Post #27 on Inflation. Impact of the Hormuz oil shock - part 4. Date 2026-7-8

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This is the last update post (part 4) to the 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.

Links to the previous posts[1]: Link to part 1 (2026-4-3), Link to part 2 (2026-5-5), Link to part 3 (2026-6-8)

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 $90.84/barrel throughout the month. This led to a YoY CPI reading of 3.256%.

April oil prices finished the month at 108.64 $/barrel while averaging close to 100.32 throughout the month leading to YoY CPI reading of 3.81% in April. In May WTI oil prices averaged 102.13 $/barrel which resulted in YoY CPI rising to close to 4.25%.

In June, oil prices finished the month near 70.00 $/barrel while averaging close to **85.52** $/barrel throughout the month. According to our model, these values are expected to lead to YoY CPI reading close to **3.7%** in the next BLS release for June of 2026 (on the 14th of July of 2026).

Even though there is still some uncertainty regarding the final resolution of the Hormuz conflict, we are writing this closing post under the assumption that the brunt of the oil shock is behind us, and oil prices will normalize to pre-crisis levels in the coming months. The spillover effects on YoY CPI readings will continue being felt in the coming months, as we explain below.

1. Scenario 1 (moderate) – Short-term oil shock. Designed in April 2026.

In the first post (part 1), published on April 3rd 2026, we outlined a possible scenario for the evolution of oil prices as a consequence of the Iran/Israel/US conflict. Figure 1, shows the scenario, which simulated a short-term shock with moderate impact on oil prices and inflation.

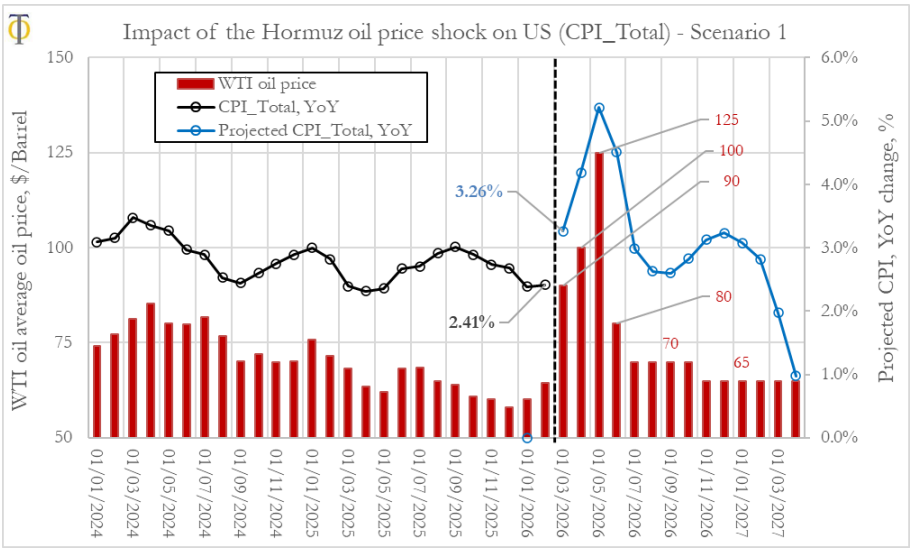

Figure 1 – Scenario 1 (moderate) for average monthly WTI oil prices and projected CPI (2026-04-03).

[1] Direct Link to the PDFs on our website:
Part 1: https://phinancetechnologies.com/content/2026-4-2_Post-22%20-%20Inflation%20Oil%20shock%20-%20Hormuz%20closure%20v1.pdf
Part 2: https://phinancetechnologies.com/content/2026_5_5_Post-23%20-%20Inflation%20Oil%20shock%20-%20part%202.pdf
Part 3: https://phinancetechnologies.com/content/2026_6_8_Post-25%20-%20Inflation%20Oil%20shock%20-%20part%203.pdf

The chart shows the possible evolution of WTI oil prices and overall CPI from March of 2026 until March of 2027. This scenario anticipated a moderate increase in oil prices with the conflict lasting ¾ months. It assumed that WTI oils prices would peak in May 2026 at around 125$/barrel (average oil price) with inflation (YoY CPI) expected to peak in May at close to 5%.

Thereafter, YoY CPI was expected to decline sharply as oil prices normalise to pre-conflict levels, reaching a value of 2.5% by September.

2. Current Scenario on 7/2026 – conflict resolved.

How did our initial moderate scenario compare to actual outcomes?

To compare the original scenario with actual developments we plot the current situation in Figure 2 that shows the actual evolution of WTI oil prices and YoY CPI from March to June of 2026 onwards. It also shows the expected future outcomes for oil prices and the CPI, assuming that the Iran/US agreement that was signed on the 19th of June of 2026 will hold, and oil prices will normalise to pre-conflict levels.

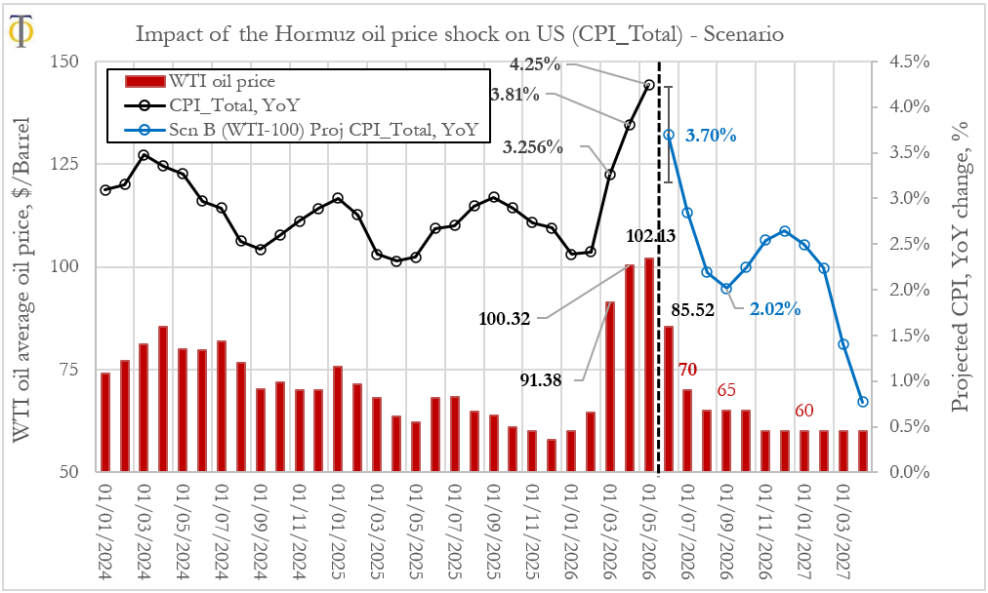

Figure 2 – Current scenario on 26/Jun/2026 showing average monthly WTI oil prices and projected CPI.

We can observe that the main difference between our original scenario, shown in Figure 1 and the actual outcome was that oil prices did not reach 125$/barrel in May of 2026, but instead peaked at close to 102$/barrel. The scenario was correct in assuming the conflict would last ¾ months and would resolve by June.

Oil prices finished in the month of June near 70.00 $/barrel while averaging close to 85.52 throughout the month which according to our model, will lead to an expected YoY CPI reading of **3.7%** in the next BLS release (on the 14th of July of 2026).

From June to September, we expect to see a quick decline in YoY CPI as oil prices normalise to pre-conflict levels, reaching a low value of close to 2.0% in September (see Figure 2).

It should also be noted that in the early part of July, oil prices have been hovering below 70 $/barrel which are better than projected by the scenario in Figure 2. This means that YoY CPI readings will likely decline even faster than anticipated by the scenario and maybe reach below 2% in September of 2026.

From March to May of 2027, year-on-year changes in the CPI are expected to decline close to below 1%, reflecting the sharp drop in oil prices after peaking in May of 2026 at 102 $/barrel. This is simply an artifact of the nature of YoY computations and should not be mistaken by an actual indication of the level of inflation at the time.

3. What to look out for going forward

Unless there is another spark in the Iran/US/Israel conflict, this is the final post in this series of posts analysing the impact of the oil shock on inflation.

Even though the conflict seems to be coming to a resolution and oil prices are close to pre-conflict levels, the impact of the oil shock will impact the YoY reading for CPI until about May/June of 2027. This is due to the simple mathematics of computing YoY changes in prices and using that as a headline reference for inflation.

We estimate that the next US Consumer Price Index (CPI) data for June 2026, which is scheduled to be released by the Bureau of Labor Statistics on August 12, 2026, will result in a (YoY) reading in overall CPI of about 3.7%.

Next, we list some key points to keep an eye on going forward:

a) Monitoring core CPI is key going forward.

With the situation in the gulf of Arabia being resolved in June/July of 2026, we expect that in a few months the rise in oil prices will be quickly forgotten by markets.

From March to May of 2027, year-on-year changes in the CPI are expected to decline close to below 1%, reflecting the sharp drop in oil prices after peaking in May of 2026 at 102 $/barrel. This is simply an artifact of the nature of YoY computations and should not be mistaken by an actual indication of the level of inflation at the time.

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.

b) 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[2]. 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[3] 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.

c) Fed Reaction

We believe that the standard Fed stance of looking through the energy shocks as a transient effect proved to be the correct course of action, as inflation expectations remained under control.

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

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

With the oil shock behind us and YoY CPI expected to decline rapidly in the coming months, towards 2% in September, we think that the pendulum of "inflation/deflation" hype will tend towards deflation. However, as mentioned previously, this will also be misleading as core CPI remains close to 2.7% and should be the preferred measure to assess ongoing inflation.

The other important event that over time will change the considerations when anticipating changes to inflation was the latest FOMC press conference (on 2026-6-17) where the new chair Kevin Warsh presented a key initiative that is aimed at better understanding the underlying factors that lead to changes in inflation as well as inflation frameworks. One of the task forces is aimed at understanding the effects of using the Fed's balance sheet (which started in with the 2008-2009 great financial crisis) on monetary policy and inflation.

In the words of the Fed chairman himself:

"Let me turn now to a few words on a key initiative that we're announcing today. I'm appointing a ***task force in each of five areas*** *that are central to the broad conduct of monetary policy: First,* ***Fed communications****; second, the* ***Fed's balance sheet****; third, our use and reliance on existing data sources; fourth,* ***productivity and jobs in an era of transformation****; and last, the* ***Fed's inflation frameworks****."*

d) Monitoring Fed balance sheet to track monetary expansion.

Ultimately, as evidenced by the recent Fed task forces described above, 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.