ECONOMIC VIEWPOINT

Conflict with Iran

Economic and Oil Market Implications

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HIGHLIGHTS

- Iran's economy relies heavily on oil extraction, with output of roughly 3.5 million barrels per day (mbd). However, ongoing hostilities are significantly limiting its production and export capacity.
- The global oil market remains resilient, supported by a 4.4 mbd surplus and ample unused OPEC+ capacity that could readily replace Iranian supply.
- Regional tensions—particularly around the Strait of Hormuz, through which 20% of global oil transits—pose a risk of severe disruptions, though market reactions have been muted so far.
- The most likely scenario points to moderate supply disruptions over roughly two months, with West Texas Intermediate (WTI) prices expected to range between US$70 and US$80 per barrel in the second quarter on average. A risk of more severe disruptions persists, which could temporarily push crude prices above US$100 per barrel.
- For Canada, higher oil prices generally lead to stronger real GDP growth and inflation at the national level. Alberta's economy and government finances are particularly sensitive to changes in oil prices. The same is true to a lesser extent for Saskatchewan and Newfoundland and Labrador. In contrast, non-energy-producing provinces like Quebec and Ontario should see higher inflation but without the boost to growth.
- Despite geopolitical risks, both the oil market and the world economy are showing strong adaptability, which generally limits lasting impacts on prices and growth. However, a broader escalation of the conflict could restrain spending and investment—effects that would be amplified if financial conditions were to tighten significantly, as evidenced by Monday's European stock market declines and global rise in bond yields.

Iran's Economy

Iran's principal economic strength remains its oil sector, which produces roughly 3.5 mbd, ranking the country seventh globally. Yet this production, along with the broader economy, has been weakened by years of sanctions following the breakdown of negotiations over its nuclear program. In 2024, Iran's real GDP stood at US$475 billion, representing about 0.4% of the global economy according to International Monetary Fund estimates.

Amid the current hostilities, Iran's ability to extract—and especially export—oil in significant quantities appears highly constrained. Still, the global market would be able to absorb such a reduction given that the International Energy Agency had anticipated a surplus of roughly 4.4 mbd for the second quarter (graph 1 on page 2). OPEC+ also has more than 4.1 mbd of unused production capacity excluding Iran, with Saudi Arabia alone accounting for nearly half of that unused capacity at around 1.8 mbd. The cartel has already announced an additional 0.2 mbd increase for April. That decision is best interpreted as a signal to the market of the group's willingness to offset any decline in Iranian production rather than as a meaningful increase in overall output.

Moreover, China—the main buyer of Iranian crude—could adjust its supply mix without significantly tightening global

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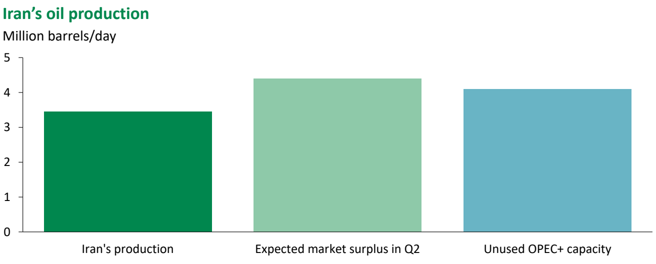
Graph 1
Iran's Crude Production Can Easily Be Replaced



Datastream, International Energy Agency and Desjardins Economic Studies

markets, as it has accumulated substantial oil reserves in recent years. As such, if production losses remain confined to Iran, the repercussions on the global oil market would likely be limited and relatively contained. By contrast, a closure of the Strait of Hormuz would be far more damaging given that Asia sources a large share of its imported oil through this strategic waterway.

Regional Escalation

Iran's retaliatory strikes targeted several Gulf countries—including Saudi Arabia, Qatar and the United Arab Emirates—damaging energy infrastructure and prompting temporary shutdowns. Tehran has also stated it closed the Strait of Hormuz, through which 20% of global oil flows. For now, shipping vessels are avoiding both the Strait and the Suez Canal due to fears of missile attacks.

The central issue remains the uncertainty surrounding the scale of potential disruptions. Extensive damage to energy infrastructure across the Gulf would drive far sharper increases in oil prices. Conversely, a more contained impact would generate only moderate upward pressure, consistent with the market's current response: WTI had risen by only about 5% as of Monday morning, a sign that investors expect a conflict without major or prolonged disruptions.

Even in the event of regime change in Iran, affiliated paramilitary groups could continue destabilizing the region. Such actions would most likely cause sporadic production or transport disruptions rather than substantial, sustained losses in global supply.

Two Possible Scenarios for the Oil Market

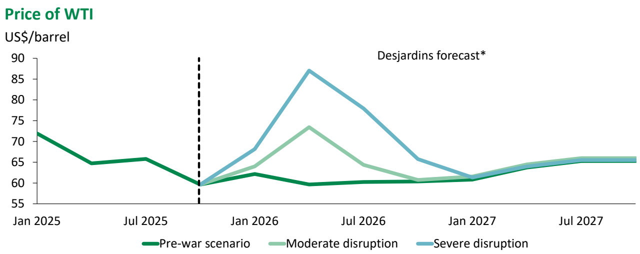
As of this writing, it remains difficult to assess how the conflict will evolve in the coming days or weeks. Uncertainty is extremely high, and the global oil market may still face meaningful disruptions and adjustments. Based on currently available information, two scenarios appear plausible.

1. Moderate Disruption (More Likely Scenario)

In this scenario, Iran would not succeed in fully closing the Strait of Hormuz, though maritime traffic through the area would fall by 25% to 50%. Regional instability and strikes on oil infrastructure would reduce global production temporarily by about 2 to 4 mbd for roughly two months. Supply would then gradually recover as other producers compensate for lost volumes.

We expect WTI prices to range between US$70 and US$80 per barrel in the second quarter before returning close to pre-conflict levels (graph 2). It is important to note that the peak could be above the anticipated quarterly average. The Brent–WTI spread would widen temporarily (graph 3).

Graph 2
A Modest Jump in WTI Seems the Most Likely Scenario



WTI: West Texas Intermediate; * Median price by scenario.
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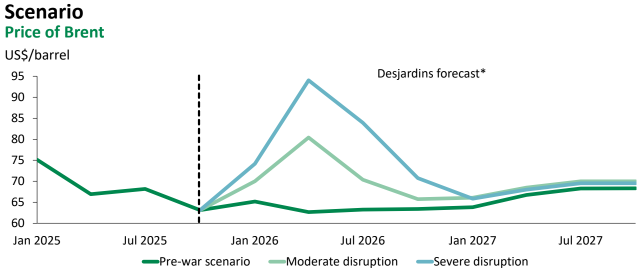
Graph 3
Brent Is Expected to Rise More than WTI in the Severe Disruption Scenario



WTI: West Texas Intermediate; * Median price by scenario.
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2. Severe Disruption

In this scenario, Iran would succeed in fully closing the Strait of Hormuz for at least one week. Such an event—removing about 20% of global supply overnight—would likely trigger a more forceful response from the US and its Middle Eastern allies.

WTI prices would surge sharply, very likely exceeding US$100 per barrel for a period. On a quarterly average basis, prices would range between US$85 and US$120 per barrel before gradually easing. The Brent–WTI spread would widen more significantly and for a longer period, while the WTI–WCS (Western Canadian Select) differential would narrow slightly. This would reflect stronger demand from Asia as it seeks to offset supply losses from the Gulf.

Natural Gas Faces a Situation Similar to Oil

European natural gas prices have doubled since the onset of the conflict in the Middle East, as the continent's supply routes are once again under threat. That said, the situation remains less worrying than at the outbreak of the war in Ukraine, when the European Union faced a lasting rupture with its main supplier, Russia. This time, maritime routes have been temporarily disrupted, but no supplier has been forced out of the market.

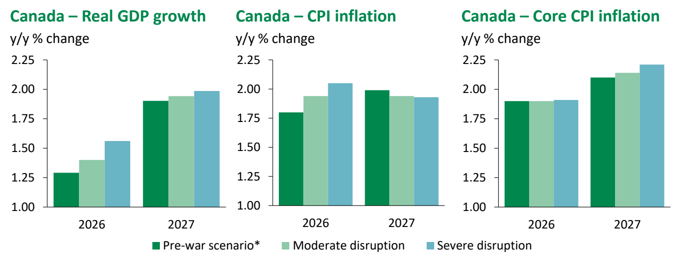
Even so, this marks a second energy shock for Europe in just four years, which could further weigh on an already fragile growth outlook. Several Asian economies are also exposed to a similar risk, including China, India, Japan and—to a lesser extent—South Korea.

As Go Oil Prices, So Go Growth and Inflation in Canada

For Canada, higher oil prices generally lead to stronger real GDP growth at the national level. Running the outlook for a higher WTI price through our macroeconomic framework results in an increase in the 2026 real GDP growth forecast from 1.3% in our February 2026 [Economic and Financial Outlook] baseline to 1.4% in the moderate disruption scenario. In the severe disruption scenario, the Canadian economy would benefit from the tailwind of both a higher WTI price and a smaller discount for WCS, pushing 2026 real GDP growth to 1.6%. The outlook for 2027 real GDP growth also gets progressively higher along with the oil price.

At the same time, more elevated oil prices should result in stronger price growth, raising the outlook for 2026 headline CPI inflation from 1.8% in the baseline to 1.9% in the moderate disruption scenario and 2.0% in the severe disruption scenario (graph 4). Total inflation should post the slowest advance in 2027 in the severe disruption scenario, as energy prices contract most sharply in that scenario. However, core inflation (total inflation

Graph 4
Higher Oil Prices Should Increase Canada's Growth and Inflation



* Based on the forecast published in our February 2026 Economic and Financial Outlook.
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excluding food and energy) risks being strongest in the severe disruption scenario in both 2026 and 2027 because of less slack in the economy and a delayed indirect impact of higher energy costs on core consumer prices. That said, the largest difference in core CPI inflation between the February 2026 forecast and the severe disruption scenario is just 0.1 percentage points, as a stronger Canadian dollar will help to mitigate some of the inflationary impact. In all scenarios, we have assumed the Bank of Canada remains on the sidelines, as downside risks to the Canadian economy linked to US trade policy and the upcoming CUSMA joint review remain relevant.

Of course, not all provinces are going to be equally impacted by higher oil prices. As we pointed out in our recent Provincial Economic Outlook, Alberta's economy and government finances are particularly sensitive to changes in oil prices. As the province has been adversely impacted by lower oil prices in recent quarters, the projected uptick in WTI and possibly smaller discount on WCS could be a tailwind to its economy. The same is true to a lesser extent for Saskatchewan and Newfoundland and Labrador. In contrast, non-energy-producing provinces like Quebec and Ontario are likely to see inflation increase due to higher oil prices but should experience slightly slower economic growth as costs to consumers and businesses increase.

The Oil Market and the Global Economy Remain Resilient

The global oil market has weathered several major shocks in recent years, from the pandemic and the war in Ukraine to trade tensions and US intervention in Venezuela. Each episode has revealed a level of resilience that consistently exceeded expectations. Even countries under sanctions, including Russia and until very recently Iran, have managed to circumvent several restrictions and maintain significant export volumes.

Against this backdrop, the recent surge in crude prices does not guarantee it will last. Once conditions in Iran and the Strait of Hormuz become clearer, prices could ease. In addition, several producers—notably OPEC+, the US, Canada, Brazil, Mexico and potentially Venezuela—have room to adjust output. This flexibility could help offset the effects of the situation in Iran and limit upward pressure on global oil supply.

The implications for the global economy will depend largely on the duration and severity of the crisis. The real GDP of major advanced and emerging economies is far less dependent on oil than during past crises. That said, Asia and China remain more exposed to the consequences of a prolonged disruption in Middle Eastern oil supply. On one hand, the US is now a net exporter of petroleum products, and a sustained increase in prices could even have positive spillovers for investment in the resource sector, which has struggled in recent years. On the other hand, higher prices would weigh on consumers' real incomes and erode profit margins for many businesses, though the overall net effect should remain modest.

Among the wildcards we will need to monitor are the repercussions on household, business and investor confidence. A broader escalation of the conflict could dampen spending and investment. These effects would likely be amplified if financial conditions were to tighten significantly, similar to the major stock market declines in Europe and the increases in bond yields observed globally on Monday.