

Why Oil Prices Aren't Spiking

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Brief Analysis

Prices are set by multiple factors in today's oil markets, so predicting shocks based on Middle East crises is not a sure bet.

Historically, Middle East wars have been associated with global oil crises. When Israeli, British, and French forces took action against Egypt in 1956 and the Suez Canal was blocked as a result, both London and Paris had to impose gasoline rationing at home. During the 1973 war, an Arab boycott caused oil prices to more than double. Iran's 1979 revolution doubled global prices again; they also briefly peaked when Saddam Hussein invaded Kuwait in 1990.

The current Gaza crisis seemed to follow suit at first: after Hamas invaded Israel on October 7, prices soared from around \$70 per barrel to more than \$90. Yet by the week of October 19, the main U.S. crude oil, West Texas Intermediate, had fallen back under \$74 per barrel, while the internationally traded Brent crude fell back under \$80.

Even the escalation to broader regional hostilities—including [Red Sea shipping attacks](https://www.washingtoninstitute.org/policy-analysis/rising-pressure-red-sea-transit) (<https://www.washingtoninstitute.org/policy-analysis/rising-pressure-red-sea-transit>) and direct U.S.-Iranian exchanges—has had little upward effect. Following multiple rounds of coalition operations against Houthi targets in Yemen, a *Financial Times* headline on January 17 read, “US-led strikes on Islamist rebels rekindle fears of oil price surge and jump in inflation.” Yet the story itself noted that war-driven price hikes were not inevitable.

Indeed, the more likely answer about the market's direction lies in the oft-repeated economic law about prices settling wherever supply and demand are in balance. Put simply: the war has not caused any reduction in the world's overall supply of oil so far, and demand remains constrained by uncertainty in the global economic outlook.

Consumption, Supply, and Demand

Current global oil consumption is about 100 million barrels per day. Saudi Arabia, Russia, the United States, and certain other countries produce more than they consume and therefore export the surplus; their total surplus

represents about half of global consumption. Some countries (most prominently Japan) are almost totally reliant on these imports; others (like China) produce some oil but still rely heavily on imports.

At present, there is no shortage in worldwide supply, and plenty of spare production, as the leaders of the OPEC+ cartel can attest. Russia's exports have been reduced by sanctions stemming from its invasion of Ukraine, while Saudi Arabia has been cutting back production in the largely forlorn hope of increasing prices and revenues (<https://www.washingtoninstitute.org/policy-analysis/saudi-arabia-signals-delays-some-vision-2030-plans>).

The resulting spare capacity has reduced any "risk premium," which in the past could have bumped up prices in times of sudden bad news. In addition, non-OPEC supplies—especially from the United States—have been growing and now almost exceed OPEC's supplies in terms of internationally traded oil.

As for the winter factor, seasonal energy demand in the northern hemisphere has already been met on the supply side, removing another potential price driver. In the United States, many areas are experiencing a colder winter than normal this year, but their electricity needs are increasingly generated by natural gas, with coal in second place and nuclear in third.

The transport market is rapidly changing as well. Cars and other vehicles have become more efficient, and many are using alternative fuels.

The China Factor

Another major factor affecting oil demand is the state of the Chinese economy. A January 18 *New York Times* story noted that the country's economic growth was 5.2 percent in 2023, but "high debt, a housing crisis that has undermined confidence, and a shrinking and aging workforce are weighing on output."

More broadly, the *Wall Street Journal* reported on January 19 that "global oil-demand growth slowed significantly at the end of last year and is expected to weaken further." Quoting the Paris-based International Energy Agency—originally established as the Western world's answer to OPEC—the story noted that "global economic growth is expected to slow this year, despite anticipated interest rate cuts...as business activity and consumer spending suffers the impact of rate hikes in 2022 and 2023." Meanwhile, OPEC has reportedly "left its expectations for this year's oil-demand growth unchanged at 2.2 million barrels a day, and said it expects demand to grow by 1.8 million barrels a day in 2025, a level still considered elevated by market watchers."

The difference in the IEA and OPEC forecasts is a reminder of the difficulties inherent in trying to anticipate oil demand and pricing in today's complex markets. Both near-term forecasts and caveats about these forecasts can be wrong. So far, the Gaza crisis and its regional repercussions have spurred little if any lasting movement on price, despite widespread fears to the contrary.

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