

# WEEKLY ECONOMIC COMMENTARY

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On New Year’s Eve, 1988, the Chicago Bears and the Philadelphia Eagles met in an NFL playoff game. During the second quarter, a dense fog descended on the stadium. For the next two hours, players, officials and commentators struggled with very limited visibility. When the air finally cleared, the Bears had won what became known as “The Fog Bowl.”

Economic players, officials and commentators are presently struggling to see through what is known as “the fog of war.” Uncertainty surrounding the course of conflict in Iran and its impact on countries and commodities is high, making decision-making difficult. That was the backdrop for a long series of central bank meetings this week.

Coming into 2026, forecasters were expecting short-term interest rates around the world to decline modestly. Inflation remains above targeted levels in many countries, but it has been declining from its pandemic highs. Tariffs placed upward pressure on the prices of some goods, but haven’t yet had the inflationary impact that some have feared. Easier monetary policy was on the horizon.

And then, the war arrived, bringing with it a series of supply shocks. While energy is at the center, other commodities have also been affected. Each week that goes by without resolution increases dislocations.

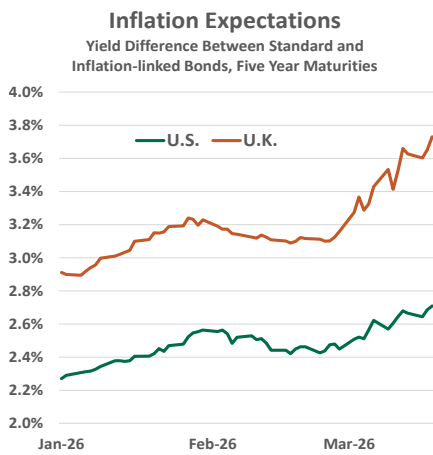
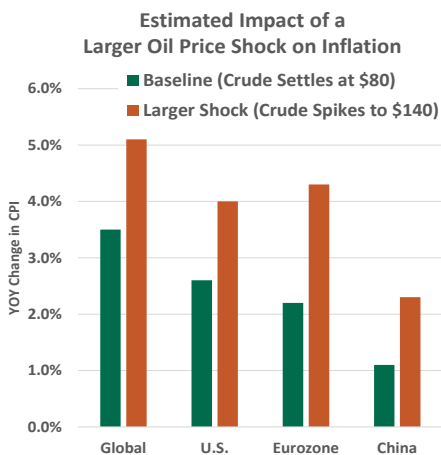
Energy prices are the most direct channel of transmission from the war to economic variables. But the costs of oil and gas influence the prices of a range of goods through the costs of transportation. Insufficient energy supplies could hinder output of a range of products, including microchips. Petroleum is an input to plastic resins, and byproducts of the refining process are used in agriculture and the processing of minerals.

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Sources: Haver Analytics, Oxford Economics, Bloomberg

We are experiencing supply chain disruptions that will take time to correct. Ships find themselves out of position, with downstream impacts to other points in the logistics system. This can add to prices and inflation.

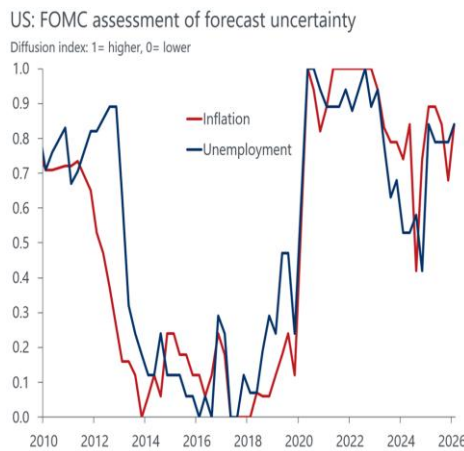
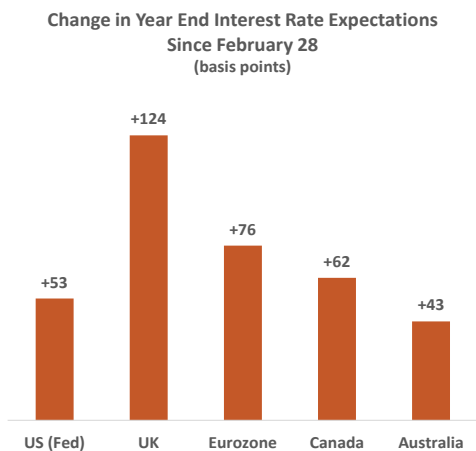
Energy prices also influence expectations. Since the war began, measures of inflation expectations have risen: changes have been more pronounced for Europe than the U.S., and higher for shorter terms than longer ones. Because the psychology surrounding prices can allow inflation to become more deeply entrenched, central banks seek to keep expectations well-anchored.

As a guideline, economists estimate that every sustained \$10 increase in the cost of a barrel of oil produces a 0.2% increase in consumer prices. The impact will tend to fade over time, as prices stabilize at a new level. For that reason, central banks tend to “look through” temporary energy shocks when assessing inflation and setting monetary policy.

While they last, increases in inflation also tend to hinder economic growth. They act as a tax on households and businesses, reducing real incomes and spending. The impact on activity in the United States is expected to be modest; the economy is still being buoyed by the technology investment boom, and this year’s tax refunds will add to disposable income. But for other markets, economic impacts could be much greater.

These opposing influences on inflation—direct upward pressure from commodities prices and indirect downward pressure from slower economic growth—are terribly difficult to balance. Markets have rushed to the conclusion that inflation risk would significantly alter trajectories for interest rates across regions; central banks had their first opportunities to weigh in this week.

**The war will have a series of influences on inflation.**



Sources: Bloomberg, Haver Analytics, Oxford Economics

The formal statement from the **Federal Reserve** expressed that the effects of the war remain uncertain, a theme which was repeated by Chairman Jerome Powell during his press conference. The consensus forecast released after the meeting reflected higher levels of both inflation and inflation risk, which informed the decision to hold rates steady. A majority of the Federal Open Market Committee still sees one rate cut this year, but our view is that it will come much later than previously thought.

The war provided the **Bank of England** a rare window of clarity. For the first time in over four years, the Monetary Policy Committee was unanimous in a decision; rates were held stable, but the group’s messaging warned that rate hikes could be on the horizon. British inflation took longer to

settle down after the pandemic, and inflation expectations in the U.K. are elevated. Markets are now expecting that short-term rates in Britain will be much higher at the end of 2026.

The euro area is likely to experience a fairly significant economic shock, as the war has caused natural gas prices on the continent to more than double. The **European Central Bank (ECB)** reduced its expectations for growth, and raised its projections for inflation. While financial markets are expecting the ECB to raise interest rates later on this year, we think that prospect is less likely.

Across markets, the war has taken interest rate cuts off the table, at least for a while. This will not be a welcome development for governments, who have been hoping that lower rates would ease the burden of servicing national debts. This will be particularly impactful in the U.K., where government bond yields have jumped and where budget tolerances are tight.

The turn of events will also create an additional complication for the succession at the top of the Federal Reserve. Legal issues surrounding the Chairman are delaying confirmation hearings for Kevin Warsh, and his challenge of mediating between the White House and the financial markets on policy has become even more difficult.

The skies over Chicago cleared within an hour after The Fog Bowl ended. Unfortunately, the fog of war that is clouding the global economic outlook is unlikely to lift anytime soon.

## Rough Patch

In the mid-19<sup>th</sup> century, the United States, Spain, Peru, Chile and Bolivia found themselves in a web of hostile negotiations, leading to armed conflict. The disputes all centered on gaining and protecting access to the richest fertilizer then known to the world: dried seabird droppings, or *guano*. While agricultural best practices have moved on to other resources, the Guano Wars teach us that nations are willing to go to great lengths to sustain their crops.

Modern chemical processes can readily create synthetic fertilizers at scale to provide the three core nutrients that plants require: nitrogen, phosphorus and potassium. Each component plays a part in raising healthy crops. Nitrogen is most important for developing strong stems and healthy leaves, especially for grains.

However, those advancements have created a chokepoint. Nitrogen is captured as a byproduct of natural gas extraction. Under high pressure, methane gas reacts with atmospheric nitrogen to produce ammonia, which is then dehydrated into solid urea. This process is only economical to perform where natural gas is abundant; nations in the hydrocarbon-rich Middle East have grown to represent roughly 45% of the world's supply of urea, exporting nitrogen to farms worldwide.

The timing of the attack on Iran has disrupted the global supply chain for fertilizer. Most farms grow one crop per year. Fertilizer is most effective when applied early in the growing season, which is starting now across the northern hemisphere. Chemicals are not reaching the farms that need them today; once plants are established, fertilizers will not be as beneficial. While urea is a stable compound, bulk fertilizers are low in value and costly to store out of the elements. And producers cannot immediately generate alternative nitrogen compounds at the speed and scale required by the planting cycle.

The disruption is similar to the stress seen in 2022 as sanctions were applied to Russian exports. At that time, Russia supplied about 13% of the world's fertilizers, and the announcement of sanctions quickly led the prices of phosphate and potash to rise over 35% each. But the market was already realigning. Sanctions on Belarus a year before had reduced its exports, while China

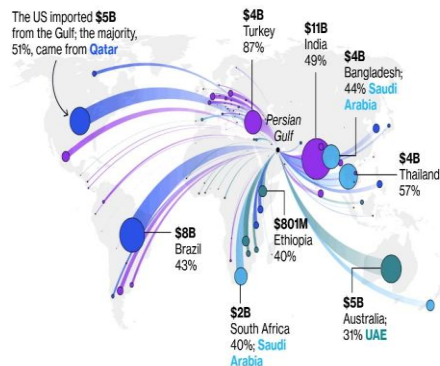
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**The changing interest rate outlook will be uncomfortable for borrowers.**

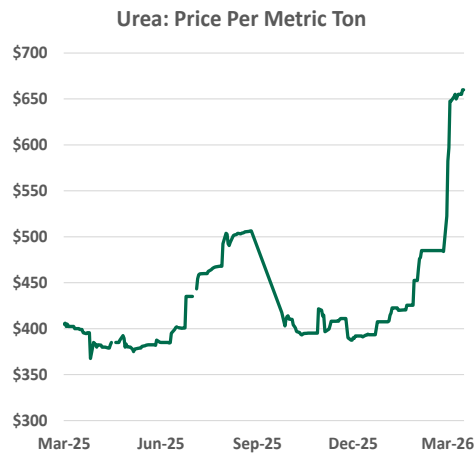
had recently restricted its own fertilizer exports to prioritize its domestic farms. Pragmatism won over principle, as the U.S. carved out fertilizer from its Russian sanctions. The European Union did the same soon after. Today’s supply disruption cannot be ameliorated with a simple policy exemption.

While Qatar, Saudi Arabia and the UAE are significant exporters, firms in India, Pakistan, Norway and the U.S. are also among the top producers of urea. Nations that have a domestic supply will thus have some buffer against shortages. Fertilizer supply chains will not be sufficiently nimble or well-supplied to re-route shipments to all nations that need them. Crops and growers in import-dependent nations like Brazil, Australia, France and Indonesia may suffer the worst effects of this crisis. Some nations are now appealing to China to reconsider its fertilizer export ban.

**Persian Gulf Exports \$50 Billion of Nitrogen Fertilizers Since 2020**  
Imports from Oman, Qatar, Saudi Arabia, UAE, Bahrain and Iran, 2020-2025  
Majority ● Oman ● Qatar ● Saudi Arabia ● UAE



Sources: Trade Data Monitor, Bloomberg



**The global food supply depends on fertilizers.**

The food economy – indeed, the size of the human population – depends on ready availability of fertilizers. A shortage will not halt farmers from sowing seeds, but crop yields are likely to be lower than normal. We will set our expectations for higher food prices in the year ahead. The Iran attack will add to food and energy prices just as policymakers are struggling to tame a rising cost of living.

The Guano Wars reached their nadir in 1865. Following attacks on U.S. guano-mining vessels, Congress authorized a deployment of the U.S. Navy to protect U.S. claims over uninhabited, fertilizer-rich islands. Gradual de-escalation came through a series of treaties negotiated over a span of decades. History may soon repeat itself, through military protection for agricultural cargo ships...or renewed interest in some unconventional fertilizers.

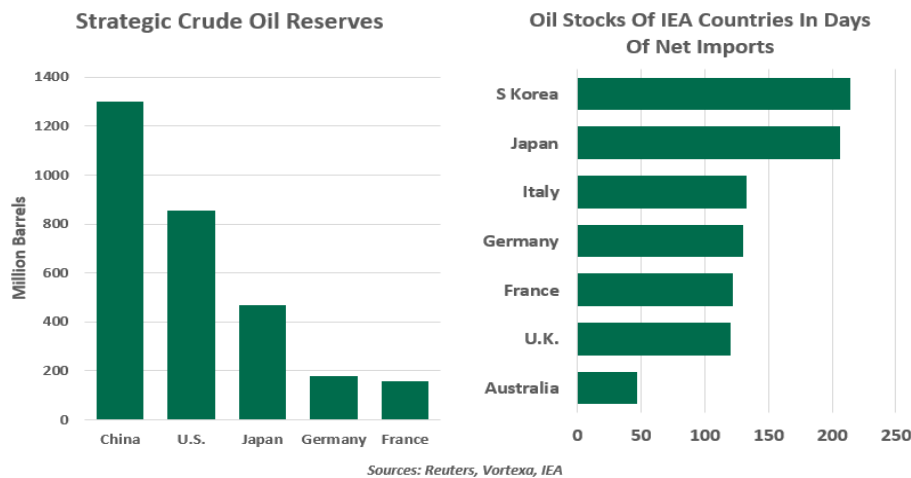
**Buying Time**

The ongoing Middle East war has once again underscored oil’s strategic importance. Vital resources warrant buffers against disruptions in the form of a strategic reserve. These stockpiles are designed not to manage prices day to day, but to insure against sudden or temporary supply disruptions. Unfortunately, not every nation can create this kind of insurance.

China is estimated to hold the world’s largest strategic oil reserves at roughly 1.3 billion barrels. While China is not a member of the International Energy Agency (IEA), the combined emergency stockpiles of the IEA’s 32 member countries are broadly comparable in size. In addition, around 600 million barrels are held by private industrial firms, which are under government obligation across IEA nations.

Within the IEA bloc, the United States maintains the largest public backstop. The Strategic Petroleum Reserve (SPR) currently holds about 415 million barrels, around 60% of capacity, after heavy drawdowns following Russia’s invasion of Ukraine. This is supplemented by roughly 439 million barrels in commercial inventories. Japan, South Korea and some European economies maintain public and industry-held stocks calibrated to meet the IEA’s 90-day import coverage requirement. India, the world’s third-largest oil consumer, holds about 100 million barrels in strategic and commercial petroleum reserves, enough to cover roughly 45 days of import volume.

With energy flows severely disrupted by an effective blockade of the Strait of Hormuz, attention has turned to coordinated releases. IEA members have agreed to release roughly 400 million barrels from emergency stockpiles, the largest drawdown in the agency’s history. The U.S. is expected to lead with around 172 million barrels, while Japan plans to release roughly 80 million.



**Strategic reserves are not a solution to sustained scarcity.**

A 400 million barrel release sounds large, but it would replace only about 20 days of the 20 million barrel per day disruption tied to the conflict. Even at maximum capacity, the U.S. SPR can release about 4.4 million barrels per day, with oil reaching markets about two weeks after authorization.

While it may seem intuitive to offset these limits by holding more strategic reserves, doing so is far from straightforward. Reserves require large upfront investment, storage, maintenance and eventual replenishment. Not all nations can afford them.

Strategic reserves are most effective at soothing markets and buying time, not at filling a sustained supply gap. In the case of the Iran war, stocks won’t be able to compensate for lost flows.

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