Post #23 on Inflation. Impact of the Hormuz (Iran) oil shock – Part 2. Date 2026-5-5

Carlos Alegria, PhD

This post is an update (part 2) to the previous post[1] (Link to part 1) that discusses the impact of the spike in oil prices due to the closure of the strait of Hormuz and the bombing of oil and gas infrastructure in the Gulf states.

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% for March of 2026 in its latest release by the BLS, which was very close to the 3.26% estimated by our model.

April oil prices finished the month at 108.64 $/barrel while averaging close to 100.32 throughout the month, which was was close to the moderate scenario we outlined in part 1 and which we update below. We also discuss the impact of the oil shock on inflation levels going forward and implications for central bank policy makers.

1. Update of scenario 1 (moderate) – Short-term oil shock.

This scenario, shown in Figure 1, 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 April of 2027.

The scenario assumes that average monthly oil prices are $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.

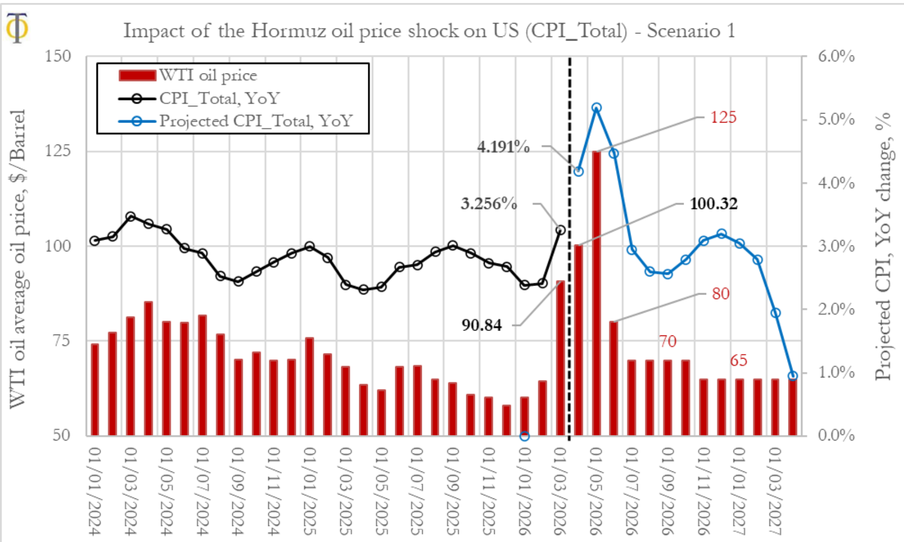

Figure 1 – Scenario 1 (moderate) for average monthly WTI oil prices and projected CPI.

The 90.84$/barrel average oil price throughout March resulted in a large rise overall US YoY CPI from 2.41% to 3.256% on the April 10th BLS CPI release. Under this scenario, we expect to see another rise in YoY CPI to about 4.1% in April of 2026 as average WTI oil prices in April were very close to our scenario estimate of 100$/barrel.

If oil prices continue rising as outlined by the scenario, YoY CPI 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 and close to 2.5%

[1] Direct Link to the PDF on our website: https://phinancetechnologies.com/content/2026-4-2_Post-22%20-%20Inflation%20Oil%20shock%20-%20Hormuz%20closure%20v1.pdf

by September. However, YoY changes in CPI are expected to remain stubbornly high (close to 3%) for an extended period, due to the shock in oil prices.

In March 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.

2. The latest Fed stance

As I discussed in the previous post (part 1), the "standard learning" for the Fed has been to look through energy shocks, but that has been conditional on inflation expectations remaining well anchored. An excellent article by [Jennifer Schonberger at Yahoo Finance][2] 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).

While speaking at Speaking the latest FOMC press[3] conference[4], chair Powell mentioned[5]:

"*At today's meeting, the Committee decided to maintain the target range for the federal funds rate at 3-1/2 to 3-3/4 percent. The economic outlook remains highly uncertain, and the conflict in the Middle East has added to this uncertainty. In the near term, higher energy prices will push up overall inflation. Beyond that, the scope and duration of potential effects on the economy remain unclear, as does the future course of the conflict itself. We will continue to monitor the risks to both sides of our dual mandate.*"

So far, the Fed stance is "wait and see", but as we'll discuss below the stage is set for a "surprise" rise in headline YoY CPI for April, to be released by the BLS on the 12th of May, which will coincide with the change of baton of the Fed chair.

In the next sections we'll explain the delicate situation the Fed (and the markets) will have to navigate in the year ahead.

3. Phinance Technologies model for core-CPI

As shown in Figure 1, headline CPI is expected to remain stubbornly high for an extended period, due to the shock in oil prices and consequently it will be an unreliable measure for underlying inflation. To assess inflation pressures, policy makers follow other metrics, of which core-CPI is the preferred measure. At Phinance Technologies we developed our own models to estimate future changes in core-CPI, for which a brief summary follows.

The inflation model EII (Early Inflation Indicator) targets estimating future changes in core-CPI for time frames of 6 to 15 months. It uses a multi-factor approach that employs different factors impacting core-CPI, such as related to consumer sentiment, economic factors or market variables. Figure 2 shows the relationship between the 12-month EII and future 12-month changes in core-CPI.

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[2] https://finance.yahoo.com/news/how-the-fed-has--and-hasnt--responded-to-previous-oil-price-shocks-090035039.html
[3] https://www.federalreserve.gov/newsevents/pressreleases/monetary20260429a.htm
[4] https://www.youtube.com/watch?v=UR2yFg--1jY
[5] https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20260429.pdf

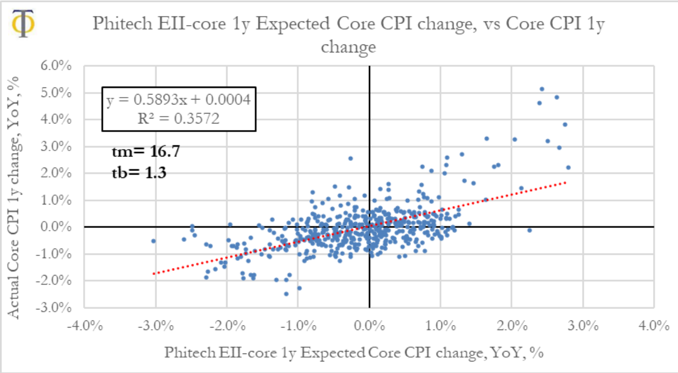

Figure 2 - Scatter plot of 1-year changes in core-CPI versus 1-year expected core-CPI change using the Phinance Technologies EII 1y core-CPI model.

The t-statistic for the slope coefficient of the regression is 16.7 which indicates that the model has a high degree of statistical significance.

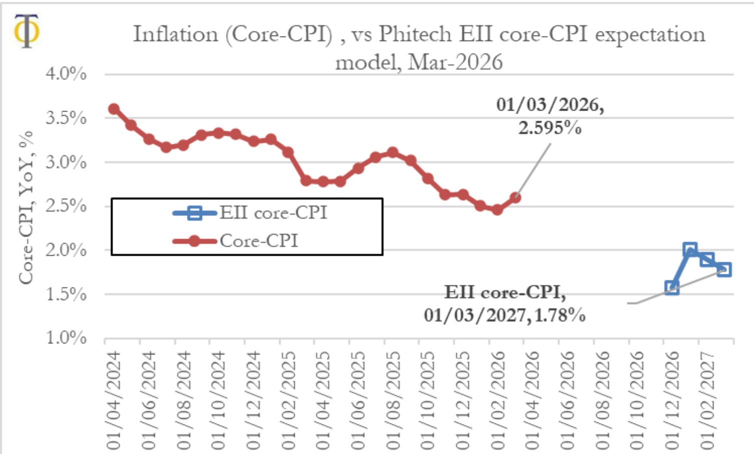

Figure 3 - Evolution of YoY core-CPI and the Phinance Technologies model for 1y core-CPI inflation, on May 5th, 2026.

When using this model to estimate future changes in core-CPI (12 months ahead), we observe that the model is pointing to a core-CPI level of 1.78% by March 2027.

4. What to expect going forward.

Based on the analysis shown above, what can we expect for the upcoming Bureau of Labor Statistics CPI release on May 12? And how can one assess inflation risks for a medium-term time frame of about 12 months ahead?

- Shock in YoY CPI expected for the April 2026 release.

As mentioned above, the spike in average WTI oil prices during March and April 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 April 2026, which is scheduled to be released by the Bureau of Labor Statistics on **May 12, 2026**, will result in overall CPI rising to about 4.1% (YoY) from its previous reading of 3.256% (YoY) in March.

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.

- core-CPI under pressure going forward.

To add to the confusion arising from the rise in overall CPI, the model for estimating future changes in core-CPI is pointing to a strong disinflationary trend for the year ahead. The changes are expected to be manifested as a slow decline over the next year.

In this context, we expect that the next US Consumer Price Index (CPI) data for April 2026, which is scheduled to be released by the Bureau of Labor Statistics on **May 12, 2026**, will result in core-CPI to remain stable or decline slightly.

- Further disinflationary risks (economic crisis).

The spike in oil prices arrives at a period when underlying disinflationary trends were already working on the economy, as we describe in our report on the outlook for the US economy in 2026[6]. 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 appears to be developing into a full-blown economic crisis.

Our report on the outlook for the China's economy in 2026[7] 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.

- 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.

5. Current inflation consensus

The current consensus for headline CPI in April 2026 is about 3.6%, which is very close to the Cleveland Fed inflation nowcasting estimates[8] which point to a MoM (Month-on-Month) increase in CPI of 0.45% and 0.21% for core-CPI. This translates into a YoY (Year-on-Year) estimate for **CPI of 3.56%** and **2.56% for core-CPI**.

In a working paper[9] by the Cleveland Fed that analyses their nowcasting estimates with other models concludes that their estimates are in general superior to other forecasters and is comparable to those of the Federal Reserve Greenbook:

"*In head-to-head comparisons, the model's nowcasts of CPI inflation outperform those from the Blue Chip consensus, with especially significant outperformance as the quarter goes on. The model's nowcasts for CPI and PCE inflation also significantly outperform those from the Survey of Professional Forecasters, with similar nowcasting accuracy for core inflation measures. Across all four inflation measures, the model's nowcasting accuracy is generally comparable to that of the Federal Reserve's Greenbook.*"

[6] https://phinancetechnologies.com/Product_USEconomyOutlook2026.htm
[7] https://phinancetechnologies.com/Product_ChinaEconomy_Outlook2026.htm
[8] "Inflation Nowcasting." Federal Reserve Bank of Cleveland. https://doi.org/10.26509/frbc-inflationnowcast
[9] https://www.clevelandfed.org/publications/working-paper/2014/wp-1403-nowcasting-us-headline-and-core-inflation

For the purpose of this post, let's assume that this statement is "true" and use the latest nowcasting estimates as the market consensus.

It should be noted that other institutions have widely varying levels of estimated inflation, such as the 4.2% expected inflation for US inflation in 2026 by the OECD[10]. However, it should be mentioned that these estimates are broad in scope, referring to average CPI levels across the whole year. As I've explained previously, this is highly misleading due to the calculation of YoY estimates and also the temporary nature of energy shocks. Even if we could see YoY CPI at 5% or more, if scenario 1 above is correct (see Figure 1), the spike will be short lived, with CPI dropping rapidly afterwards.

6. Upcoming drama at the Fed

If our estimate for YoY CPI for April of 4.1% is correct, it will be a shock for market participants and policy makers that currently expect a 3.5%-3.6% reading. Even though, as we mentioned before, in the presence of a temporary energy shock, YoY CPI measures will be highly misleading and market participants should monitor closely trends in core-CPI, we believe that YoY CPI will be headline news in all financial media articles following the upcoming CPI release on the 12th of May.

This will lead to drama at the Fed, at the moment when Kevin Warsh will take the helm as the new Fed chair. While speaking at Speaking the latest FOMC press[11] conference, chair Powell also mentioned[12] the transition to the incoming chair of the Federal Reserve Kevin Warsh on May 15th:

"*After my term as Chair ends on May 15, I will continue to serve as a governor for a period of time, to be determined. I plan to keep a low profile as a governor. There is only ever one Chair of the Federal Reserve Board. When Kevin Warsh is confirmed and sworn, he will be that Chair. Once sworn in as Board Chair, his new colleagues will elect him to chair the FOMC as well.*"

In Powell's statement, he appears to be distancing himself from policy decisions by keeping a "low profile" once the new chair is sworn in. The new chair will be given a "baptism of fire" if our projections for a 4.1% headline CPI level are correct. Market participants and policymakers alike will be confronted by a "surprise" rise in inflation to a level that would likely bring panic to bond market vigilantes.

The new Fed chairman would be in the line of fire of a political storm where the current US administration is facing unsustainable re-financing costs and bondholders would be demanding higher interest rates to protect their purchasing power.

In our opinion the most reasonable course of action would be to keep a "wait and see" stance for a few more months and monitor closely **core-CPI** while playing down the headline CPI measure. At that time, the underlying disinflationary trends in the form of the economic risks to the US and Chinese economies mentioned before would become clear. Additionally, the geopolitical situation in the middle east could be resolved.

It will be interesting to watch the drama unfold and in particular the loudest media and market analysts and participants, that will use the shock for advancing their political or economic aims (never let a good crisis go to waste).

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

[10] https://www.cnbc.com/2026/03/26/global-forecasting-group-sees-us-inflation-at-4point2percent-this-year-much-higher-than-fed-estimate.html
[11] https://www.federalreserve.gov/newsevents/pressreleases/monetary20260429a.htm
[12] https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20260429.pdf