

Our View

Are Oil Markets Delusional? The Trump Oil Price Discount

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As reported in *Financial Times* on June 2, Robert McNally, the Rapidan Energy Group's founder, believes the "oil market has got it badly wrong."¹ He offered this explanation:

After a moment of panic the market settled into a **delusional expectation** it's all going to end soon, with a stroke of Donald Trump's pen... "Donald Trump's going to realize he made a mistake. He's going to do a deal with Iran. All of that trapped oil is going to flow. The fields will come back."

McNally thinks the market's "optimistic" (or delusional) expectation is "unlikely," stating that prices "could soar in July or August close to \$200," which would be "a level that would force the 'most gruesome and unpleasant form of demand curtailment and a broader economic downturn.'"

Chevron and Exxon have also warned of higher prices when inventories are drawn down, although neither described the market as delusional. Still, one must ask whether that is the case. It is, after all, surprising to hear some of the most ardent free-market supporters assert that supply and demand forces are not pricing oil properly.

In fact, markets are being perfectly rational. Prices today reflect the equilibrium between contemporaneous supply and demand. There is no delusion.

However, current market conditions prevent market participants from preparing for a likely supply decline later this year if the Persian Gulf remains blocked. The backwardation in all petroleum markets makes it impossible for commercial firms to build precautionary stocks, which, were they able to do so, could be profitably sold to moderate the price increases that McNally and others expect.

Prices are surprisingly low given the disruption's magnitude.

Dated Brent remained below \$100 per barrel in the latter part of May after rising as high as \$144 in early April. Viewed in the context of the twenty-two prior disruptions I have identified, prices should be around \$130 now.

¹ Jamie Smyth, "Oil industry faces 'gruesome' demand shock from Iran crisis," *Financial Times*, June 2, 2026 [<https://tinyurl.com/vxp2k8dm>].

Prices fell back from the high April levels when consuming nations released strategic stocks. Another moderating factor was China’s oil imports and use dropping sharply as it released oil from its strategic reserves. Add to that the financial constraints that forced many Asian nations to cut their oil purchases. These actions reduced the magnitude of the Iran war supply cut by nearly twelve million barrels per day. The table presented here summarizes the moderating impact of these factors.

Exxon, Chevron, and McNally pointed out that some of these adjustments cannot continue. For example, incremental supplies exported from the United States will drop. McNally’s suggestion of a delusional market implies that prices should reflect the expectation of a larger shortage.

In making his assertion, McNally should have—but did not—explain why the firms that buy oil, some of whom are likely his clients, are sitting on their hands.

Backwardation is one explanation. Some firms that supply products to consumers would no doubt like to accumulate stocks and profit from the price rise McNally predicted. Because the increase is uncertain, even if McNally is a good forecaster, these companies would probably want to hedge and, in some cases, would be required to do so by their banks. Unfortunately, hedging today locks in a large loss. For example, a McNally client who bought diesel at the end of May and sought to sell forward to November would immediately incur a \$ 9-per-barrel loss due to market backwardation. The loss this transaction would have incurred a year ago would have been perhaps \$1 per barrel.

Few firms can afford to accept such losses on significant product volumes. Instead, as a marketer once explained, when backwardation is like this, his firm sends workers into tanks with sponges to pull out every drop.

Fear of government intervention is a second explanation. Here is where the “Trump Oil Price Discount” comes in. The executives and analysts projecting much higher oil prices seem to expect the US government to operate rationally regardless of market developments. I doubt they really believe the Trump administration will do so, however, especially if gasoline prices head toward \$6 per gallon. As the editors of *The Economist* wrote last month, “Mr. Trump’s administration is already debating a possible export ban.”²

Such an action would likely depress prices in the United States, possibly violently. Oil in tanks would suddenly be worth much less. The risk boosts the incentive to hold no oil. Every US firm in the oil business has every reason to minimize its inventory holdings today to protect against the uncertainties created by President Trump.

Speculators also fear government intervention. Oil futures markets rely on passive investors (speculators) to balance them because there is generally a surplus of firms seeking to sell futures

Supply Factors Reducing the Price Impact of Global Crude Oil Supply Loss Caused by Iran War (Million Barrels per Day)	
Factor	Supply Loss Reduction
Reduction in Chinese Demand	5.4
Increase in US Exports	2.9
Decline in Consumption	2.0
Decrease in Japanese Imports	1.4
Total	11.7
Source: EIG; PKVerleger LLC.	

² “Oil prices could soon rise convulsively,” *The Economist*, May 14, 2026 [<https://tinyurl.com/y8cv3t47>].

to hedge physical holdings. Passive investor buying can lift the market into contango, promoting stock building.

Today, those with plentiful speculative funds have a plethora of options. They can buy oil futures, AI stocks, or invest in SpaceX, to name several. Investors, though, seem to have turned away from oil, possibly fearing that a random statement or action could drive prices down and cause losses.

The conclusion, then, is that the market behavior is entirely rational, not delusional. Prices are low today because supplies remain available. Prices will rise if supplies become tight, as McNally and others predict. Markets will not move in anticipation of tightness, however, because participants lack confidence that government policies will permit a substantial price rise.