

Global crisis, local response: Canada's energy sector amid Middle East instability

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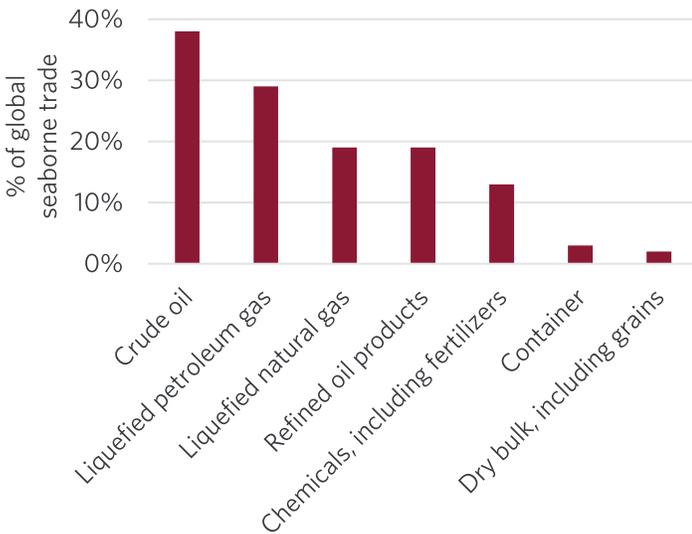


Key takeaways

- The closure of the Strait of Hormuz highlights the risks of relying on geopolitically sensitive regions for energy. **Canada's political stability and large resource base position it as a key alternative supplier, strengthening the global case for investing in Canadian energy companies.**
- Canadian energy companies have strong fundamentals: superior assets, lower production decline rates, long reserve life, and a competitive cost base. Their focus on financial discipline and shareholder returns further supports a bullish long-term outlook, regardless of short-term commodity price swings.
- International investment interest in Canadian energy is rising, particularly from US and European investors seeking stable jurisdictions and long-life assets. This trend is expected to continue as energy security remains a priority.
- While infrastructure bottlenecks currently limit rapid production growth, targeted investment and supportive policy could unlock further expansion and market diversification, especially towards Asia. This would enhance Canada's role in global energy markets and reinforce the bullish case for the sector.

Mark Obrai [MO]: The ongoing conflict in the Middle East is a tragedy on a human level, with serious implications for global markets – particularly in Asia, which is significantly dependent on energy exports flowing through the Strait of Hormuz. The situation continues to evolve, but as of the time of publication the Strait – which transports about 25% of global energy – is effectively closed.

Share of global seaborne trade passing through the Strait of Hormuz



Source: UN Trade and Development (UNCTAD), based on data provided by Clarksons Research as at 2026. Note: In 2024, total oil transported through the Strait was around 20 million barrels per day (bpd), or the equivalent of 25% of global seaborne oil trade. Crude oil and condensate account for 14 million bpd and petroleum products for 6 million bpd.

The conflict, even when resolved, is likely to impute a risk premium into commodities transiting the Strait for the foreseeable future. While the Middle East will remain a source of oil, natural gas, nitrogen and sulfur, importers are acutely aware of the risks of overreliance on the smooth operation of a critical chokepoint.

Canada, as a politically stable and geographically advantageous producer of energy and other natural resources, can play an important role in stabilizing the global economy. This has immediate and long-term constructive implications for Canadian companies.

To examine how Canadian energy producers, distributors and other companies are meeting these challenges, today I'm joined by Leo Han, Senior Equity Analyst, Aayush Tandon, Senior Credit Analyst, Erik Franco, Senior Research Analyst, and Paola Moquillaza Bello, Senior Research Analyst.

Thank you for participating in this discussion.

Historical and global context

[MO]: Erik, let's start with you. From a historical perspective, how does this disruption compare?

Erik Franco [EF]: Our proxy for the geopolitical risk premium suggests this episode is not (yet) synonymous with the oil-price spike that occurred after the Russian invasion of Ukraine in 2022. At \$100/bbl, oil prices are approximately 40% higher than fundamentals would otherwise suggest whereas in 2022, it reached 75%.

Going back further, this episode is also not as severe as the so-called "Tanker Wars", when Iran mined the Strait of Hormuz causing oil prices to double in 1986-87. One crucial difference at that time is that about 60% of global oil supplied transited through Hormuz whereas today it is closer to 20%.

That said, it will likely take time for the oil market to normalize once tensions simmer down. Fully restoring output in shuttered oilfields can take months, and previous spikes in geopolitical risk premia show that it can take years for buyers to trust fundamental drivers following traumatic events.

[MO]: How are various global regions reacting?

[EF]: The IEA has announced a 400 million barrel release from its strategic reserves to ease some of the pain from the blockage of the Strait, while Chinese diplomats appear to have negotiated agreements for their ships to transit unhindered. The Trump administration has also promised to escort ships through the Strait, though a detailed timetable has not yet been announced, and some European countries have deployed warships to protect their assets in the region.

The implication here is that the Middle East may no longer be seen as a reliable source of energy going forward, and the world will likely have to further diversify its energy sources to insulate themselves from future shocks. The Russian invasion of Ukraine was a good example of this, with European countries shifting their natural gas purchases away from Eastern Europe. Unfortunately many turned to the Middle East to fill the gap.

Canada's capacity and readiness

[MO]: If parts of the world shift their sourcing towards more stable producers, namely Canada, can our industry respond? Specifically, do we have the production capacity and distribution infrastructure to supply what the world needs?

Leo Han [LH]: Thanks for the question—let's break it down a bit. Canada has a tremendous resource base; in fact, we're home to the fourth largest oil reserves in the world, just behind Venezuela, Saudi Arabia, and Iran. But when it comes to actually increasing production and getting oil to market, things get more complicated.

There are two main factors holding the industry back from ramping up production quickly. The first is pipeline capacity, or rather, the lack of it. We do have several proposed expansion projects in the works, but most of them are still a year or two away from coming online.

The second factor is investor influence. Over the past few years, investors have pushed producers to focus on financial discipline—meaning they're prioritizing balance sheet strength and shareholder returns, like dividends and share buybacks, instead of aggressive growth. So, most companies are targeting just 3–5% annual production growth. There might be some small increases here and there, maybe through delayed maintenance turnarounds, but we haven't seen any big announcements about growth capital yet.

Of the two, infrastructure is really the bigger issue. As Canadians, I think it's important that we come together and advocate for these nation-building projects, especially at times like this. That's what will ultimately help support the industry's long-term growth and competitiveness.

Paola Moquillaza Bello [PMB]: Like Leo said, Canada's ability to increase supply is limited, as the industry is already nearing maximum operational capacity. Since 2016, production growth has primarily resulted from higher utilization of existing infrastructure rather than the expansion of production capacity. Capital investment in Canada's non-renewable energy sector began to decline in response to evolving policy decisions and was further exacerbated by the 2014 oil price crisis, which drove capital expenditures in oil and gas extraction to historic lows—a trend from which the sector has yet to recover.

Consequently, Canada is not positioned to significantly increase oil and gas supply in the short term, largely due to distribution capacity constraints. Addressing these limitations will require substantial capital investment and a multi-year timeline.

[MO]: Do you expect to see increased international investment interest in Canadian resource companies or infrastructure as a result of this crisis?

[LH]: We've definitely seen increased interest in the sector ever since the Russian-Ukraine conflict began a couple of years ago, which really brought the importance of energy security back into focus for everyone. The most significant increase in funds flow has come from US investors, but we're also seeing more European ownership in many Canadian producers and infrastructure companies.

A lot of global investors are looking for stable jurisdictions and low-decline, long-reserve energy assets—all of which align well with what Canada has to offer. While we're still in the early stages of global generalist investors putting substantial capital into Canadian resources, the trend is clearly moving in that direction. Interest is picking up, and with growing optimism around an improving regulatory environment, we expect this momentum to continue.

Impacts to Canadian equities and bonds

[MO]: Canadian resource equities have strengthened in response to the conflict. Can you elaborate on what you're seeing and why?

[LH]: Canadian energy stocks had a really strong year in 2025, even though commodity prices were declining, and that momentum carried well into 2026—before the Middle East conflict even escalated.

Equities have performed well as a result of the conflict, but they're still meaningfully underperforming the underlying commodities. The main reason for this disconnect is the difference between spot and future prices, and the market's expectation of a relatively quick resolution to the war. When people discuss oil prices, they're typically referring to the spot price, but companies don't necessarily benefit from that or make decisions based on it. It's the futures strip prices that really matter.

The back end of the futures curve—prices post-2026—hasn't moved meaningfully above \$70, which suggests the market remains skeptical about the duration of the conflict or the extent of damage to energy infrastructure in the region. We haven't seen many investors chasing the rally, as there's an expectation that a pullback is coming soon. Our contrarian view is that once there's a resolution to the war, we'll see a lifted floor for oil prices, and at that point, oil equities will likely experience a re-rating.

[MO]: Before this conflict started you were already bullish on Canadian energy producers. The Middle-East conflict must strengthen your case?

[LH]: As we highlighted in our thought pieces back in 2024,ⁱⁱⁱ there are several reasons why we remain structurally bullish on Canadian energy companies—reasons that are independent of our outlook on the underlying commodity price. We believe there's still room for these companies to appreciate over the medium to long term.

Fundamentally, Canadian producers have superior assets, lower decline rates, longer reserve life, and a competitive cost base. Over the past few years, management teams have really embraced a new philosophy focused on cleaner balance sheets and more competitive shareholder returns, which are exactly what investors are looking for in today's market.

The fundamental reasons we favor Canadian energy producers have only been reinforced by the Middle East conflict.

[MO]: Higher energy prices tend to create the potential for an inflationary pulse. How do you see this affecting Canadian bonds, both sovereign and corporate?

Aayush Tandon [AT]: For sovereigns (and I include the provinces here), all else being equal, rising energy prices have an asymmetric effect. An uptick in energy induced inflation in the context of a soft labour market constrains the Bank of Canada (BoC), providing a steepening impulse to the short end of the curve. On the other hand, the trade channel stands to improve fiscal health likely flattening the long end. The impact on credit is more varied, as energy producers and carriers benefit from a boost to the topline while other segments of the economy like the consumer and manufacturing feel the pinch. Though directionally true, the extent obviously depends upon the length of the conflict.

Canada is a significant net exporter of oil and gas, and rising global energy prices benefit Canadian producers, government revenues, and the broader resource sector. While consumers face higher fuel costs, the overall macroeconomic impact is more balanced than in other countries. Surging WTI oil prices due to the conflict in the Middle East could significantly reduce or even flip Alberta's projected \$10B deficit, which would improve the fiscal picture at the provincial level. Higher royalty revenues also improve the Federal fiscal balance over time.

Before this crisis, the BoC delivered 275 basis points of cuts since the 2023-24 peak—more than any other G7 nation—but longer-term bond yields moved higher. The yield curve has steepened as term premia have risen, with fiscal concerns placing upward pressure on longer-term yields. Assuming the conflict is more prolonged than initially thought, a markedly improved fiscal picture at both the provincial and federal levels, will shave some of that term premium off, thereby flattening the long end of the curve.

From a credit standpoint and I'll restrict my comments to energy because as I mentioned earlier the impact on different segments of the economy is varied. So, the Canadian corporate bond market is dominated by Financials, Energy and Infrastructure. The FTSE Corporate Index has greater exposure to Financials and Energy than the equity index. This is critical. Energy is a far larger share of the Canadian credit universe than in the US, meaning the sector dynamics matter a lot more for benchmark-level spread movements here in Canada.

The picture for energy issuers is nuanced. Upstream and integrated producers see improved cash flows which, is broadly supportive for spreads. However, the balance sheets of Canadian E&Ps are strongest they have been with record deleveraging post 2022. Spreads have been historically rich for some time now, so investors need to find mispriced or undervalued opportunities, for instance in services, to exploit this theme.

That is something our credit team leads on, identifying credits not just in Canada but more broadly in North America and Europe that stand to gain in this environment. The other segment of the energy complex are midstream players. Pipelines tend to do better in a volatile environment but are less likely to directly benefit from a run-up in energy prices. While we don't have a significant refining base in Canada, there is a shortage of products globally. As such, we are constructive on the refining space.

Canada's future

[MO]: Looking into the future, what impact might increased energy exports have on the domestic Canadian economy?

[PMB]: It is not necessary to look far into the future to observe positive effects. A sustained increase in oil prices is already advantageous for the Canadian economy, as it improves the terms of trade, strengthens the Canadian dollar, and enhances profitability for energy sector companies.

Over the longer term, a sustained rise in real energy exports would directly contribute to higher GDP and increased government revenues. The impact on employment, however, is likely to be more indirect and occur over time. Given the capital-intensive nature of the oil and gas industry, direct job creation is limited. Nevertheless, the resulting income gains from increased energy exports should stimulate domestic demand across other sectors, thereby supporting broader employment growth.

[MO]: How might this crisis and Canada's response affect the country's long-term positioning in global energy markets?

[PMB]: This presents an opportunity to enhance Canada's position in the global energy market through greater diversification. Although Canada possesses one of the world's largest oil reserves, aligning ecological objectives with a meaningful increase in oil supply remains challenging, particularly given that Canadian oil extraction is more carbon-intensive than the global average.

Nonetheless, targeted policy adjustments could facilitate investment strategies that balance moderate expansion of production and distribution with diversification of geographic market exposure. Investments enabling increased distribution of Canadian oil sands to Asian markets—while reducing distribution costs—would not only improve profitability for Canadian energy companies, but also mitigate Canada's geopolitical reliance on the United States.

[MO]: Thank you everyone for participating.



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ⁱ <https://www.cibc.com/en/asset-management/insights/investment-research/canadian-energy-companies.html>

ⁱⁱ https://www.cibcassetmanagement.com/email/assets/documents/pdfs/Canadian_Energy_2024_En.pdf

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