Russia/Ukraine FAQ: Oil spike implications

March 17, 2022

This FAQ is designed to help provide perspective on the current Russia/Ukraine crisis.

Q. What is behind the rise in oil prices?

A. Russia is the world's largest oil exporter and the second largest crude oil exporter[1], and Ukraine is a key transit country for Russian exports to Europe[2]. For both countries, mineral fuels (coal, petroleum, and natural gas) is the largest export category. A large percent of the European Union's total energy imports comes from Russia—close to 40% of its coal and refined petroleum, and around 25% of its crude oil and natural gas. From the start of the invasion on February 24 through March 9, the price of crude oil rose nearly 30%—a gain of almost 100% for the previous 12 months according to Bloomberg.

We have also seen European natural gas prices return to their January 2022 highs, and pressures are likely to continue as hostilities in Ukraine persist. Natural gas prices in Europe were already soaring before the invasion. We saw a huge spike at the beginning of 2022 as alternative sources of energy failed to provide enough electricity to meet demand. Prices in the U.K. rose close to 10x from where they were 2021, while prices in Europe were 7x higher.

Since Russia's invasion of Ukraine, areas that already faced high energy costs are now facing even more pressures as global sanctions against Russia—including a U.S. ban on Russian oil shipments—have resulted in one of the largest oil-supply disruptions since World War II.

Q. What do similar price spikes in oil during the 1970s tell us?

A. It's hard to compare today's price spikes to those that occurred in the 1970s. Energy intensity is now much lower than it was 50 years ago, while energy efficiency is much greater. There are also a larger number of alternative energy sources today.

Q. Does the spike in oil prices mean we will see an economic downturn or recession?

A. While rising oil prices do not necessary foreshadow a recession, oil price surges that happen over a relatively short period can shock an economy and cause a recession due to both direct and indirect impacts of higher energy costs on households and businesses.

Direct impacts of higher energy costs:

- Households that have higher gas bills are left with less money in their budget to spend on other goods and services.
- Businesses that rely on fuel to operate (such as airlines, or those that must ship goods) face higher production expenses.

[1] https://www.iea.org/reports/russian-supplies-to-global-energy-markets/oil-market-and-russian-supply-2
[2] https://www.iea.org/countries/ukraine

Indirect impacts:

- Businesses that want to reallocate capital and labor (for instance, auto manufacturers seeking to decrease production of sport utility vehicles in favor of fuel-efficient vehicles) may face costs and time delays—which, in aggregate, could result in lower overall demand and output in the short run.
- Uncertainty caused by surging oil prices may result in consumers pausing purchases of durable goods and firms delaying irreversible investments—the combination of which could lead to an economic slowdown.
- Despite growing inflation concerns, consumer spending appeared strong in the U.S. last year. However, the surge in energy prices from the invasion could force individuals to reduce discretionary spending as a result.

Q. Is recession a foregone conclusion?

A. No, we do not believe that a recession is a foregone conclusion. Prior to the invasion, the world economy was showing solid momentum in growth. Europe was coming out of pandemic lockdowns, while the U.S. economy had been recovering since the second half of 2020 and was expected to post above-average gains in the first quarter (although that estimate will likely come down given current energy and food spikes).

Even with oil prices surging in the wake of Russia's attack, households and businesses are generally still in good shape. This is especially true in the U.S., where there remains ample excess savings at the higher end of the income scale. Although gross domestic product growth is expected to slow, we maintain a relatively solid outlook for the world's major economies.

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