

EconoFact Chats: The Economic Consequences of the Iran War

Binyamin Applebaum (New York Times), Nicholas Bloom (Stanford), Michael Klein (EconoFact) and David Victor (UC San Diego)

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Michael Klein

I'm Michael Klein, executive editor of EconoFact, a non-partisan web-based publication of The Fletcher School at Tufts University. At EconoFact, we bring key facts and incisive analysis to the national debate on economic and social policies, publishing work from leading economists across the country. You can learn more about us and see our work at www.econofact.org.

Clark Merrifield

Welcome everyone. I'm Clark Merrifield, Senior Editor at the Journalist's Resource. Thank you for joining us for today's webinar co-hosted with EconoFact out of Tufts University on 'The Economic Consequences of the Ongoing War in Iran.' Our panelists today are Binyamin Appelbaum, lead writer on economics and business for the New York Times editorial board, Nicholas Bloom, the William D. Eberle Professor of Economics at Stanford University, Michael Klein, the William M. Clayton Professor of International Economic Affairs at Tufts University, and Executive Editor of EconoFact, and David Victor, Distinguished Professor of Innovation and Public Policy at the University of California, San Diego. Binyamin will discuss how the conflict began and where it stands, followed by David on the effects on oil supply, Nick on economic uncertainty stemming from the war, and finally, Michael on other macroeconomic effects. That's it for me for now, we're gonna jump in. Binyamin, we've entered week three of this war. If you could just summarize briefly, how this conflict began...what do we know about why the U.S. started this?

Binyamin Applebaum

So the big picture, which probably is familiar to most of you, is that on February 28th, the United States and Israel launched airstrikes against Iran for the second time in the last 12 months. Those airstrikes continue now, we're now in the third week of airstrikes, and Iran has responded with its own aerial assaults, as well as with interventions in the Strait of Hormuz, through which a significant portion of the world's oil flows to markets and consumers. It's a mess, basically, and we can talk more about the economic dimensions of the mess, but geopolitically, we are now in unprecedented territory. We've got multiple nations in the Middle East under attack, feeling tremendous strains on their economies and on the safety of their civilian populations, and no clear way forward. The United States has not particularly articulated what its goals in this war are. President Trump at various times has talked about desiring regime change in Iran, about wanting to prevent Iran from developing a nuclear weapon, but it's not clear how he intends to get there, or how we'll know when he's gotten there. And so we're in this strange situation of being passengers on a train without a clear destination.

Clark Merrifield

Great. Thank you. David.

David Victor

Sure, thank you. It's great to be with you today. I guess today's event is sponsored by the word mess, because when you look at the oil markets, it's the same situation. I'll say two things about it. First is just the size of the disruption is massive, widely reported, biggest in history. I mean, it's volume and time. Up to 20 million barrels a day are typically flowing through the Straits of Hormuz. And the time so far, we're 20 days in, so that's up to 400 million barrels—that's the size of the releases that have already been announced from the...coordinated releases from the Strategic Petroleum Reserves around the world. So that gives you a sense of why the markets didn't immediately calm down when they saw these releases. In the real world, we haven't lost a full 20 million barrels per day. Some cargos are still going through the straits. There are ways of getting oil around the Strait of Hormuz. And there'll be, after this, a big kind of doubling down on these alternative exit strategies, but that's not the situation today. So that's the first point, is just the size of disruption is enormous. Second is about the markets themselves. Tremendous volatility in oil prices, and I think for two reasons. One is the markets don't really know who to believe. Because of all the things that Binyamin laid out, there isn't really reliable information about what we're doing, what we've actually damaged, what the other damages are in the region, and so on. And there hasn't already also been a serious program to plan for the aftermath of this, or even the running of the war. Normally, you'd build up and you'd work on what the minesweeping operations and escort operations are going to be. You'd work on coordinated releases in advance to send a signal to the market, you'd work on all kinds of other things. And basically, as far as I can tell none of that happened. And so they're playing catch-up, and nobody really knows what to believe. And so the possibility that large volumes could be absent from the global markets for even longer than we've seen, a lot longer than we've seen...that's what's really spooking the markets right now.

Clark Merrifield

Thank you, David. Nick?

Nicholas Bloom

I was going to pick up on a topic that Binyamin and David already raised, which is uncertainty. So weirdly, I started my PhD on uncertainty 30 years ago. So I've been studying this for a long time, and the first thing to point out is, it's damaging. You can imagine that higher uncertainty leads firms to pause on hiring. They're not going to hire new people if they don't know what's going to happen. They pause on investment, and particularly on research. This thing can take a while to show up. I'll give you an example, which is Brexit. Brexit happened in my homeland. You can probably hear I'm British. Initially, you didn't see a lot, but after 10 years, the Brits are about 5% poorer in terms of GDP. It's about \$3,000 per person, which is huge. Come to think of

it, it's like having some part of a house extended, it'd be like using super cheap timber in it. You might not see a problem in week one, month one, year one, but at some point it's going to show up. So I think this is kind of a festering, long-run issue. There are two problems about uncertainty around Iran – one smaller picture, one bigger picture. The smaller one, Binyamin and David covered very well, which is, we have just no idea what's going to happen. I mean, is this thing going to last for another week, a month, a year? Is it going to be regime change? What's even happening right now? You've seen from examples like Syria, from Iraq, from Afghanistan, these things can take years to play out, so I think we're in a total fog. The bigger picture is Trump himself, and the current administration is just a massive generator of uncertainty. Somebody said he's a one-man uncertainty machine. And you just see this and all these measures of uncertainty, they spiked in early 2025. They just remained incredibly high. Now, from talking to folks, there's a few theories out there. One is, look, this is how he ran his businesses in real estate and in entertainment...that you keep the other side guessing, you continuously change your mind. His 'art of the deal' thing is you just want to kind of leave everyone else unprepared, so we should be expected to see more of this. We've had ICE raids, and the Liberation Day, and the threats on Greenland and Venezuela, and now Iran, and so this thing is going on. Another more cynical claim I've heard is that he wants to keep the Epstein files off the headlines, that's like kryptonite for his base. And so either way, what we've seen is just over a year now of continuous uncertainty, and I think we're going to see this going on. Why is this a problem? Well, it is already starting to damage labor markets. So if you see in the US, that's what's been called the 'great hesitation,' because hiring rates are well down. And a big driver of that is business is just uncertain. And I think if this continues, we're going to see a speed reduction on the US economic growth.

Binyamin Applebaum

I was going to say...uncertainty is clearly a key theme here, and one we should talk more about. There's also the certain stuff that's happening in the short term. And I think airlines are a really useful microcosm for thinking about the short-term economic effects of what's happening in the Middle East. They're visible, you can see the units moving around, easy to measure, et cetera. And we're seeing three discrete phases so far. The first is that a bunch of economic activity is just not happening because of the war. Those are the flights that have been grounded, thousands of flights, at some of the world's major airline hubs, and that's playing out in other economic areas as well. The second is, you're starting almost...within a few days after the conflict began, you saw airlines beginning to reroute flights around the conflict zone, around the affected airports, a revival of economic activity, but that economic activity happens at greater expense. You can see on a map that the routes are being bent and every mile in the air costs money. The price of fuel has gone up, and so economic activity is resuming, but at a higher cost. And then the third phase, which has already begun, is the adjustment phase, as the economy begins to figure out new ways of doing things. And I thought it was interesting already, last week you saw airlines like Lufthansa and Qantas, which are not reliant on those Middle East hubs, adding flights to their

schedules to connect Europe and Asia. Most traffic between Europe and Asia now flows or had flowed before the war through these Middle Eastern hubs, and you're already seeing airlines on either side of that equation beginning to adjust and plan for a world in which that's no longer true. I think you can map all three of those kinds of things onto a lot of other economic areas, even before you begin getting into the question of what the long-term effects are going to be.

David Victor

I mean the big uncertainty is about how long this goes on and how much disruption we have for seaborne travel, and we'll talk about that. The really big question is how much damage is being done to the infrastructure, and that's important because of the export potential. So, for example, here we are on a Monday. Over the weekend, there were, from President Trump himself, reports about the damage that we did to Kharg Island. Not clear how much damage has been done there, that's the dominant export hub for Iranian oil. And you know, like Iran or not like Iran, Iranian oil is an important part of the global market. And so there, it seems like more damage is being done for the long term. Meanwhile, a lot of the infrastructure seems to be in reasonably good shape. For example, the Qatari's shut down all their gas operations as a precautionary measure, also, because there's no place for the LNG (liquefied natural gas) to go. That should be relatively easy to restart with minimal damage, and that 20% of global LNG supply will come back online as soon as the ships have a way to get to and from Qatar. So I think this is a tremendous amount of uncertainty about what the longer-term picture looks like after kinetic operations.

Michael Klein

Speaking of uncertainty, you know Nick mentioned that he wrote his dissertation 30 years ago. I started studying economics almost 50 years ago. This was in the 1970s when we were faced with a supply shock. And macroeconomics had to sort of come to terms with this, and what we learned was that supply shocks are really hard to deal with, because usually you think of monetary policy trying to raise rates in order to fight inflation, or lower rates to try to fight unemployment, but a supply shock affects both of these. Oil isn't the only supply shock now. Tariffs are a supply shock for the United States and other countries. The cutoff in immigration is a supply shock for U.S. labor markets. The uncertainty is like a supply shock, and these things also have a demand shock aspect to them as well. The rise in oil price is like a tax on people's ability to spend, as are tariffs. So, what we're seeing is that the economy had not been doing great in February...before the 28th, before the invasion, the inflation rate was still well above the Fed's target of 2%, it was 2.8%. The unemployment rate was 4.4%, and these numbers are going to get a lot worse once we get accurate numbers for March. The Fed is in a real bind, and it's not only in a real bind because there's a supply shock, it's in a real bind because there are real concerns about the Fed's independence. The independence of a central bank is a very hard-fought thing to obtain, and it's very important. And up until recently, the Federal Reserve and many other central banks had gained a real element of independence, which made their jobs easier, because if people expect inflation to be lower, that helps keep inflation lower. But now, with all of the attacks on

the Federal Reserve, and the nomination of Kevin Warsh and the concerns that he's going to do the president's bidding, inflation expectations have been rising anyway before the oil price shock. Now this is going to contribute to it. So central banks tend to look through energy price shocks because they think of them as temporary, and try not to respond too much to those. Here, there is the uncertainty about the length of the war, the uncertainty about what will happen to oil prices, the uncertainty about the Fed, the uncertainty about what's happening with immigration – how a lack of enough workers could lead to rising prices. So this is an incredibly challenging time and the Federal Reserve is going to be faced with some really difficult choices to make in the next half year or so.

Clark Merrifield

Uncertainty is not something that markets like, and people want to have at least some idea of what the risk is moving forward. The question is, can you suggest a timeline of economic impacts we might look for if this conflict continues to go on for two weeks or a month or two months or even longer? What are those impacts as this drags out for weeks and weeks, or even months?

Nicholas Bloom

So already we've heard from the panel. Binyamin, for example, talked about airlines, things that are happening here and now. So I'll talk about uncertainty, and I'll talk about one other big one. So uncertainty, the best analogy is actually Brexit. We have a very clean event study there. And everyone thought Brexit would be a disaster at the time. It wasn't, actually. Nothing that bad happened, and the economy chugged along. What you see is 10 years later, in fact, it's almost 10 years after the vote now, there was a big loss in GDP. And it's because a lot of longer run investments in particular get paused. So firms thinking, well, we'll do this R&D program, we'll build this new factory, let's just wait and see. And so that tends to accrue over time. The other area that oddly I worry about, and has been really the saving grace for the US economy is AI. And just to explain a minute...just to backstop, there's been a number of headwinds in the US right now – less immigration, trade has been harder, there's been higher uncertainty, but AI has been driving a lot of what the growth we've seen directly and indirectly. And the issue for AI is that the oil price spike is putting up energy prices pretty sharply, and it hasn't quite immediately...feed through. AI is an incredibly energy-intensive technology, way more than any others. And indirectly, there's also political pressure now building in the US to regulate it. You've seen Bernie Sanders has been demanding the end of data centers. If energy prices go up, you can follow the dots. There's more political pressure to push back on AI and its energy use. And that could be another big issue for US growth, actually, I could see coming reasonably soon.

Michael Klein

On the uncertainty issue, we used the index that Nick and his co-authors put together, and Nick mentioned the spike in uncertainty at the beginning of Trump's term. What we found in a memo

that we published in EconoFact is that when uncertainty spiked, typically what happened is the dollar strengthened because it was seen as a safe haven. The two periods where that did not happen, when uncertainty spiked, the dollar actually weakened, were the first four months of Trump's first term, and the first four months of Trump's second term. So this also speaks to concerns about what could happen to financial markets, something we haven't yet really brought up, but there are a lot of concerns now about risk premium in financial markets...people talking about private credit being a real threat, and something that we can't really recognize because a point was made that when companies go bankrupt, it becomes public knowledge. With private credit, there's a lot of behind the scenes things going on to lower the interest payments, or add interest payments to principal or something like that, so there could be a lot more distress in private credit than is evident.

David Victor

Just briefly on the AI dimension, it's really interesting. This is a reminder that in some ways the situation in the United States or North America is quite different from the rest of the world. Our price of oil, and therefore the price of things that people see on a regular basis, gasoline, for example, jet fuel, comes out of the global market. Our natural gas prices, though, are very different because of the horizontal drilling and fracking revolution. So, natural gas prices in the United States are about \$3 a million BTU. They've bounced around at 10 times that level in Europe because the Europeans are very dependent on imports of LNG from the United States. And some of those imports are going to be drawn to Asia as basically the Qataris production that would have gone to Asia is not available. So for a lot of the world, gas itself is coming out of a global market, not quite as fluid as the oil market. United States, not yet. A growing fraction of our gas is being exported as LNG. So eventually there'll be a tighter coupling between US gas prices and global gas prices. We're not there, not even close to that point yet. And so this really matters for a lot of things, including the AI revolution, because so much of the power supply for AI data centers, the electricity for that, is more or less priced against the natural gas market. The price of electricity is a function principally of gas prices, and some other factors of cost of transmission and things like that. That's really insulated the United States from some of the harm that we might otherwise see immediately flow into the data center...and electricity or electro-tech facing parts of the American economy.

Clark Merrifield

Yeah, great. Thank you. We also have some questions coming in about what are the effects potentially on alternative energy supplies. It's still just week three of this. What would be some of the headwinds, or any potential shifts in a long-term movement away from oil and towards other [inaudible]?

David Victor

I can start on that. Yeah, we're only three weeks in, but the opining on this matter happened immediately, or if not before the attacks. I think this is a little bit like one of those inkblot tests. You see the price of oil go up, the price of a lot of other energy that more or less comes out of the oil market, at least globally...that goes up. And then what's the response? In Europe, the response has been to double down on their energy transition, to double down on the emission goals, to double down on reducing their dependence on gas, including imported gas and oil from Russia, more renewables, more nuclear. Many senior European politicians have now said that the turn away from nuclear power was a strategic mistake. So that's biasing in the clean direction. I think right now, at least at the federal level, the US policy has been to double down on more oil production. And so we see these radically different views about what to do in response to this. All that said, as the price of oil and other conventional fossil energy goes up, the rivals are going to become more competitive. They actually will probably create a boost in demand for that and all kinds of supply chain crises associated with that. But that should be beneficial for clean energy over the long term. But I think insofar as the future of energy depends on political choices, to me, what's interesting is this divergence in responses as opposed to the convergence.

Binyamin Appelbaum

I'd just note a couple of things from history. The first is that the oil shocks of the 1970s really fueled the innovation in renewable energy that we are reaping the benefits of today. It wasn't immediately realized or implemented at a mass scale, but the technologies really came out of that era. And so you definitely can see a response. One way of responding to uncertainty is to say, well, how do we reduce uncertainty going forward? How do we become more energy independent? And I think you could certainly imagine companies gambling on that and investing in new clean energy technologies. I think nations may also feel that incentive. China has made a strategic imperative out of becoming less reliant on Middle Eastern oil. It is still, however, heavily reliant on Iranian oil in particular. This is going to be a reminder for China's leaders of the benefits of reducing that reliance long-term. Obviously, in the United States right now, our leaders are taking a very different set of conclusions, but you could imagine us under a future administration similarly concluding that this is a reminder of a strategic vulnerability that we ought to reduce. But I'd note that there's a flip side historical lesson as well. After the Gulf War conflicts a couple of decades ago, the way that those countries rebuilt was by pumping oil and making it available cheaply. They went hard at the market as a means of restoring their own economic fortunes, and you'll probably see that again, too. If you are a country in the Gulf and you now have a big bill to pay for rebuilding and you are in one business and one business only, you're going to try to do more of that business.

Michael Klein

So I would follow up with that by mentioning four things: Cadillacs, Toyotas, Hummers, and Priuses. In the 1970s, the United States and other countries used a lot more oil per dollar of GDP.

And what happened along with the alternative sources is greater conservation. And so we went through that. And then you think about the Hummers when oil was very cheap, you don't see many Hummers on the road now, you see a lot more electric vehicles. So there's also sort of that aspect. And in a way we have to be a little bit careful about using the 1970s as a comparison, even though I started off with that. And the two main reasons are the lower dependence on oil for a given amount of GDP, and the other is, in the 1970s, we had a decade of inflation, so inflation expectations were really baked in. So we're at this point where we're using less oil per dollar of GDP. One concern, though, is that inflation expectations might not be as baked in, or low inflation expectations might not be as baked in as they were five, ten years ago.

Clark Merrifield

We have a couple questions here about the labor markets, which were mentioned briefly, but I think that we should jump more into that and interest rates for homes. These are two big issues that affect people's lives very directly. We can start with the job markets, not as high unemployment as we've seen in history, but it is turning out to be a tighter market. How is the conflict affecting the job market?

Nicholas Bloom

Happy to jump in on that. So the labor market's kind of 5 out of 10 right now, if I was to give an overall number. So if you want to look on the good side, unemployment is relatively low. I think it's 4.6, 4.7%. And just to put that in perspective, the average post-World War II in the US is 5.5%. So unemployment is low compared to the long-run average, and we're still seeing some job creation. So what is the bad side of it? Job creation levels are very low. I think a lot of that's because of the anti-immigration policy. So immigrants are big drivers of job creation. If you go back two, three years, we're creating a couple of hundred thousand jobs a month. Now it's close to zero. The other, I think, by far the most worrying sign is that it's very hard to get a new job. So hiring rates are down. So separation rates, as in how quickly leave or get fired is down, but hiring is also down. So it's kind of like, you remember that movie Frozen? I can't remember... Elsa has frozen the labor market. It's not good. And I teach at Stanford, and Michael and David are also teaching and then come in contact with a lot of undergrads, and they're kind of nervous because it is harder to get a job. What will the event in Iran do? I think it's going to make that worse. Why is that? Well, Econ 101 tells you if you're a firm, you don't go and hire a new employee if you're uncertain. Why? Because that hiring action involves some sunk costs. And if you make a mistake, it's an expensive mistake. And if you don't know the future, you tend to pause. And the same goes with investment. So investment generally creates employment alongside it. So my prediction is it's going to chill the labor market even more. So we may not see unemployment go up. But I think what we're going to see is it's a lot harder to get a job. So if you're in a current job now, don't leave it. It's going to be difficult to get a new one. If you know folks looking for a job right now, that's definitely a tricky situation to be in, and it's just got worse.

Michael Klein

And with interest rates, the interest rate that you pay reflects what people expect inflation to be. And as inflation expectations start to rise, the interest rates will rise as well. And that inflation may or may not be realized, so it could actually turn out to be very expensive to borrow money now, if inflation doesn't end up being as high as you thought it might be, and you're paying back in, you know, more expensive dollars than you expected. So with higher interest rates, mortgages are gonna become more expensive, car loans are gonna be more expensive, borrowing for big ticket items are gonna be more expensive, for companies it's more expensive to invest. And also, as I mentioned before, with these credit spreads, with more concerns about risk, companies, if they want to float bonds on the market, that's going to become more expensive. And if stock prices continue to fall, you can't raise as much money through equities as well. Financial conditions will probably deteriorate, would be my guess, based on what's going on right now.

Binyamin Appelbaum

And I just want to underscore something of what Michael said. For your average consumer who's thinking about buying a house, when inflation expectations drive up mortgage rates, they just experience that as an increase in mortgage rates. That's bad enough. That's going to tend to diminish the number of people who want to buy houses and the amount of money they can spend on those houses. For corporations, it's even more impactful because of, as Michael pointed out, the fact that there's a concern that if those inflation expectations don't hold up, you get trapped in a situation where you borrowed expecting higher inflation, and then your revenues reflect lower inflation, and corporations are acutely attuned to that risk. And so for them, this is doubly impactful. It makes it even less likely that they will invest under these circumstances.

Michael Klein

And the great historical example is the late 1970s, early 1980s, when inflation was very, very high, Volcker came in to take over the Fed, and inflation drops, so people find that it's very, very expensive to pay back the loan. So we have the Latin American debt crisis, we have the farm crisis at that time, and that's a lesson that we should all be heeding.

Clark Merrifield

Well, we will leave it at that. This has been a really insightful hour, and I want to thank you all for being here and for doing this. We will have the video up as soon as we can. Go to journalistresource.org. or econofact.org and sign up for our newsletters to be sure to get that video if you would like to watch this again. Thank you all again. Thank you audience members for being here. And we will see you next time. Thank you. Take care.

Michael Klein

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