

Asset Allocation Bi-Weekly



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Confluence Investment Management offers various asset allocation products which are managed based on “top down,” or macro, analysis. We publish asset allocation thoughts on a bi-weekly basis, updating the report every other Monday, along with an accompanying [podcast](#).

China Cuts Its Energy Imports

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As we’ve noted before, the most immediate economic and financial market risk from the Iran war is the possibility of further price hikes for oil, natural gas, and some other commodities that depend heavily on shipping through the Strait of Hormuz. Because of the war, the strait has now been essentially shut down for more than three months. Global energy and other commodity prices have indeed increased. As shown in the chart below, near Brent crude oil futures prices jumped approximately 50% in the weeks after the war started on February 28. However, the escalation in prices has been relatively contained and prices have even started to fall back recently. That’s despite assurances from economists and energy analysts that prolonged closure of the strait would inevitably lead to further price hikes. In this report, we show that a massive pullback in Chinese energy imports has probably been a key reason why prices haven’t risen as much as feared, at least so far. We also show that the pullback in Chinese energy demand has helped set the stage for recent stock market dynamics.

Brent Crude Oil Futures Prices, \$ Per Barrel

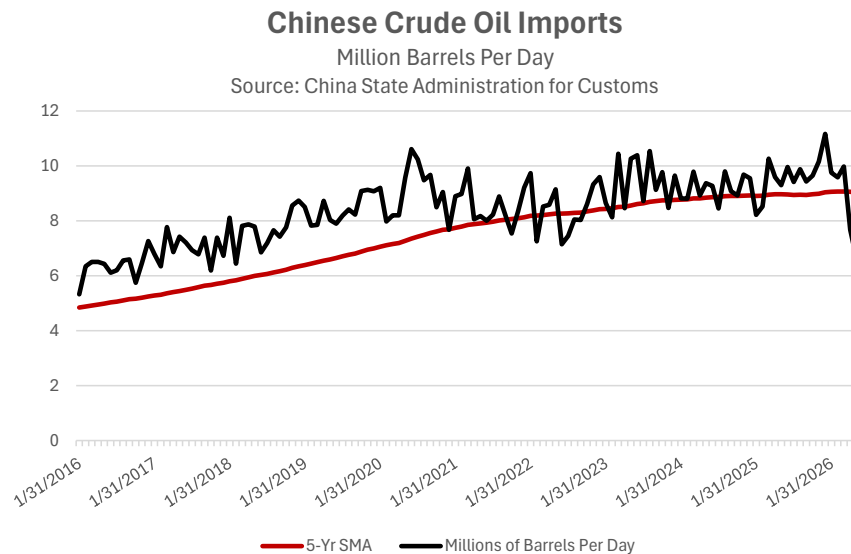
Source: ICE



The unexpected pullback in energy prices was a mystery in recent weeks, especially since official data and anecdotes suggested that the closure of the strait was forcing countries around the world

to use up their inventories. For example, the International Energy Agency [warned in its May market review](#): “[The world is drawing oil inventories at a record pace as importing countries confront unprecedented disruptions to Middle Eastern supplies.](#)” According to the IEA, global oil stocks had plummeted by almost 250 million barrels since the start of the war, with even steeper declines if stranded stockpiles in the Middle East are excluded. Such inventory depletion would normally be expected to boost prices.

More recent data appears to solve the mystery about why energy prices haven’t risen further and have even fallen back. Recent data shows Chinese oil imports have dropped to approximately 6.6 million barrels per day, down 38% from the average of about 10.6 mbpd in 2025. The drop of about 4.0 mbpd equates to almost 4% of current global oil demand. It could also offset much of the net reduction in global oil shipments through the strait, which analysts estimate to be between 6.0 and 12.0 mbpd.



Chinese energy imports and inventories are notoriously opaque, so these figures are uncertain. Nevertheless, if China really has cut its energy imports as indicated, it would go far toward explaining why energy prices have started to pull back, at least for now. We still believe that a long delay in opening the strait would keep alive the risk of further energy inventory depletion and renewed price spikes. However, China’s apparent disdain for paying elevated prices and its willingness to cut back deliveries is having a salutary impact on global prices and helping calm the world’s financial markets for now.

Going forward, if this trend continues, it will have big implications. For example, China’s ability to forego expensive energy imports helps validate its “all of the above” energy policy, in which it has invested in the full span of possible energy sources, ranging from coal, oil, and natural gas to nuclear, wind, and solar. China is now benefiting from the flexibility it has gained from having such a broad array of energy sources. We also think this situation illustrates how much economic flexibility China has gained from building its enormous strategic reserves of energy and other commodities. Although China won’t reveal the true level of its inventories, outside analysts



estimate that they are currently several times bigger than the US's Strategic Petroleum Reserve. It would be no surprise if governments around the world now take a lesson from China's approach and try to adopt a similar all-of-the-above energy policy and start rebuilding inventories once the war is over and prices come back down.

For the financial markets, the decline in oil prices wrought by China's import cuts has probably been a key reason for the recent modest retreat in inflation concerns and in government bond yields. For example, the yield on 10-year Treasury notes fell from about 4.65% in mid-May to about 4.45% at the start of June. We suspect this has encouraged investors to return to the frenzied buying of US large cap technology stocks related to artificial intelligence. It has also arrested investors' early 2026 rotation toward value stocks. As we noted above, however, the continued war in Iran is likely still depleting energy inventories around the world, including in China. That likely translates into a continued risk of further energy price spikes and rising bond yields in the coming months if the war isn't resolved.

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