

Our View

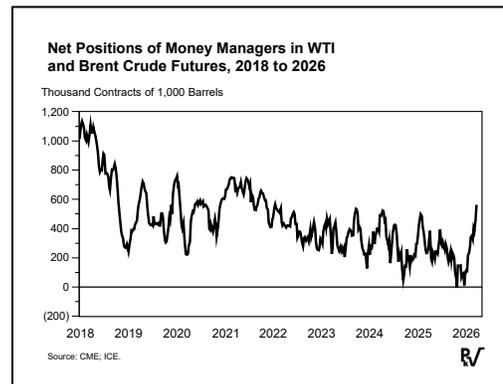
The Worst Energy Disruption since World War II

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Commentators who view the impact of the current energy market disruption as modest are deluded. The economic effects will almost certainly exceed those of the 1973 and 1978-79 disruptions in the US and worldwide. The harm will occur for five reasons.

- First, oil-exporting countries will need increased income to repair their damaged production and export facilities. They have the market power to raise prices and the will to act. They will find ways to delay boosting output while keeping Western politicians mollified.
- Second, the lost refining capacity will cause diesel and jet fuel prices to at least double, if not more. The high product prices will allow refiners to bid crude past current equilibrium levels of \$140 per barrel. We have made this point in previous reports.
- Third, the loss of LNG export capacity, while modest relative to global demand, will require a twofold increase in gas prices. The United States and US energy firms will be the principal beneficiaries.
- Fourth, as a commodity currency, the dollar will strengthen, aggravating the economic impact on European and Asian consumers while penalizing US farmers and manufacturers.
- Finally, proposals that governments intervene by selling oil futures would be a horrible mistake. Increased speculative activity (see figure here) already seems to have added \$26 per barrel to prices. Upward pressure on prices could be dramatically reduced if, for instance, the government required noncommercial traders to post 100% margins against their positions.



The economists simulating the impacts of the disruption in windowless rooms fail to understand many, if not all, of the consequences of this episode.