



Disruptions to the Strait of Hormuz and Their Significant Effect on the Global Economy

Over the past week, the onset of conflict in the Middle East has illustrated how the global economy is tied in with regional stability. The consequences of military escalations and confrontations, especially with energy-producing countries in the region, have substantial international implications that extend far beyond the Middle East itself. Global markets are immediately affected, especially when important trade passages are involved. In retaliation to the coordinated U.S. and Israeli attacks against Iran last Saturday which set off fresh conflict in the region, Iran essentially closed the vital Strait of Hormuz. The move caused immediate economic consequences, with oil and gas shipping rates soaring. Container ships are now avoiding the waterway altogether amid Iran's threat to fire at any ship crossing the strait. The number of tankers crossing through is extremely limited, with only Iranian and some Chinese ships being able to cross. This closure has halted roughly 20% of the world's oil and gas shipments, causing energy prices to surge, which have caused supply chain issues, and already impacted economies around the world, including in the United States.

The international oil benchmark, Brent crude, jumped by a staggering 13% on Monday, the highest in more than a year. Brent Crude is the primary global pricing benchmark for oil contracts, essentially acting as a "reference price" for oil. Countries use it to set the price of the oil they buy and sell. So, when Brent rises, it signals that supply shortages and the price of oil will change, because oil will be harder to get. Worldwide, this prompts fuel prices to increase, including the price of gasoline in the United States. Since oil is traded in an international global market, even countries who produce a lot domestically still experience the impact on prices and shortages when the Brent figure spikes. U.S. crude prices have jumped before in previous conflicts, like in tanker seizures or drone strikes with Iran, and the stock markets experience short-term volatility as well. Shipping companies and even airlines in the United States were also negatively impacted because fuel is among the most important things in these industries. In the past, when seeing these short-term rises in oil prices, U.S. presidents have applied diplomatic pressure and other forms of regulation to manage oil price spikes. With the Iranian Hostage Crisis for example, President Carter banned oil imports from Iran and applied domestic price controls to lower costs. The objective is to avoid any long-term effects on the economy. In this latest conflict, President Trump has ordered the Navy to protect maritime trade, but it is still uncertain how things will play out.

Historically, the Strait of Hormuz route was used for transporting ivory, silk, and spices. Now, it is the primary maritime trading route for oil and gas from major producers such as Saudi Arabia, Iran, Iraq, UAE, Kuwait, and Qatar. It is also a highly strategic location, connecting the Persian Gulf and Arabian Sea, allowing millions of barrels to pass through each year. About a fifth of the world's oil passes through here, therefore, any disruption impacts oil trade and prices significantly. The strait's narrow geography makes it one of the most important "chokepoints" in the world and there are few alternative routes that are as efficient and capable of handling such large amounts of exports. Thus, should the war persist for a substantial amount of time, Iran's threat to essentially shut down the strait, if long-term, would not only increase the price of oil, but it would increase inflation and slow GDP growth across the globe. Insurance costs for shipping would rise as well and energy importing countries would face supply shortages, especially those in East Asia and Europe. Even in the United States, higher oil prices can affect the cost for consumers, and the Federal Reserve would be under a lot of stress with managing inflation.

Ultimately, the Strait of Hormuz crisis demonstrates how interconnected our global economy has become. A major disruption of such a critical trade route can unsurprisingly have severe consequences for the global economy and affect both financial markets and trade industries. If the shutdown continues, the strain could move beyond short-term spikes in oil and gas prices, and lead to more long-term problems like economic instability, investment reductions, slow economic growth, and wide-ranging trade impacts. As a result, the outbreak of war with Iran may carry with it weighty and lasting economic consequences.