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Global Markets Strategy
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Dry powder

Global Commodities Research
Natasha Kaneva
(1-212) 834-3175
natasha.kaneva@jpmorgan.com
Lyuba Savinova
(1-212) 270-3781
lyuba.savinova@jpmchase.com
Artem Fakhretdinov
(1-212) 272-1839
artem.fakhretdinov@jpmorgan.com
JPMorgan Chase Bank NA

For the first time since the start of the Iran conflict, we don't have a baseline view. We simply don't know how to model the endgame.

At the onset, we thought we did. We assumed there were economic red lines the US administration would be unwilling to cross: $100 oil, gasoline near $5 a gallon, a 4% headline inflation or a 5-handle on the 10-year Treasury yield. Those constraints gave us an implicit timeline, and we expected that by June there would be some form of agreement to reopen the Strait.

Six months later, many of those lines have been crossed, yet the exit strategy is less clear, not more. Oil is above $100 and the 10-year yield has a 5-handle. Gasoline, at $4.37, remains at record seasonally adjusted levels even though peak driving season is behind us. More concerning, diesel is at an all-time high of $6.31 a gallon heading into winter—the period of peak seasonal demand—while inventories sit at all-time lows.

The market is on edge, in our view. Based on current supply and demand conditions, we estimate September fair value at $90, yet Brent is trading at $106. Using our rule of thumb that every 1 mbd of supply disruption adds roughly $4 to the price, that $16 premium implies the market is pricing in the *risk* of an additional 4 mbd of losses on top of the 10 mbd already disrupted—rather than a confirmed, enduring reduction in supply.

And there is no shortage of risk for the market to price. Over the past week, the conflict has opened new pressure points across the region. Houthi advances along Yemen's Red Sea coast and into the Bab el-Mandeb have put another critical shipping route at risk, while an attack on Saudi Arabia's East-West pipeline temporarily shut a key alternative route for crude exports.

Nor is the volatility contained to the Gulf. Despite President Trump's claim of an energy truce. Ukrainian drones struck Russia's Slavyansk refinery on Saturday and, in a more significant display of reach, hit the Taneco refinery in Tatarstan—more than 1,200 km from the Ukraine-Russia border—on Sunday, followed by the Syzran refinery in Russia's Samara region on Monday. Meanwhile, Russia launched attacks on the Ukrainian capital and other cities.

With no clear signals from either the US or Iran that they are prepared to de-escalate—and absent a diplomatic breakthrough on September 24, when President Trump and President Xi are set to meet in DC—the assumption that the disruption is temporary is becoming increasingly difficult to sustain.

So what happens if it doesn't?