What if Oil Hits US$200 per Barrel?

Mapping the Potential Causes and Implications of a Rise to US$200 Oil Around the World

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by Erik Lundh and Gurleen Chadha

The prospect of Brent crude oil prices rising to US$200 per barrel may not be as remote as it sounds. What could cause such a spike and what are the implications? Major disruptions to Russia's oil production and exports could result in prices at this height—even if other countries try to step in to offset the shortage. The economic implications of US$200 oil are severe and include widespread inflation and slower economic growth around the world.

Insights for What's Ahead

What might drive oil prices to US$200 per barrel? There are many pathways to Brent crude climbing to US$200 per barrel, or even higher. They include risks like new sanctions on Russian oil, oil boycotts from key importers, disruptions to oil transportation networks, and political volatility within Russia. Although Russian oil could be potentially absorbed by other markets, including China and India, secondary sanctions on those economies would effectively strand Russian oil exports.

A scenario we conducted shows a 30 percent reduction in Russian oil production would yield US$195 Brent oil prices even if other global suppliers scaled up their production to offset the loss. This exercise is theoretical, but it illustrates that substantial disruption to Russian oil exports would have a severe impact on global oil prices.

What are the economic implications of US$200 oil? Higher inflation and lower economic growth around the world. According to our research, global CPI inflation in 2022 could rise an additional 0.9 points over our base case scenario to 6.1 percent year-over-year.[1] Meanwhile, the resulting headwinds to economic activity in 2022 could pull global GDP growth down by 0.2 points to 3.3 percent year-over-year.[2] While this would not trigger a global recession, it would exacerbate troublingly high inflation rates.[3]

What more can government and business leaders do? The results of this exercise underscore the sensitivity of Brent oil prices to Russian oil production and exports, and the spill over effects on the global economy. Governments can look to other markets to help fortify energy security and implement policies to mitigate the negative impact of higher energy costs on businesses and consumers (e.g., adjusting taxes and regulation). Firms should anticipate higher input costs and prepare to raise prices or absorb costs in profit margins.

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[1] The consensus forecast for 2022 global consumer inflation is 5.2 percent year-over-year, according to Consensus Economics' March Survey of International Forecasts.

[2] The Conference Board currently forecasts global GDP to grow by 3.5 percent year-over-year in 2022. (link)

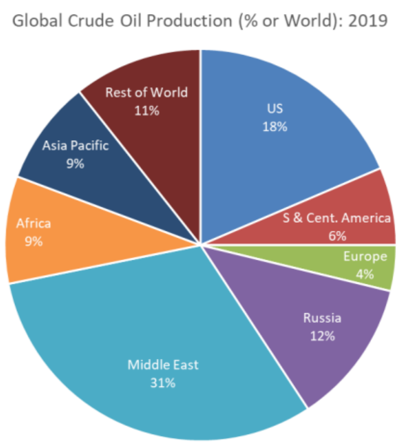
[3] We define a global recession as a year in which global GDP growth falls below 2.0 percent year-over-year. (link)

Russia’s Outsized Role in Global Energy Production

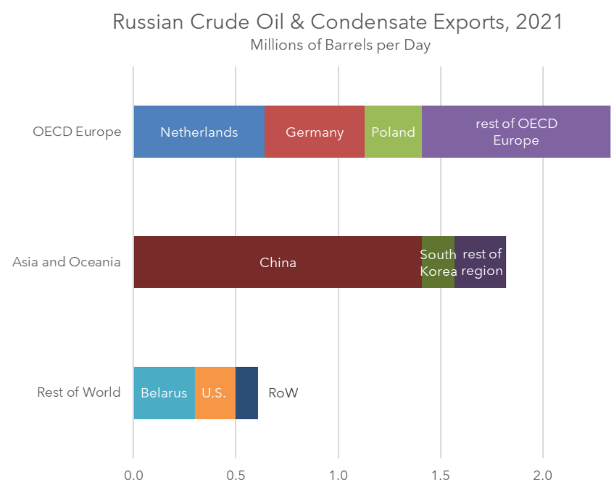
While Russia’s economy only accounts for 3 percent of global GDP, its crude oil production constitutes 12 percent of the world total. Russia’s economy is only about the size of the state of New York, but it punches well above its weight in energy production. Russia accounts for 12 percent of global crude oil production.[4] Much of that production is sent overseas, making Russia the second largest oil exporter after Saudi Arabia.

Of the 12 million barrels per day of crude oil that Russia produced in 2019, just 29 percent was consumed domestically. The remaining 8 million barrels per day were exported–primarily to European and Asian markets. In 2021, prior to Russia’s invasion of Ukraine, OECD Europe consumed nearly half of Russian crude oil exports and China consumed one-third. The remaining sixth was consumed in other parts of the world–with the US accounting for just 4 percent (**Figure 1**).

Figure 1. Russia is a Major Producer and Exporter of Crude Oil



Sources: 2022 edition of the bp Energy Outlook 2050, and The Conference Board.



Sources: U.S. Energy Information Administration, and The Conference Board.

Impact on Oil Prices from War in Ukraine

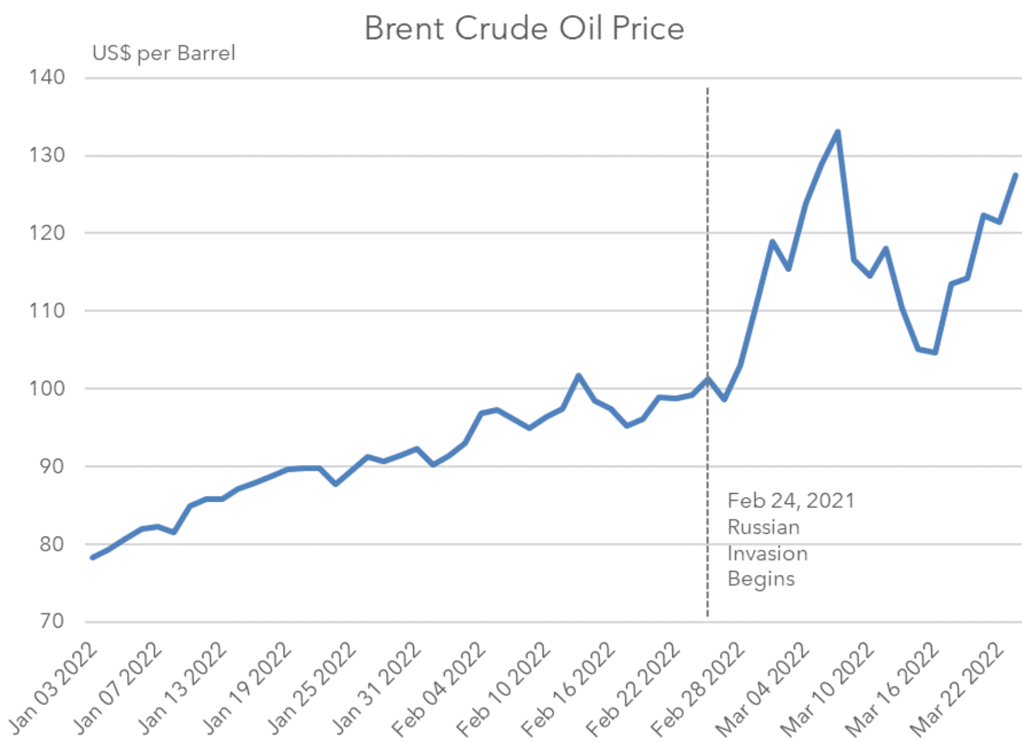
Crude oil prices have risen precipitously. Russian oil production and exports have thus far not been heavily impacted by the war in Ukraine or the associated sanctions, but risks to these critical supplies have already driven crude oil prices higher. Futures contracts for Brent oil have risen from about US$80 per barrel at the beginning of 2022 to US$127 per barrel in early March **(Figure 2)**. This is primarily due to concerns that future supplies may be disrupted due to new sanctions on Russian oil, boycotts, or that critical transportation corridors could be cut-off or

[4] 2022 edition of the bp Energy Outlook 2050

even destroyed (some oil pipelines run through Ukraine). If any of these events were to go from theoretical to actual there would be an even larger impact on the price of crude oil around the world.

Indeed, the rise in oil prices to date has already begun to increase consumer inflation rates in various parts of the world. In addition, other prices that are energy-sensitive are rising in parallel. This includes food prices, which are subject to higher production and transportation costs. The pain associated with these higher inflation rates is especially acute among lower income people who often live paycheck to paycheck.

Figure 2. Brent Oil Price Rises on Concerns About Russia Supply Disruption



Sources: FT, Haver, and The Conference Board.

Pathways to US$200 Oil

In the event of an actual disruption to Russian oil exports, global oil prices would spike. The resulting spike would incentivize other producers to raise output, thereby limiting the overall impact. However, according to our estimates, not enough spare capacity exists globally to completely offset a total loss of Russian oil exports, making a price shock unavoidable **(Figure 3)**.

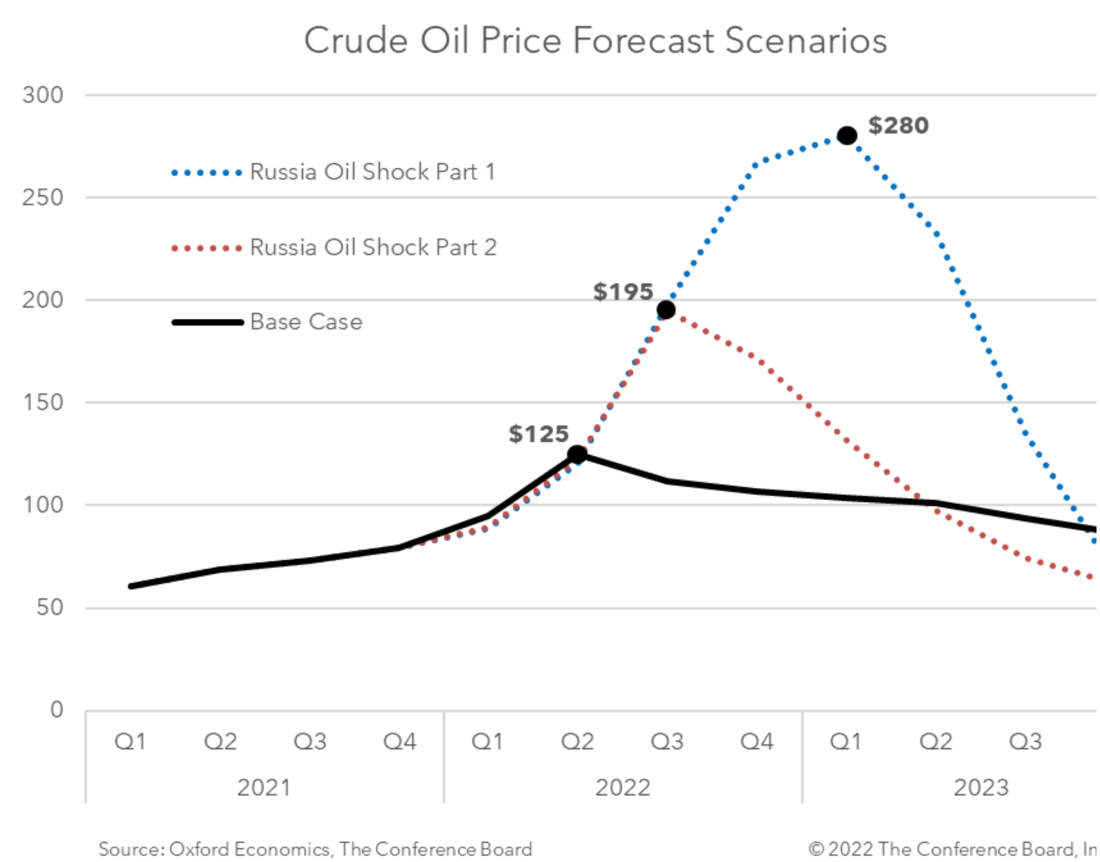
Base Case: Our current scenario assumes a prolonged increase in oil prices. Our forecast assumes that Russia intensifies its aggression in Ukraine, as strict financial sanctions are

imposed. The turmoil lasts several months before an agreement is reached. Major oil companies exit from Russian oil projects, hurting production. While no major boycotts or sanctions directly impact Russian oil exports, uncertainty drives Brent oil to an average quarterly price of US$125 per barrel in Q2 2022.

Russian Oil Shock Scenario: Part 1 - Russian production collapses. In the first part of our scenario, we introduce a shock to Russian oil production starting in Q2 2022. Production levels that quarter are reduced by 33 percent from Q1 2022 levels and remain repressed until the beginning of 2023. The result is a massive spike in Brent crude oil prices that peaks at an average quarterly price of US$280 per barrel in Q1 2023. Thereafter prices moderate as Russian crude oil production gradually begins to rise again.

Russian Oil Shock Scenario: Part 2 - Alternative suppliers step in. In the second part of our scenario, we pair the Russian production shock in Part 1 with a lagged increase in production levels in other economies with spare capacity—namely, the United States, Saudi Arabia, Kuwait, Iraq, and UAE. However, this spare capacity is not large enough to completely offset the lost Russian output and, as a result, Brent crude oil prices climb to an average quarterly price of US$195 per barrel in Q3 2022.

Figure 3. Crude Oil Price Forecast Scenarios—US$125, US$195, US$280 per Barrel



Sources: Oxford Economics, and The Conference Board.

Economic Implications of US$200 Oil

If crude oil prices spike to US$200 per barrel, inflation would rise sharply, and economic growth would slow. According to our model, world CPI inflation would increase by 0.9 points to 6.1 percent year-over-year in 2022.[5] US CPI inflation would increase by 1.1 points to 7.3 percent, Chinese CPI inflation would increase by 0.6 points to 3.1 percent, and Eurozone CPI inflation would increase by 0.8 points to 6.5 percent.[6] However, as prices for Brent declined from their peak in Q3 2022 inflation would decelerate and result in a decrease in inflation of 0.5 percentage points year-over-year in 2023. This is primarily due to base effects.

In terms of Real GDP growth, the damage is slightly less severe. According to our model, global Real GDP growth would decrease by 0.2 points to 3.3 percent year-over-year in 2022. US growth would decrease by 0.1 points to 2.9 percent year-over-year, Eurozone growth would decrease by 0.2 points to 2.6 percent year-over-year, and Chinese growth would decrease by 0.1 points to 2.8 percent year-over-year.[7] In 2023 global GDP growth is not affected, but the impact on individual economies varies.

It is notable that US$200 oil would not result in a global recession. According to our research, a global growth rate of 2.0 percent or below is only achieved if oil prices rise to close to US$300 per barrel.[8] This price level is seen in Part 1 of our Scenario, where the decline in Russian output is not offset by other producers.

Figure 4. Impact of Russian Oil Shock Scenario on Inflation and GDP Growth

Impact of Russian Oil Shock Scenario on Inflation and GDP Growth

	CPI Inflation (Annual, Δ %Y/Y)			Real GDP Growth (Annual, Δ %Y/Y)	
	2022	2023		2022	2023
World	0.9%	-0.5%	World	-0.2%	0.0%
US	1.1%	-0.9%	US	-0.1%	0.0%
Eurozone	0.6%	-0.5%	Eurozone	-0.2%	-0.1%
China	0.8%	-0.3%	China	-0.1%	-0.3%

Sources: Oxford Economics, and The Conference Board.

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5 The consensus forecast for 2022 global consumer inflation is 5.2 percent YoY, according to Consensus Economics' March Survey of International Forecasts.

6 According to the March BlueChip Economic Indicators Survey the 2022 consensus forecast for consumer inflation is: 6.2 percent YoY for the US, 5.7 percent YoY for the Eurozone, and 2.5 percent YoY for China.

7 The Conference Board currently forecasts global GDP to grow by 3.5 percent year-over-year in 2022. (link)

8 We define a global recession as a year in which global GDP growth falls below 2.0 percent year-over-year. (link)

Concluding Thoughts
US$200 Oil is Possible

This exercise demonstrates that, yes, there is a clear path for Brent crude prices to rise to close to US$200 per barrel. The 30 percent reduction in Russian oil production used in our scenario may even be modest. As outlined earlier in this report, a boycott from OECD Europe alone would drastically reduce foreign demand for Russian oil and result in a production decline. If other buyers, especially China, were to reduce their orders as well, then the result would be even higher prices.

While the path forward remains unclear, a surge in Brent crude prices would place further upward pressure on inflation rates around the world and, in turn, slow global economic growth.

Policymakers should reflect on these economic implications as they consider their response to Russia's aggression in Ukraine, and business leaders should keep a watchful eye on developments.

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