

FALLING OIL, RISING CRACK SPREADS: WHY INFLATION STAYS ABOVE TARGET

October 2026

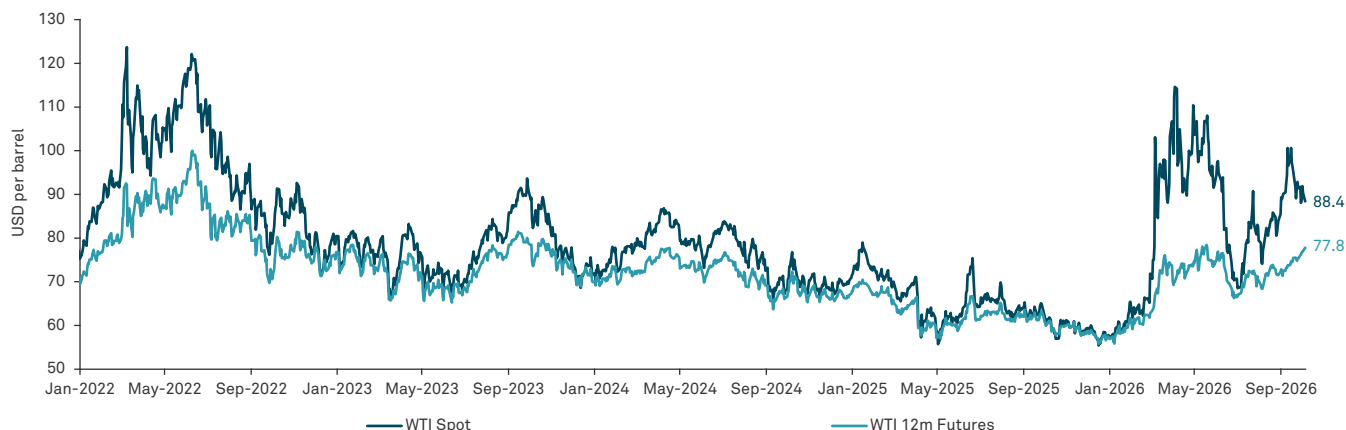
After eight months of conflict in the Middle East, elevated crude oil prices remain a noticeable source of market concern. Ceasefire opportunities have faded, embargoes and shadow tanker fleets are now a routine feature of oil flows through the Strait of Hormuz, and the threat of sizable near-term supply disruptions persists. The latest spike in crude prices follows attacks on Saudi Arabia's East-West pipeline and Iran-allied Houthi militia threats to disrupt oil shipments through the Red Sea.

Crude Prices Point Toward Normalization

Longer-dated (12-month) oil futures prices have not risen as sharply as front-dated contracts — or relative to previous geopolitical conflicts — and signal some degree of normalization in energy markets. This is because long-dated futures prices are considerably lower than their 2022 peak (during the Russian invasion of Ukraine) when it reached \$100/barrel (spot price > futures price = backwardation). Put simply, markets see less risk of widespread damage to long-term supply, an assessment we share. We expect a workable resolution of, or diversification away from, the Hormuz bottleneck.

West Texas Intermediate (WTI) Crude Price - Spot & 12th Month Futures

WTI spot prices are trading at a substantial premium over 12-month futures which remain considerably lower than its peak levels in 2022 (Russia-Ukraine conflict) highlighting a relatively lower risk of long-term supply disruptions.



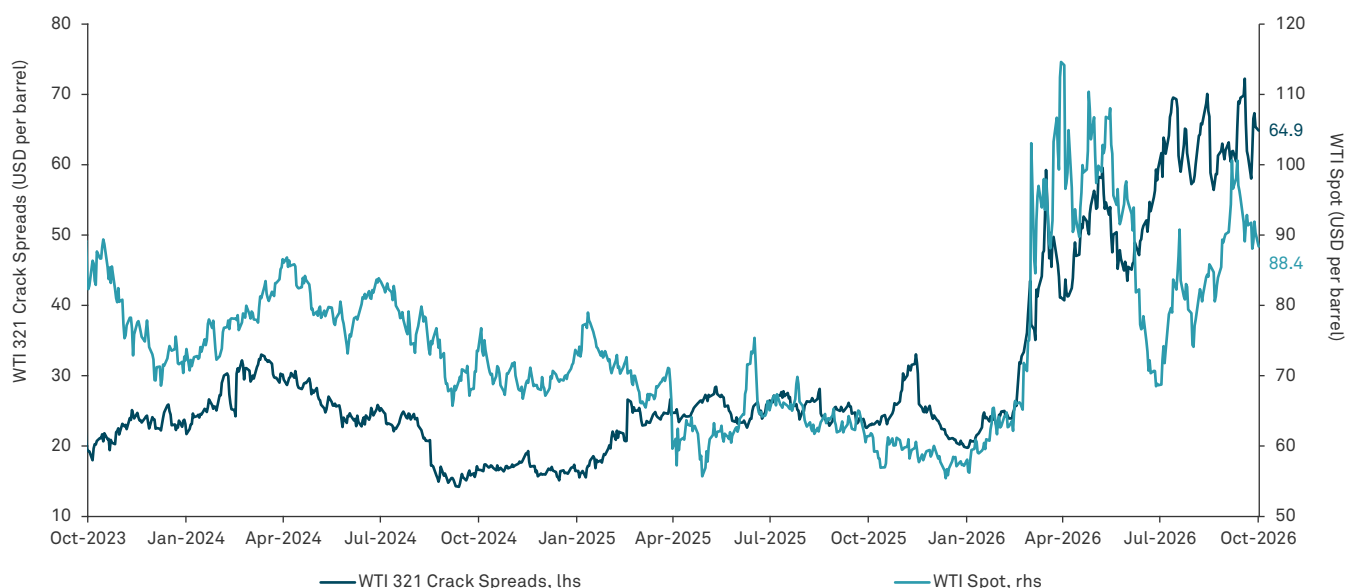
Source: Data as of October 6, 2026. Charts are for illustrative purposes only.

The Crack Spread Disconnect

Even so, despite our base-case expectation that crude prices will normalize in roughly 9–12 months, the U.S. could still feel the lingering effects of energy costs. The main reason is that refined product prices (crack spreads vs. crude) have kept rising even during periods when crude prices fell. This breaks from historical experience, where changes in crude oil prices have mostly explained price changes in diesel and gasoline.

WTI Crude Oil Price vs Crack Spreads

Diesel prices have trended considerably higher, than levels implied by WTI spot - highlighting shortfalls in refined product supply.



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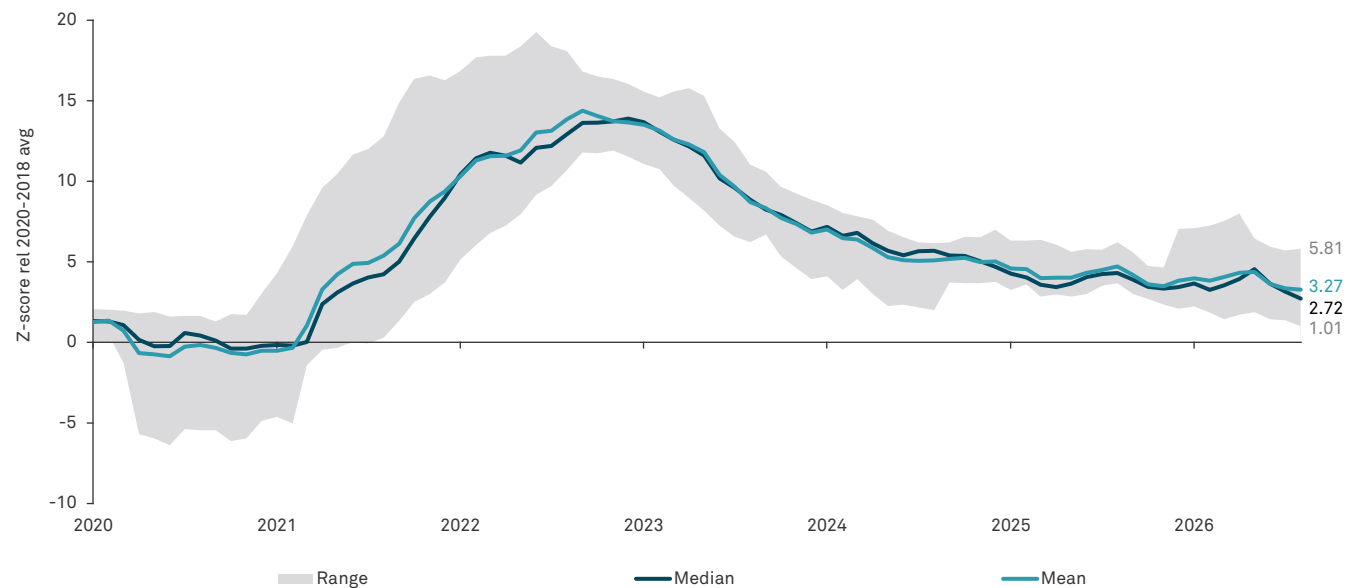
The main reason crude prices and crack spreads have decoupled is tightness in refined product supplies, driven by disruptions to global refining activities (e.g., Ukrainian drone strikes on Russian refineries, Chinese export controls on refined products, and disruptions in the Middle East supply disruptions). As a result, U.S. distillate inventories are 14% below their five-year average and gasoline inventories 6% below. Imports to the East and West Coasts have run 32% below their five-year average since the conflict began, leaving diesel and gasoline prices at the pump elevated and unlikely to ease quickly with implications to inflation perception and potentially broader prices.

Why the U.S. Is Different

The U.S. economy has two other features that could keep trend inflation elevated. First, like many developed economies, it has become less energy intensive, which softens the growth hit from an oil price shock. Second, unlike Europe or Japan, the U.S. is now a major energy producer. As a result, higher oil prices support activity in oil-producing states and could fuel firmer employment. The demand-driven inflation effect is particularly visible in housing: per the U.S. Federal Reserve (Fed), home prices in energy-producing states rise about 2 percentage points in the year after an oil shock.

US: Measure of Trend Inflation

Trend inflation, a measure of inflation persistence, remain above the Fed's target and closer to 3%



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Overall, an oil price shock may hurt U.S. growth less than in prior decades, thanks to the economy's lower oil-intensity. But it can still keep core inflation elevated through prolonged high crack spreads and relatively stronger domestic demand in oil-producing states. The inflationary impact of oil shocks also depends on the initial macro conditions. Oil shocks tend to be more inflationary when inflation expectations are high, labor markets are tight, fiscal policy is loose, and real policy rates are low. Right now, the U.S. economy checks some of those boxes.

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