PERSPECTIVES

Hamas Attack on Israel: Geopolitical & Business Impacts

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INTRODUCTION

In this article, we provide an update on the highly significant Hamas attack on Israel, and its potential wider economic and geopolitical impact on the Middle East and beyond.

Israel suffered the deadliest day in its history on 7 October, when Hamas fighters conducted an apparently highly sophisticated operation to break through the Gaza security barrier. The attack involved thousands of rockets, the seizure of multiple towns and small military bases, the kidnapping of dozens of Israeli civilians and the killing of hundreds at a music festival. The incursion – which occurred on the Sabbath morning of a Jewish holiday – saw the first fighting in Israel proper since the state's establishment in 1948, and was likely timed to fall almost 50 years to the day after the start of the Yom Kippur War, a surprise Egyptian-Syrian assault on Israeli forces.

The Israeli government has declared a state of war for the first time since that conflict, called up 300,000 reservists, and launched vast military strikes on suspected Hamas targets in Gaza, leaving hundreds dead. Israel has imposed what it describes as a "complete siege" on the Strip, tightening the 16-year Israeli-Egyptian blockade on the territory and cutting off all food, water and energy supplies. It is likely to launch a ground invasion in the coming days, aimed at rescuing its abducted citizens and potentially removing Hamas from power in Gaza.

The Israeli military says it has re-taken all areas seized by Hamas, though some Hamas fighters likely remain in the region and the border has not yet been secured. Meanwhile, there has been sporadic violence in Jerusalem and the West Bank, and clashes along the Lebanese border to the north, as Israeli forces seek to prevent any attack by the Iran-backed Shia group Hezbollah, which could escalate into a broader regional conflict.

BACKGROUND & CONTEXT

The unprecedented violence came amid rising tensions between Israel and the Palestinians, albeit primarily in the West Bank, where a record number of Palestinians have been killed this year. Prime Minister Benjamin Netanyahu came to office for the third time in December 2022 with a narrow coalition of far-right and ultra-Orthodox partners, who are closely aligned with the roughly 650,000 Jewish settlers in the West Bank and East Jerusalem. There have also been claims of growing violence between settlers and Palestinian villagers, and provocations by ultranationalist ministers at Muslim holy sites in Jerusalem. The slow response of Israeli military forces to reach the Gaza border areas has in part been attributed – by some Israeli media reports – to a recent diversion of troops to manage the escalating unrest in the West Bank.

At the same time, the Palestinian Authority (PA) – which governs the main Palestinian urban areas of the West Bank and has maintained security there since the end of the Second Intifada (Palestinian uprising) in 2005 – is increasingly weak. Moreover, 87-year-old PA president Mahmoud Abbas is marginalised and aging, and has refused to allow a clear successor to emerge. Hamas will therefore have seen the rising West Bank unrest, coupled with the PA's dwindling authority, as an opportunity to demonstrate that it – rather than Abbas – is leading the Palestinian resistance to Israel in response to the recent perceived provocations.

The Islamist group will also have sought to exploit an ongoing Israeli political crisis over judicial reform, which has led to the largest anti-government protests and strikes in Israeli history, including the refusal of some military reservists to serve. The domestic infighting caused by Netanyahu's political agenda – seen by critics as eroding Israel's democratic nature in a bid to shield himself from corruption charges and promote settler and religious causes – has arguably distracted the country's political and security leaders. This may have led the attackers to view Israel as unprepared to prevent and now respond to Hamas' attack. There is already widespread anger at Netanyahu, blaming him for failing to prevent the most devastating civilian losses in Israel's history. Claims by an Egyptian intelligence official that Israeli counterparts had ignored repeated warnings of "something big" – strongly denied by Israel – will only intensify such criticism.

Indeed, the scale and sophistication of the operation represents a massive intelligence failure and a humiliation for the Israeli political and military establishment, which had believed that Hamas was not currently seeking to provoke a war and was instead focused on building on marginal economic gains in the Strip.

Finally, it is also reported that Iran – which has strong ties with Hamas and provides covert funding, supplies and intelligence support – was involved in the planning or directing the attack, possibly as a means of disrupting apparent progress towards an Israeli-Saudi normalisation deal, which Hamas also opposes. Any firm evidence of Tehran's direct involvement in the weekend's attack will clearly raise the risk of a regional conflict. We outline potential scenarios below, and the economic, political and market implications of the new conflict.

SCENARIOS

1. Full-scale Gaza invasion – high likelihood

A full-scale invasion of Gaza – aimed at toppling Hamas from power in the Strip – is highly likely. There is – unsurprisingly – mass outrage in Israel at the scale of civilian losses, and most Israelis will back the use of force to end Hamas' 16-year rule over the territory, to ensure the South never again faces such violence. For their part, Netanyahu and his government will need to demonstrate a military success to compensate for anger in Israel at their failure to prevent the attack.

An invasion will likely be highly challenging for the Israeli army, given they will be entering densely populated and extremely hostile urban territory. The fighting will therefore probably be protracted and result in high losses, and there is no obvious way Israeli forces can hold the area for a prolonged period, though they may confiscate land along the border to expand the buffer zone.

The US has deployed a naval support group to the Israeli coast, which may contribute to any future operation. Indeed, for now, there is unprecedented Western backing for Israel's right to respond through military force, but this will undoubtedly ebb once Palestinian casualties in Gaza mount. Anti-Israel protests, both in the Muslim world and in European countries, will likely grow more frequent, potentially risking the security of Jewish or American staff. Reflecting this threat, an Egyptian police officer killed two Israeli tourists and their Egyptian guide in Alexandria on 6 October.

2. Iran-backed Hezbollah opens second front; Third Intifada – moderate likelihood

There have been isolated clashes on the Israel-Lebanon frontier, with the Israeli government fearing that Hezbollah intends to open a second front of conflict, as it did in 2006. Israel has already repelled a cross-border raid into its territory and has responded with air strikes on Hezbollah targets.

It is possible that Hezbollah will wait until Israel launches a full-scale assault on Gaza, before carrying out its own attacks, which will most likely involve rocket fire and kidnap attempts. Hezbollah is currently part of Lebanon's ruling coalition, and so any conflict risks drawing in elements of the Lebanese state.

Furthermore, the Shia group is closely aligned with Syria, which has hosted large numbers of Hezbollah fighters, who helped shore up the Assad regime during the early stages of the civil war. Israel has carried out frequent air strikes on Hezbollah targets in Syria since 2012, and so any fresh Israel-Hezbollah violence could also draw in Damascus, resulting in a broader regional war.

Separately, Hamas cells in the West Bank – which are far weaker than in Gaza – may escalate violence in the territory. The PA – led by Hamas' bitter rival Fatah – is presumed to be keen to avoid a conflict with Israel and maintain stability in the West Bank, from which it benefits financially. However, in the event that the PA feels its popularity and relevance decline in relation to Hamas, hardliners within the movement may seek to stoke greater violence. This would result in a Third Intifada, with high-level clashes between Israeli and PA security forces, and possible unrest in Arab communities within Israel proper.

3. Israeli strikes on Iran – low likelihood

The complexity of the Hamas operation suggests that the Islamist group may have received support from Iran. For now, Israeli and American officials have said there is no hard evidence that Iran was central to the attack.

Should this change, however, the Israeli government will come under strong domestic pressure to launch strikes on Iran. Netanyahu has for three decades portrayed Tehran, rather than Palestinian militant groups, as the primary threat to Israeli security, and has long sought to use military force to disrupt Iran's nuclear programme.

However, the US will be exceptionally cautious about any such attack, fearing broad destabilisation of the Middle East and major disruption to the global economy (see below).

MARKET & BUSINESS IMPACT

Energy prices jumped on Monday morning amid investor fears of regional instability. Israel is not a major oil producer, but it has halted operations of its large Chevron-operated Tamar gas platform in the eastern Mediterranean, which also exports to Egypt and Jordan. That said, any conflict limited to Gaza – or even Lebanon and Syria – will have only limited impacts on **global supply chains**, given these regions are not major exporters. This will change in the event of a wider conflict involving Tehran, since Iran is one of the world's largest energy producers and could block access to the Hormuz straits, a major shipping route through which a quarter of the world's oil supplies flow

There are unlikely to be any major **sanctions** implications for now. Hamas, Hezbollah, Syria and Iran are already subject to broad Western restrictions, and there will be limited opportunities to extend these further. However, the U.S. may seek to tighten enforcement of sanctions on Iranian oil, which have reportedly been overlooked by Western officials in the hope of boosting global supplies and thus pushing down prices.

The crisis will have major implications for business in the Gulf. Negotiations to restore the 2015 **Iran nuclear deal** – which former President Trump ended three years later – will almost certainly be suspended, limiting the prospects of lifted Western sanctions and renewed business in Iran in the foreseeable future.

Meanwhile, the Biden administration's efforts to secure an **Israel-Saudi normalisation** agreement will also collapse, since Israel will now refuse to make the limited concessions to the Palestinians demanded by the Kingdom. The Saudi government will also be mindful of intense domestic support for the Palestinian cause, which Riyadh had hoped to overlook in pursuing a deal. Recently announced plans to establish a transport corridor between India and the EU via Saudi Arabia and Israel might also now be put on halt.

As for the **UAE and Bahrain**, which signed their own normalisation deals with Israel in 2020, these are likely to hold – at least for now. Notably, both countries have condemned Hamas – in a subtle attempt to highlight their rival Qatar's association with the Islamist group – in contrast to most other Arab states. Abu Dhabi and Manama see the Israel deal as critical to their diplomatic relations with Washington, and have benefited from economic and military deals with Jerusalem. However, if Israel is perceived to commit vast human rights abuses in Gaza in the coming weeks, then the Emirati and Bahraini governments may have little choice but to respond to public pressure and suspend diplomatic relations.

For its part, **Qatar** will likely avoid Western censure for its close diplomatic and financial relationship with Hamas. Doha is able to play a critical mediating role between Jerusalem and Hamas, and is already supporting negotiations to secure the release of Israeli hostages. However, Israel will be extremely unwilling to make any concessions for now, likely preferring to pursue military action.

As for **Ukraine**, the Hamas attack may potentially revitalise Western backing for Kyiv. This had begun to wane in recent months amid frustrations at the slow progress of the Ukrainian counter-offensive despite vast sums of financial aid. Ukrainian President Volodymyr Zelenskyy has been quick to associate his country's struggle with Israel's, and has offered unwavering support for the Israeli government, despite Jerusalem's lukewarm backing for Ukraine since the Russian invasion. It seems this is in part intended to garner support from right-wing populist elements in the US Republican Party and among certain EU leaders, especially in Hungary, Poland and Slovakia, who are staunchly pro-Israel but have been increasingly reluctant to support Ukraine.

Western support for Ukraine may also increase as a result of an unusually hostile attitude towards Israel in the Russian state media, which has blamed the West for the attack. The Kremlin may be eager to encourage a regional conflict in the Middle East, which it may hope will distract the West from supporting Ukraine. However, Iran is a critical supplier of arms to **Russia**, and so Moscow will likely want to avoid any Israeli operation that disrupts this.

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