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MONEY

Iraq crisis fuels concern for oil prices

Many moderate-income Americans in no position to weather ongoing spike in gasoline costs

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Sharp surges in the world's oil prices usually end up dragging the economy down, so analysts are watching the crisis in Iraq for risks to U.S. consumers and the globe's fragile recovery.

Oil prices have climbed to a nine-month high amid the escalating insurgency, and stocks have reflected some modest jitters over the uncertainty. But as long as the fighting remains confined to northern Iraq, and away from the key production and shipping areas of the south, analysts do not expect the type of oil shock that can set off recessions.

Still, many moderate-income Americans are in no position to weather an ongoing spike in gasoline and other energy-related prices, so some economists are guarded as geopolitical and oil risks continue.

"Prices will remain elevated during this crisis even if there are no disruptions of supplies," IHS energy analysts said in a report. "Just the risk of such outages will add to the geopolitical premium on prices."

Economist **Bernard Baumohl, of The Economic Outlook Group**, alerted clients last week of "an emerging threat to the current U.S. economic expansion."

He noted that the cost of living has been rising in the U.S. since the start of this year, and "wages have utterly failed to keep up." So if energy prices continue to escalate because of turmoil in Iraq, "the strain on household budgets is expected to worsen."

As a result, consumers would have to divert more money to gasoline, leaving less for other spending — a clear drag on the economy.

Pressures will also weigh on Europe, which is just pulling out of a recession and also facing possible high natural gas prices because of Russian force in Ukraine. But economists note that the weak economies in Europe and some emerging markets have also limited demand for oil and kept oil prices from rising.

"It seems reasonable to flag up $120 (for Brent crude oil) as the danger point for the global economy if the Iraq crisis escalates and oil prices continue to climb on fears of further supply disruption," Capital Economics economist Julian Jessop said in a note to clients. On Tuesday, Brent was $113.45 a barrel on the ICE Futures Europe exchange.

"In the unlikely scenario where the Islamic State of Iraq and Syria (ISIS) enters Baghdad, Brent could head $10 to $15 a barrel higher," Bank of America Merrill Lynch commodity analyst Francisco Blanch said in a report. "In the highly unlikely scenario where 2.6 million barrels a day of Iraqi exports are disrupted, the impact would be quite severe, with Brent rising as much as $40 to $50 a barrel."

So far, the effect of fighting in Iraq has been muted because the "conflict in Northern and Western Iraq is far from the southern oil fields and export terminals from where nearly all oil exports originate," Goldman Sachs commodities analyst Damien Courvalin said in a report. "The probability of the conflict reaching Iraq's southern oil fields and the Basra terminal is low."

But if instability continues for the long term in Iraq, oil prices are likely to stay high because of constraints on worldwide oil supplies.

Iraq has been significant in the growth of global oil production, accounting for about 48 percent of the increase in 2012. And the

International Energy Agency has estimated that 60 percent of OPEC's production growth this decade will come from Iraq as facilities are expanded and upgraded.

Yet, under unstable conditions in Iraq, oil companies might be reluctant to invest in upgrading facilities, said Courvalin. With exports falling far behind expectations, tight global supplies of oil could lead to higher prices.

That's a problem, because production is in decline in most oil-producing countries, Ned Davis commodity strategist John LaForge said in a report. And while the U.S. is producing more oil, "it is not exportable at this time."

"Do not expect the U.S. shale boom to help global oil prices anytime soon," said LaForge. Oil prices are contingent on world markets.

"Libya is a scary example of what could happen to Iraqi exports, should the situation spiral out of control," LaForge noted. "Prior to the overthrow of Prime Minister Gaddafi, Libya was producing 1.6 million barrels a day." Three years later, Libya is producing a small fraction of that.

The world isn't running out of oil, but it is short of oil at about $100 a barrel, Peter Tertzakian, chief energy economist for ARC Financial Corp., noted in a report. "Restoration of stable production is not likely anytime soon. A long list of oil producing countries — Libya, Yemen, Syria, Iran, South Sudan and Nigeria to name a few — are lame or limping."

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