Post #22 on Inflation. Impact of the Hormuz (Iran) oil shock. Date 2026-4-2

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In this post we provide a concise analysis of the impact of the spike in oil prices precipitated by the armed conflict in Iran that led to the closure of the strait of Hormuz and the bombing of oil and gas infrastructure in the Gulf states.

On the 28th of February of 2026, a major armed conflict was initiated by coordinated U.S. and Israeli airstrikes targeting Iranian military infrastructure and regime leadership. The strikes took the lives of Supreme Leader Ali Khamenei and other top officials of the Iranian regime, triggering Iranian retaliation against Israel, U.S. bases, Gulf state infrastructure and restrictions on movement across the strait of Hormuz.

Oil prices spiked during March of 2026, from a value of $64.495/barrel on the 1st of March, to 101.38$/barrel on the 31st of March, averaging slightly above $90/barrel throughout the month. The spike in oil prices has spurred renewed concerns of high inflation, which was already an ongoing issue since 2022.

1. Fed Reaction so far

An excellent article by Jennifer Schonberger at Yahoo Finance[1] on 29th of March, 2026 summarizes well the main considerations that policy makers are facing. On the one hand, inflation will be impacted by the rise in energy prices, but on the other hand, the inflation shock will likely be temporary and rising interest rates too early could risk derailing the economy (on top of higher oil prices that can be equated to a tax hike). The "standard learning" for the Fed has been to look through energy shocks, but that has been conditional on inflation expectations remaining well anchored.

While speaking at Harvard University on the 30th of March 2026[2], Fed Chair Jerome Powell said the US central bank sees no immediate need to raise interest rates in response to the recent oil price shock, arguing that inflation expectations remain under control and that tightening policy now could unnecessarily weigh on the economy later.

Speaking at Harvard University, Powell mentioned[3]:

- *The Fed is not yet facing a point where it needs to respond to higher energy prices with a rate increase, as policymakers still do not know the full economic effects of the Iran war and tariff-related price pressures.*
- *Inflation expectations do appear to be well anchored beyond the short term," Powell said, while noting that the central bank would remain mindful of the broader backdrop when making future decisions.*
- *Oil prices have surged over 45% in a month following attacks on Iranian and Gulf oil infrastructure and the closing of the Strait of Hormuz.*
- *Powell said the current policy rate, held in a range of 3.5% to 3.75%, remains "a good place" for the Fed as it monitors developments in the economy, including geopolitical tensions and their impact on inflation.*

Next, we'll add our own analysis of the impact of the Hormuz closure oil shock, discuss two possible scenarios for oil prices and inflation and outline the main challenges that the Fed chair will face in view of the economic risks and underlying disinflation trends in core CPI in the coming months, outlined in our report on the outlook for the US economy in 2026.

[1] https://finance.yahoo.com/news/how-the-fed-has--and-hasnt--responded-to-previous-oil-price-shocks-090035039.html

[2] https://www.youtube.com/watch?v=oqeGhgbEwr0

[3] https://www.aa.com.tr/en/americas/fed-chair-powell-signals-no-urgency-for-fed-rate-hike-amid-oil-shock/3885437#:~:text=ISTANBUL,and%20their%20impact%20on%20inflation.

First, however, I'll provide a context to the developments in inflation since 2020, which contribute to overall inflation perceptions and policy actions by the Fed. Akin to a scalded cat, Fed policymakers are likely to try to prevent the inflation genie jumping again out of the bottle, after managing to bring it back to 2.41% by February of 2026.

1. Inflation context.

The Covid-19 pandemic led to the inflation genie escaping the bottle, after 30 years of subdued inflation.

During 2020 and until mid-2021, inflation seemed to be under control but since then it has exploded due to the unprecedented expansion of money that was a coordinated economic response to the government lockdowns enacted in March/April 2020 was bound to set loose the inflation genie.

In the second edition of my book[4], I argued that the inflation that started mid-2021 was not a temporary phenomenon, and did not originate from problems in global supply chains, but was in essence a monetary phenomenon and also a result of the pent-up demand from the pandemic lockdowns that led to record savings by households[5]. Like a coiled spring, the economy rebounded sharply with supply chains struggling to keep up.

To control inflation "at any cost", the Fed embarked in a policy of quantitative tightening (by reducing its balance sheet) as well as an aggressive series of rate rises from 0.25% to 0.5% in March 2022, to 5.25% to 5.50% in July 2023. The result of the policy actions by the Fed led to an unprecedented drop in the money supply, as measured by the M2 aggregate. As a consequence, inflation subsequently dropped from its peak of close to 9% in mid-2022 to close to 2.5% in 2025.

Since then, inflation has been hovering stubbornly just below 3%, which is too high for comfort for Fed policymakers. By February of 2026, core CPI stood at 2.46% while overall CPI was running at 2.41%, which were close to the Fed's 2% target inflation rate.

This inflation-disinflation cycle from 2022 to 2025 is illustrated in the **B** area marked by the dashed circle in Figure 1. The chart also shows changes in energy CPI, which are plotted on the right-hand scale. We can notice that both core CPI and overall CPI rose during the period, together with a large rise in energy CPI reaching above 40% YoY at its peak in June of 2022. The rise in **both** overall CPI and core CPI was due to the underlying phenomenon being driven by an expansion in the money supply and not an energy shock.

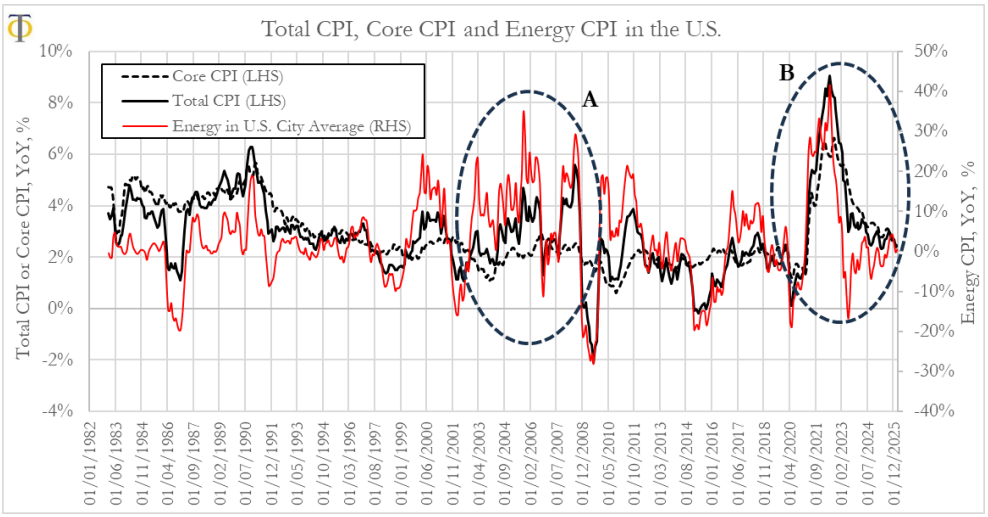

Figure 1 - Evolution of US CPI, core CPI and energy CPI from 1982 to February of 2026.

The period defined by the dashed circle **A** in Figure 1, illustrates another time period where energy inflation spiked, reaching close to 40% YoY changes in 2006. We can notice that in this instance, even though overall

[4] https://a.co/d/0avQD4ZF

[5] https://phinancetechnologies.com/content/2022-05-28%20Inflation%20LinkedIn%20Post-3.pdf

CPI rose together with energy inflation, core CPI remained stable and subdued during the period. This was due to the rise in energy CPI not being accompanied by a large expansion in the M2 money supply.

Additionally, it should also be noted that the energy component typically accounts for approximately **6% to 8.5%** of the total Consumer Price Index (CPI) basket in the US (including motor fuel, electricity, and home heating). While it represents a relatively small component, its high variability and seasonality lead to energy often having a disproportionate impact on overall inflation, which could easily reach 20% or more of monthly changes in the CPI. In Figure 1 we can observe that YoY changes in energy CPI are about 5x larger than YoY changes in overall CPI.

This is the main reason why central bankers tend to look over temporary spikes (up or down) in energy and focus on core CPI or inflation expectations.

2. Relationship between oil prices and energy CPI.

As previously mentioned, energy CPI accounts for about 6%-8.5% of overall CPI. However, how are oil prices related to energy CPI?

To answer this question, in Figure 2 the relationship between energy CPI and changes in WTI oil prices is plotted. The chart on the left refers to how monthly changes in average oil prices during the current month and preceding month are related to changes in energy CPI. The chart on the right compares year-on-year changes in average oil prices over the month with year-on-year changes in energy CPI.

It can be observed that the relationship is very strong. It should be noted that energy CPI is impacted by changes in oil prices in the current month but also the preceding month as the impact of changes in oil prices is somewhat delayed from market prices to prices available to the public. Even though this is only a "quick analysis", oil price changes are a very powerful explanatory variable for energy CPI.

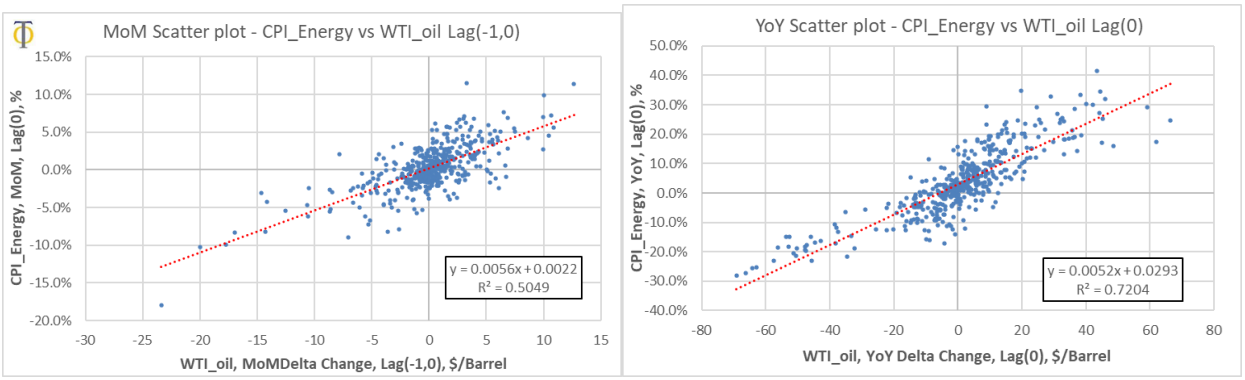

Figure 2 – Relationship between changes in WTI oil prices and energy CPI. Left: Month-on-Month (MoM) changes. Right: Year-on-Year (YoY) changes.

The chart on the left implies that a 10$ change in oil prices (in both the current month and preceding month) leads to a 5.6% monthly change in energy CPI.

Oil prices averaged 60.04$/barrel in January of 2026 and 64.05$/barrel during February of 2026. In March of 2026, oil prices spiked from a value of $64.495/barrel on the 2st of March, to 101.38$/barrel on the 31st of March, averaging slightly above $90/barrel throughout the month. Let's put these figures in

Oil price change ($/barrel) in February 2026: ($64.405 - $60.04) = $4.4

Approximated oil price change ($/barrel) in March 2026: ($90[6] - $64.405) = $25.6

Implied monthly change in energy CPI: ($25.6+$4.4)/2x0.0056 = **8.4%** (100.8% annualised).

[6] $90/barrel is a conservative estimate for the average WTI oil price during March 2026.

The spike in oil prices is expected to lead to a 8.4% monthly spike in energy CPI in the next CPI release. When performing a similar computation using year-on-year changes, we expect to see a about 14% YoY change in energy CPI in the next CPI release[7]. A back of the envelope calculation of what this would imply for overall CPI assuming energy CPI represents 8% of overall CPI, we estimate overall CPI to rise by about 1.1%, to a value of about 3.5%, assuming all other variables remain constant[8].

The model above is quite simple but provides an idea of the impact of changes in oil prices on energy CPI. Next, to have a useful navigation map for the unknown future developments in the Gulf of Arabia, I'll outline two simple scenarios for the evolution of oil prices and the impact on **overall CPI** until March of 2027. The first scenario represents a moderate oil shock while the second a severe shock.

3. Scenario 1 (moderate) – Short-term oil shock.

This scenario, shown in Figure 3, represents a short-term shock with moderate impact on oil prices and inflation. The chart shows the evolution of WTI oil prices and overall CPI until the 28th of February of 2026, as well as projected values until March of 2027.

The scenario assumes that average monthly oil prices (per barrel) are 90$ (March), $100 (April), $125 (May), $80 (June) and thereafter hover close to $65 a barrel. It assumes that the US/Iran conflict will linger on for a few months, with tensions peaking in May with oil prices averaging $125 per barrel. From June, oil prices would start retreating towards pre-conflict values.

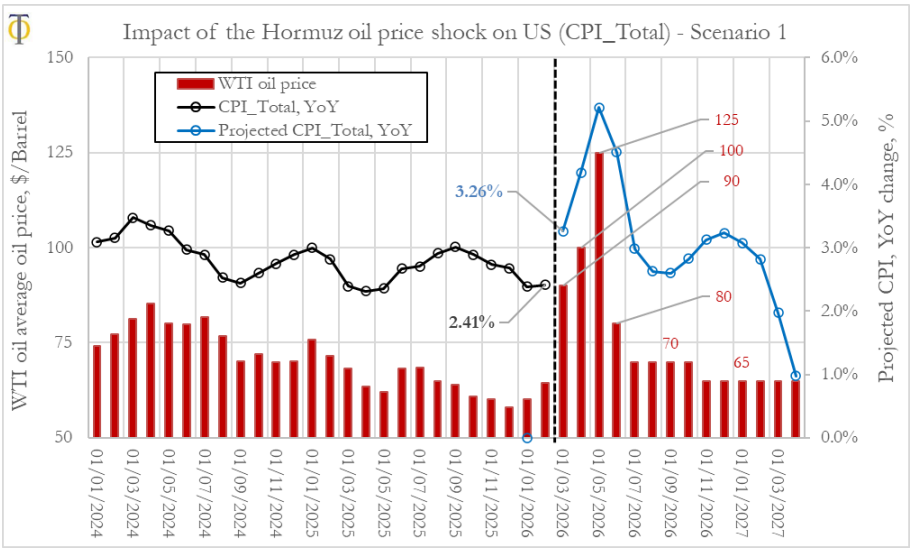

Figure 3 – Scenario 1 (moderate) for average monthly WTI oil prices and projected CPI.

Under this moderate scenario, we can observe that on the April 10th CPI release we expect to see overall US CPI rise from 2.41% to 3.26%, which is due to the 90$/barrel average oil price throughout March. As oil prices continue rising, inflation is expected to peak in May at close to 5%. Thereafter, year-on-year CPI is expected to decline sharply reaching a value of 3% by July. However, YoY changes in CPI are expected to hover close to 3% for an extended period, due to the shock in oil prices.

In the early months of 2027, year-on-year changes in the CPI is expected to decline close to 1%, reflecting the sharp drop in oil prices after peaking in May of 2026 at 125$/barrel.

[7] Bureau of Labor Statistics on April 10, 2026

[8] The increase in oil prices is in effect a tax hike for consumers which leads to deflationary forces due to lower consumer demand. The overall inflation rate is a balance of all these forces.

4. Scenario 2 (severe) – large oil shock.

This scenario, shown in Figure 4, represents a severe shock in oil prices and inflation. The chart shows the evolution of WTI oil prices and overall CPI until the 28th of February of 2026, as well as projected values until March of 2027.

The scenario assumes that average monthly oil prices (per barrel) are 90$ (March), $100 (April), $125 (May), $150 (June), $250 (July), $175 (August), $100 (September) and thereafter hover close to $65 a barrel. It assumes that the peak of the impact of the US/Iran conflict has not been reached yet, with tensions over the strait of Hormuz and Gulf states infrastructure intensifying until July of 2026. From August, oil prices would start retreating, reaching pre-conflict values only in October as supply chains re-normalize.

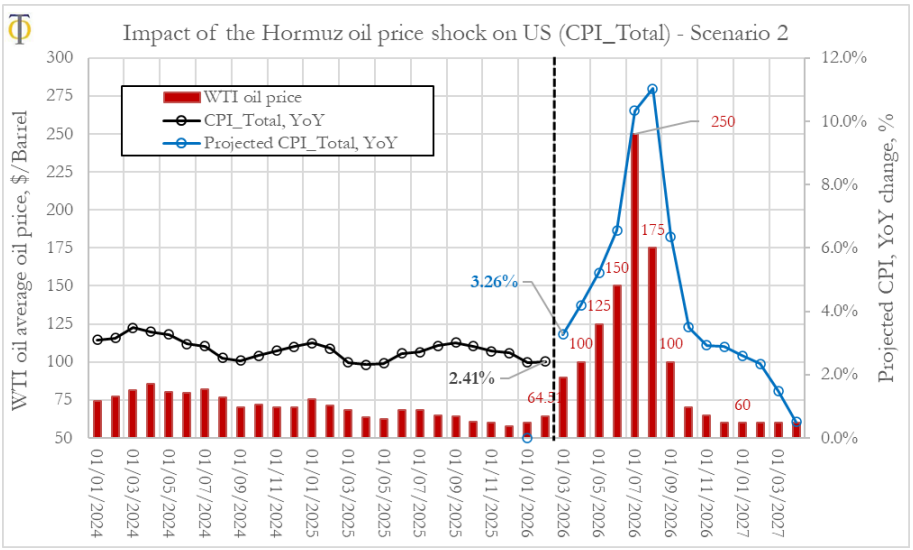

Figure 4 – Scenario 2 (severe) for average monthly WTI oil prices and projected CPI.

Under this scenario, we can observe that on the April 10th CPI release we expect to see overall US CPI rise from 2.41% to 3.26%, which is due to the 90$/barrel average oil price throughout March. As oil prices continue rising, inflation is expected to peak in August at close to 11%. Thereafter, year-on-year CPI is expected to decline sharply reaching a value of 3% by November or December.

In the early months of 2027, year-on-year changes in the CPI is expected to decline close to 0% (and likely below 0% by May of 2027), reflecting the sharp drop in oil prices after peaking at 250$/barrel in July of 2026.

5. What to expect going forward

a) Short-term impact on CPI.

As mentioned above, the spike in average WTI oil prices during March of 2026 will lead to a rise in energy CPI and overall CPI.

We estimate that the next US Consumer Price Index (CPI) data for March 2026, which is scheduled to be released by the Bureau of Labor Statistics on April 10, 2026, will result in a monthly (MoM) rise in energy CPI of about 8.4% (100.8% annualized), and a 14% YoY rise energy CPI. The rise in energy CPI will be accompanied with a jump in overall CPI to about 3.2% to 3.5% (YoY).

Once the inflation numbers are released there will be renewed confusion on the true nature of the ongoing process and the magnitude and duration of the inflation spike.

b) Understanding ongoing developments.

To understand the full extent of the impact on inflation of higher oil prices, we need to monitor ongoing developments in oil markets (independently of the (geo)political rhetoric) and use the two scenarios described above as guidelines for estimating the impact on CPI.

Even in scenario 2 (extreme oil shock), overall CPI will likely peak close to 11% and then quickly revert back to trends prior to the oil shock. We also expect a period of lower than "normal" CPI in early 2027 caused by the reversal of oil prices (and corresponding negative energy CPI).

c) Monitoring core CPI is key going forward.

If the situation in the gulf of Arabia is resolved earlier than that outlined in scenario 1, then, we expect that the rise in oil prices will be quickly forgotten by markets, but YoY inflation numbers will continue to reflect the temporary spike in energy prices during the next 12 months.

Consequently, going forward (until mid-2027), **core CPI** should be the preferred measure to assess inflation trends. We believe this will be the key metric policy makers will be monitoring.

d) Demand destruction and longer-term disinflation trends.

The spike in oil prices arrives at a period when underlying disinflationary trends were working on the economy, as we describe in our report on the outlook for the US economy in 2026[9]. We identify the ongoing risks to the US economy which are both internal and external.

Internally, the weak housing market which has been sustained by the large inflow of illegal migrants from 2020 to 2024 is showing weakness and disinflationary trends. Additionally, the stock market appears to be in a bubble akin to the 2000 bubble, led by AI, which is showing signs of popping in the private credit market. Finally, externally, the impact of the ongoing real estate crisis in China could develop into a global economic crisis. A prolonged oil shock could accelerate this process.

Our report on the outlook for the China's economy in 2026[10] explains the scope and scale of China's problems, and why China is on the verge of entering an acute stage of its crisis. Due to China's size, the spillovers across the globe would be profound.

We expect the deflationary trends described above will be exacerbated by the demand destruction implied by the higher energy prices which act as a global tax on consumption.

e) Monitoring Fed balance sheet to track monetary expansion.

Ultimately, to understand the underlying developments in inflation going forward, apart from tracking core CPI, one needs to monitor closely signs of an expansion in the Fed balance sheet, which then leads to an expansion in the M2 money supply.

The manner in which central banks react to an enduring oil shock, with impact on global supply-chains and global economies, is key to understanding the future path of core-CPI inflation.

Thank you for reading. I hope this post helped clear up the noise instead of adding to it.

[9] https://phinancetechnologies.com/Product_USEconomyOutlook2026.htm

[10] https://phinancetechnologies.com/Product_ChinaEconomy_Outlook2026.htm