that anyone can really put their finger on what's gonna happen and- Yeah ... but what are you keeping your eye on with respect to maybe unexpected trends or adaptations that you're watching as this conflict progresses? Anything interesting?

[01:26:28] **Rory Johnston:** Yeah, I think that, like, there's, again, there's a lot...

[01:26:31] You're gonna see a lot of headlines of, like, total Middle East flows of crude ex-Iran or, like, all of these ways of dicing up the data to make a story work. I think at the end of the day, we know that there's a lot of oil going out of the Red Sea. We know there's a lot of oil going out of the Gulf of Oman and kind of-

[01:26:47] **Nate Hagens:** Which could stop if the-

[01:26:48] ...pipeline exploded again.

[01:26:50] **Rory Johnston:** And it's been off and on as well. So, like- Yeah ... but, like, right now we know that there's oil going out there. But I think that, like, people are like, "Oh, don't focus on Hormuz. Focus on the whole Middle East." I think Hormuz is still actually, like, really important, and I think the kind of bellwether of actually how this conflict is going.

[01:27:04] The other stuff I actually think is obviously relevant for the market, but not as relevant for the conflict per se. So I'm watching Hormuz transits every day.

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I'm watching the volume and intensity of Iranian attacks. Again, one of the weird things was that we didn't see a lot of Iranian attacks in Hormuz through September when these volumes were rising, basically back to almost pre-war levels, at least excluding Iranian oil briefly there.

[01:27:28] And then all of a sudden, the UN General Assembly ended, and then there was this massive spike to the highest bombardment of the war, basically roughly two attacks every day.

[01:27:37] **Nate Hagens:** Maybe they were hoping for some resolution at the UN.

[01:27:40] **Rory Johnston:** Basically, right? Yeah. So now there's this question of, like, is this the new status quo?

[01:27:44] Are we gonna see a re-escalation of the conflict after the midterms? There's so many ways this could go, but I think at the end of the day, the actual factors that are moving around in our mental model should remain the same. What's the volume of attacks? How much oil is getting out? How much of the oil is being loaded?

[01:27:58] And what's the cost of that oil to the final consumers?

[01:28:01] **Nate Hagens:** So I will close with the same question I closed with in our first conversation, if I recall correctly. Give us a best case, worst case, and base case for oil and products and the world economy in the coming year.

[01:28:21] **Rory Johnston:** Okay. So in 2027, I think the base case is that this persists for at least another four to six months, that we still see on-again, off-again attacks from Iran.

[01:28:33] We see extremely high shipping rates, extremely high cost of all of this stuff getting its way through Hormuz, but you are getting some volumetric relief.

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Like, we're not in March and April forever, thankfully. I do think the best case is that this ends. Like, I think at the end of the day, the midterms happen, you know, the Republicans get, like, a solid shellacking, and a chastened and humbled President Trump says, "Okay, we'll wrap it up, and we'll try and really do what we were elected to do and make it more affordable."

[01:29:07] I think that's unlikely, but I think that's the best case. In that world, I think that we get more oil out of Hormuz, and we kind of get back onto that surplus rollercoaster that we started this year with. It's gonna take a year or so to rebuild those stockpiles, but then 2028 becomes a year where we're gonna see lower prices and forced rationalization again.

[01:29:27] **Nate Hagens:** Before you get to your worst case– ... let me just double-click on what you just said, because I think President Trump wants to get out of the Middle East. He just can't. So if the Democrats win, and if President Trump is chastened and everything you just said, and we do leave, bring the aircraft carriers and all the military home, what does that portend for the Middle East and the future of oil if the US military presence is gone?

[01:29:58] **Rory Johnston:** That Iran would get some kinda cut, I think, or some kinda payoff. I think that, you know, there's been a lot of debate about whether or not Iran is getting some kind of shadow toll through this whole conflict. We had, on my podcast, Oil Ground Up, the head of policy and geopolitics from Kpler, a woman named Michele Brillhard, and she shared, which was very fun to make some headlines in the podcast.

[01:30:20] But she shared that her personal belief, not necessarily Kpler's house view, but her personal belief that Iran was getting paid off. Not that it's, like, your VLCC is worth this much and that equates to a total of this, but I view it more as, like, a monthly subscription rate that you're subscribing to Iran not hitting your ships with drones.

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[01:30:40] I think, you know, there is still a possibility of that happening, although I think the probability's lessened given this recent kind of spike back up. But I think that's something that we could see. Even a billion dollars a month being paid to Tehran is an order of magnitude cheaper than the implications of a continuation of this current scenario.

[01:30:59] So I think that's the best case, I think, right now, honestly.

[01:31:03] **Nate Hagens:** So two million barrels of exports a day at \$100 a barrel is \$200 million a day worth of oil, but what that does for the world economically is orders of magnitude greater than that amount. Yeah. A billion dollars is peanuts really.

[01:31:25] **Rory Johnston:** Well, exactly.

[01:31:26] And I think that's the thing, is that at the end of the day, the White House doesn't want this. The White House doesn't wanna end the war with Iran getting a massive payoff. But I think that it's much cheaper than all of these Gulf producers shipping their barrels through pipelines. Yeah. I mean, like– Right

[01:31:39] it's really hard to compete with the economics of a gigantic normally open waterway. But then shall we talk about the worst case? Please. 'Cause that's where things get especially spicy. Please. I think that at this stage, even if we have a much smaller deficit today, and by all indications we have a much smaller deficit today than we did in March.

[01:32:01] **Nate Hagens:** We have a smaller daily deficit– Yes ... but not overall deficit.

[01:32:05] **Rory Johnston:** Well, and this is the thing, right, is that, you know, in terms of the stock and flow model, the flow deficit is lessened today versus March

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and April, but the accumulated stock has been drawn down so aggressively. And again, we know for sure what's left in the OECD commercial storage tanks.

[01:32:21] We're guessing about how much additionally is drawn down in China or other emerging markets where we have less visible data. But we know for a fact that there have been two-plus billion barrels of oil that should've been produced in the Middle East this year that weren't. That had to come from somewhere, or again, it was an absent build that may have occurred otherwise.

[01:32:42] I think, you know, that means that even a smaller deficit today is much more important and impactful in the market than even a large deficit was earlier on where you had all these buffers. So we've drawn down all these buffers, and we're in a much more precarious situation now. Should this continue even at this level for another six months, I think the direction of travel of both crude and refined products is still higher from here, that inventories are still gonna continue to decline, and we're going to end up in a situation where, again, all of this stuff is just super, super expensive until demand throttles back.

[01:33:16] **Nate Hagens:** Okay, so leaving the demand throttling it back aside for the moment, of course we can't do that because they're completely linked. But is it a linear rise, or is there some point, with Strategic Petroleum Reserve and stocks, that we go below that it becomes a nonlinear rise?

[01:33:35] **Rory Johnston:** It's hard to say for sure because it's kind of never really happened before. So I think it's probably wise to assume it will not be linear, that I don't think that all of this will come all at once. But I do think that, you know, eventually... Again, like, there's still this assumption that this will end, and on the other side of this there's a surplus.

[01:33:56] I think that base case, that consensus is beginning to weaken, that maybe we're not gonna have a big surplus. Maybe we'll have a small surplus, so

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it's gonna take that much longer to get off the floor of these inventories or whatever else. I think all of that gradually shifts. But then eventually you're gonna see this moment where, say, you get one little spike up and, you know, an attack or a renewed outage on the East-West Pipeline, which could go down tomorrow or could even be down now, who knows.

[01:34:22] All of this stuff could happen and there's nothing that would necessarily prevent the market from jumping back into the same psychology it's had for the rest of our entire careers, Nate, right? I think that, like, right now we are in this new paradigm of thinking about how oil should be priced that's basically eight months old.

[01:34:40] **Nate Hagens:** Yeah.

[01:34:40] **Rory Johnston:** There's nothing to say that it doesn't jump back to the last hundred years of how we would've priced this type of risk historically.

[01:34:46] **Nate Hagens:** Do you have any closing comments for our viewers who have learned from you on these issues today and in your first interview?

[01:34:54] **Rory Johnston:** I would encourage you to follow along at commoditycontext.com and on Twitter at [rory_johnston](https://twitter.com/rory_johnston) and the podcast at Oil Ground Up.

[01:35:03] But I think more generally, I think just find someone you trust in this market and kind of stick to a framework. I think there's so much... I find the temptation is inevitable, right? You're always gonna be tempted. There's so much politics, so much kind of prior here that you're gonna be tempted and torqued around by the latest talking points, the latest headlines.

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[01:35:22] The headlines are very distortionary at this moment because they're picking small pockets of small questions that kind of obfuscate from the broader story that's still going on. Find the people, the analysts, and the kind of frameworks that you trust for understanding how this works, and kind of follow along because I think that's the only way that you yourself can actually build confidence and handicap these- Yeah

[01:35:43] These headlines and tweets you see along the way.

[01:35:46] **Nate Hagens:** On all topics. On all topics ... that's great advice. Thank you, Rory. I really appreciate you as an honest broker in this space, and I've learned from you, and to be continued, my friend.

[01:35:59] **Rory Johnston:** Thank you so much for having me back, Nate.

[01:36:01] **Nate Hagens:** If you'd like to learn more about this episode, please visit thegreatsimplification.com for references and show notes.

[01:36:09] From there, you can also join our Hylo community and subscribe to our Substack newsletter. This show is hosted by me, Nate Hagens, edited by No Troublemakers Media, and produced by Misty Stinnett and Lizzy Sirianni. Our production team also includes Leslie Batt-Lutz, Brady Heyen, Julia Maxwell, Gabriella Sleiman, and Grace Brunfelt.

[01:36:33] Thank you for listening, and we'll see you on the next episode.