

# Trump's Oil War sets fire to his Own Economy

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US President Donald Trump has provided multiple and often conflicting reasons to explain why he joined Israel in attacking Iran and assassinating its leadership without provocation. Since those reasons are obviously untenable, the attack can only be read as brute militaristic aggression driven by a desire to win popularity at home and arrest the decline in the US' global status. However, that project has failed rather quickly.

The failure is at multiple levels. First, the expectation that the operation against Iran would be as smooth, even if more violent, as the attack on Nicolás Maduro's Venezuela has been belied. Not only have Iran's rulers anointed a new Supreme Leader but the country has also shown no signs of imploding. On the contrary, in the three weeks (and counting) into the war to force "regime change", an over-bombed Iran has not just stood firm but pushed back powerfully. The US is shown as being vulnerable, and Trump's social media arrogance, a bad and costly joke.

Second, Iran's response has not only resulted in military losses for the attackers who fear putting "boots on the ground" but inflicted damage across the Gulf countries that host US bases. Trump's statement on March 16 was revealing: "They hit Qatar, Saudi Arabia, the UAE, Bahrain, Kuwait. Nobody expected that. We were shocked."

Iran's response to an unprovoked attack has economically destabilised the whole region, frightening expatriate businesses and migrant workers, disrupting air traffic, and undermining tourism. Elements crucial to the Gulf countries' strategy of diversification away from oil-revenue dependence are being challenged. In time, the Trump administration will be seen as solely responsible for that destabilisation through its unilateral and unwarranted action.

Third, Trump's plan to make Iran's oil-revenue dependence its Achilles heel by imposing sanctions on trade is being paid back by Iran. By attacking oil facilities in other countries in the region and by the near closure of the Strait of Hormuz, Iran has adversely affected global oil supplies, triggering profit-hungry speculation by transnational firms that dominate trade in oil and oil products and setting off a spike and volatility in oil prices.

Fourth, faced with the ignominy of having roiled the oil markets through his unilateral action, Trump decided to roll back the sanctions he had placed on imports of Russian crude and oil products by third countries, delivering windfall gains to Russia and tearing up his plan to force Russia to end its war in Ukraine and come to the negotiating table with no (or minimal) conditions.

Finally, the view that the energy self-sufficient US economy would not be as adversely affected as the rest of the world by the bottlenecks to oil supply and the spike in oil prices is proving to be a myth.

A major shock to the Trump administration was clearly the speed and extent of oil price increases, with benchmark prices having strayed upwards of \$100 a barrel. Following the first attacks on Iran on February 27, the price of the benchmark Brent crude rose 36 per cent by March 9, with the West Texas Intermediate (WTI) variety rising by 41 per cent. Such large and rapid increases are not explained by actual demand-supply imbalances. There are enough

reserves around to weather an immediate halt in production and shipping, and the dominant opinion initially was that the war would end soon. Prices spiked because of the stranglehold of a few large firms—like Vitol, Trafigura, Glencore, and Gunvor—on the global physical trade in oil. That stranglehold facilitates and encourages speculation to push up prices and garner superprofits.

The role played by speculation came through in the sharp downturn in prices in a single day based on Trump's claims for the first time that the war would end soon and the prices of oil would return to pre-war levels. On March 10, the increase in the prices of the Brent and WTI varieties relative to the day before the US aggression came down to 21 and 25 per cent, respectively, from 36 and 41 per cent the previous day. But it did not take speculators much time to recognise that their assessment was wrong, pushing prices higher once again, with the price increase relative to February 27 on March 13 at 41.5 per cent and 47.3 per cent for Brent and WTI, respectively.

The role speculation plays was also evident when the International Energy Agency's decision to release 400 million barrels of crude from strategic reserves had no effect. Speculators read that as a signal that governments had taken the potential for price increases seriously, judged that such action would drain the emergency reserve, and concluded that the oil market turmoil would be less transient than was first expected.

### **The war's impact on inflation**

The greater shock for Trump was that the damaging impact of the oil price increase was severe on the US as well, although his country does not face shortages of oil and oil products. Private firms ruling the trade have raised domestic prices, with the all too visible and sensitive "price at the pump" for automobile owners rising as well.

Moreover, with oil being an intermediary in the production of a range of commodities and driving the cost of transportation, oil price increases are pushing up prices of almost all commodities. The war has also impacted shipping, disrupting supply chains, undermining production, and raising costs. Hence, the war's impact on inflation is far greater than the immediate increase in petroleum and oil product prices.

But these are the general price effects of the war- and speculation-induced oil shock. There are specific areas of concern such as hydrocarbon-based fertilizers, whose prices have risen and will rise further before the imminent planting season. This could dent farmers' support for Trump and the Republicans before the all-important mid-term election in November.

Inflation, by eroding real incomes of households, is expected to reduce discretionary spending of households, affecting first the retail sector and then those supplying the goods in the consumption basket. In anticipation, exchange traded funds tracking share prices of firms in the retail trade have lost around 10 per cent of their value over the last month.

With no clear signs of an end to the war, fear of a not-so-transient inflation has also gripped US markets. It does not help that the market sees Trump's Budget Bill as leaving a gaping hole to be financed with debt, which is perceived as inevitably inflationary.

The next step is likely to be a spike in policy interest rates by the Federal Reserve in an effort to dampen price increases. With labour markets cooling before the attack on Iran, the Federal Reserve had been rethinking its stance on reducing interest rates. Now, there is likely to be a

return to interest rate hikes instead. That would affect the bond markets, with bond prices falling, and would require unwinding of financial market bets placed by borrowing cheap to invest in equity.

Decades of loose monetary policy and years of near-zero interest rates in the US had triggered a speculative boom in financial asset markets. And real economy growth, even if moderate, rode on this bubble. The after-effects of the unilateral war threaten to unravel that speculative boom. By March 13, the S&P500, in a trend indicative of the mood in Trump administration-favoured stock markets, had fallen by 3 per cent over the month. The slump in stock markets too could set off damaging real economy consequences with effects on those who derived no benefits from the financial boom. Stagflation is the new threat that is denting Trump's popularity even further.

With the November election not far away, Trump having ignored the US' vulnerability is caught in a situation from which he struggles to extricate himself. That explains the desperation with which he has demanded that allies, including the UK and Europe (and even China), join US efforts to provide protective naval escort carriers to restore tanker traffic through the Strait of Hormuz. Despite threats of action if they do not comply, his demand has been turned down. Not everybody wants to be the victim of Trump's bravado.

With only Israel as partner in war, Trump is trapped. Rather than make America great again, he is showing how vulnerable the US is.

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