Price is the Ultimate Rationing Vehicle

3/4/22

Prior to the Russian invasion, the oil market was tight. The prompt price was $10 dollars above the December 2022 quotes. While governments have been reluctant to impose sanctions on Russian energy, the markets have done it for them. 2-2.5 MMB/D of Russian Oil Export has been lost to the markets. This has effectively wiped out the global spare capacity and has created a bidding war for prompt barrels. The result is a $20 backwardated market between now and December. Tanker owners and some buyers have been reluctant to load Russian oil for fear that their assets might be confiscated.

The gap between demand and available supply can only be closed through price. The Administration could moderate (not eliminate) the size of the spikes by sitting down with the industry and finding short-term ways to increase supply. That doesn't seem to be in the cards.

Oil demand is price inelastic, which means that large price changes are required to bring about smaller changes in demand. If there is an Iranian deal, we might see a short-term respite in price. But that will be short-lived. Iranian supply over the next 4-6 months won't come close to offsetting the Russian loss. In addition, the recent announced release of 30 million barrels from the SPR might take much longer to deliver than April/May due to pipeline constraints.

While the price spikes we've experienced over the past week are painful, there is more pain to come.

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