

Dollars & Sense

Dire Straits: The Central Bank Calculus of the Iran Oil Shock

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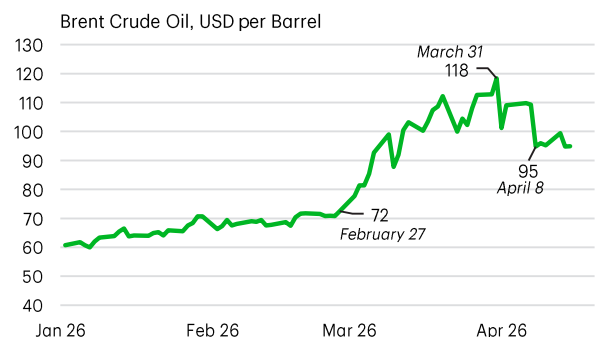
Highlights

- The Iran conflict has triggered a major energy supply shock, pushing oil prices meaningfully higher and extending the inflation impulse beyond what was initially expected.
- Provided a longer-term peace deal is reached in the coming weeks, we still see a narrow window for the Fed to deliver on two more rate cuts in Q4.
- Longer-term Treasury yields are expected to drift 20 basis points lower by year-end, bringing the 10-year back to 4.10%. The greenback is likely to remain under pressure, with the trade weighted measure falling another 2% by the end of the year.
- A further escalation in the conflict would quickly result in oil prices retesting recent highs, Treasury yields turning higher and a strengthening of the dollar. Under this scenario, the Federal Reserve would likely remain on hold well into next year.

The war in Iran has produced the largest supply disruption to global energy markets in modern history. At its peak, the price of Brent crude – the global benchmark for oil prices – had reached over \$118 per barrel. Prices have fallen sharply following the U.S., Israel, and Iran agreeing to a two-week ceasefire on April 7th, but at \$98 per-barrel, remain considerably above pre-conflict levels (Chart 1). Through all the recent volatility, broader financial conditions have only tightened on the margin. But the situation remains incredibly fluid and could quickly re-escalate should negotiations on a longer-term peace deal fall apart.

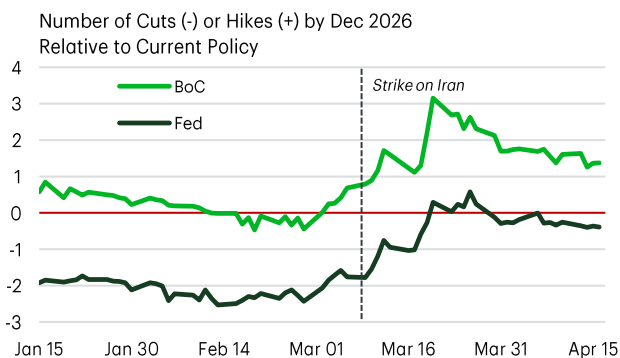
Our revised [oil forecast](#) has WTI averaging \$95 per-barrel through the Q2, with some of the risk premium coming out in H2-2026 under the assumption that a peace agreement is reached over the coming weeks. But this alone will not result in an im-

Chart 1: Iran Conflict Triggers a Major and Potentially Persistent Energy Supply Shock



Source: IntercontinentalExchange, TD Economics. Last Observation: April 16th, 2026

Chart 2: Markets Reprice Policy Rate Expectations Higher



mediate normalization of oil flows through the Strait of Hormuz. Physical bottlenecks, mine clearing operations, repositioning tankers globally and clearing port backlogs all suggest it'll take months, not weeks, for oil flows to completely normalize.

Central Bank Expectations Have Whipsawed

The sharp increase in energy prices is already being felt by households and businesses on both sides of the border, with gasoline and diesel prices up 38% and 43%, respectively, since late-February. With the length of the conflict unclear and the inflationary impulse already rearing its head, expectations for central bank policy actions have whipsawed. At its peak in late-March, Fed futures went from pricing in a little more than two-cuts to just over a 50% probability of a rate hike! Cooler heads have prevailed following the ceasefire, with pricing now showing 10 basis points of cuts by year-end (Chart 2).

No Move is the Best Move ... For Now

As we noted in our [Quarterly Economic Forecast](#), the energy shock is hitting the U.S. economy from a point of strength. Final sales to private domestic purchasers – the best gauge of underlying demand – expanded by 2.6% in H2-2025, suggesting solid momentum heading into 2026. At the same time, growth is expected to benefit from last year's interest rate cuts, new household and business tax cuts that came into effect this year and the ongoing push to ease regulation. An energy shock alone will not materially shift the outlook – even if crude prices were to remain elevated for another several months. This is because the U.S. has be-

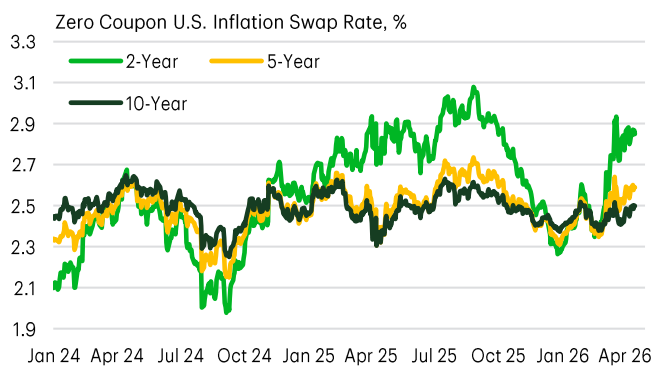
come both more energy independent and less energy intensive in recent decades. What could challenge this narrative is if financial conditions were to suddenly and dramatically tighten, which runs the risk of sending a more meaningful confidence shock through the economy. That's not our base case, but it remains a plausible downside risk, particularly if the temporary ceasefire does not yield a more permanent resolution to end the conflict.

From the Fed's perspective, there's no rush to make a policy move. At today's target range of 3.50%-3.75%, the Fed funds rate is already at the upper end of the FOMC's median estimate of neutral. And yet, growth is still expected to run slightly above potential, even after accounting for some hit from higher energy prices.

A key metric for policymakers to watch in the months ahead will be inflation expectations. The fear for Fed officials is that the longer inflation remains structurally above its target, the greater the risk that inflation expectations become unanchored. Encouragingly, this has not yet occurred. While short-term measures have turned higher, medium-and-longer-term inflation expectations remain consistent with the Fed's 2% inflation objective (Chart 3). But any signs of upward drift could reshape the FOMC's thinking and start to stir chatter on whether the next move should be a rate hike.

Our baseline forecast still sees the potential for as many as two more rate cuts this year, with the risks skewed to later and potentially fewer cuts. For now, we see the Fed on hold through September. Even assuming Kevin Warsh is confirmed by the Senate Bank-

Chart 3: Longer-Term Inflation Expectations Remain Well Anchored

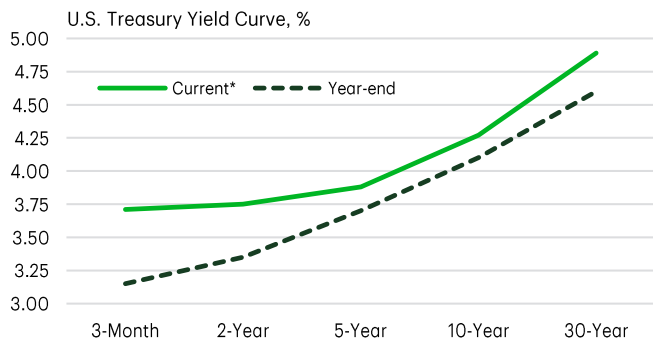


ing Committee and is in seat as the new Fed Chair by June, he's likely to face an uphill battle convincing a majority of the voting FOMC members to support an immediate policy pivot towards lower rates. Based on the most recent "dot plot", 14 of the 19 FOMC participants expect one or fewer cuts by year-end. Not all participants who submit forecasts are voting FOMC members, but even if all five individuals who support multiple rates cuts were voters, they would still be two votes shy of a majority.

Treasury Yields and Greenback to Head Lower

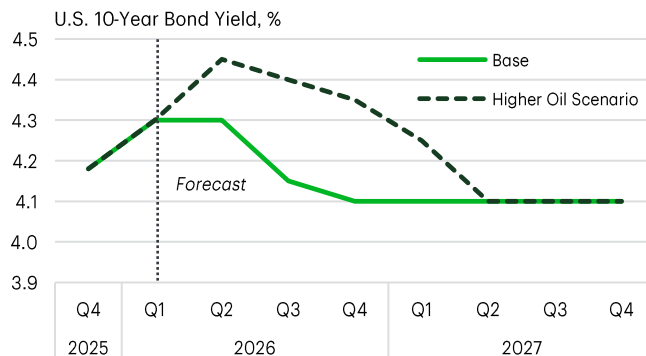
It's this lingering risk of resurgent inflation and the knock-on effects it could have on the Fed's ability to deliver on rate cuts that have kept Treasury yields some 30-40 basis points above pre-crisis levels. But if we're right, and rate cuts do materialize later this year, the inflation premium that's still priced in Treasuries should have come out. That suggests the 10-year Treasury yield will drift back closer to its pre-crisis level of 4.10% by year-end (Chart 4). On balance, a further narrowing of interest rate differentials vis-à-vis other advanced economies should work to put a bit more downward pressure on the dollar, potentially falling by another 2% by year-end.

Chart 4: Yields to Drift Lower by Year-end



*Current as of close on April 15th, 2026. Values are end of period. Source: Federal Reserve Board, TD Economics.

Chart 5: Yields Push Higher Under Prolonged Disruption Scenario



Note: Values are end of period. Source: U.S. Federal Reserve, TD Economics.

Prolonged Disruption Would Keep Fed on Hold for Longer

Of course, this all assumes everything goes as planned. But what if negotiations for a longer-term peace agreement were to fall apart leading to Iran maintaining strict control of tanker traffic for another few months? Under this scenario, WTI is assumed to average \$128 per barrel in Q2 and drift only modestly lower through H2-2026 as physical shortages maintain a higher risk premium on oil prices through this year and into 2027. Relative to our current baseline, economic growth in the U.S. is lower by about a tenth this year (2.3% vs. 2.4%) and three-tenths next year (1.9% vs. 2.2%). Headline inflation rises by low double digits on a q/q annualized basis in Q2-2026, with secondary effects keeping core measures north of 2.5% (q/q, ann.) through H2-2027. This keeps the Fed on hold through mid-2027. The 10-year Treasury yield moves higher over the near-term – reflecting the higher inflation premium – and reaches a peak of 4.45% in Q2, before edging back to 4.3% by year-end (Chart 5). The near-term escalation reignites the flight to safety trade, pushing the dollar back up 2% again in Q2, retracing its recent depreciation, though most of this unwound by the end of the year.

Interest Rates & Foreign Exchange Rates

Interest & Exchange Rates		Spot Rate Apr-16	2025				2026				2027			
			Q1	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Interest Rates														
Fed Funds Target Rate		3.75	4.50	4.50	4.25	3.75	3.75	3.75	3.75	3.25	3.25	3.25	3.25	3.25
3-mth T-Bill Rate		3.61	4.21	4.24	3.86	3.57	3.61	3.80	3.40	3.15	3.15	3.15	3.15	3.15
2-yr Govt. Bond Yield		3.75	3.89	3.72	3.60	3.47	3.79	3.70	3.40	3.35	3.35	3.35	3.35	3.35
5-yr Govt. Bond Yield		3.88	3.96	3.79	3.74	3.73	3.92	3.85	3.75	3.70	3.70	3.70	3.70	3.70
10-yr Govt. Bond Yield		4.27	4.23	4.24	4.16	4.18	4.30	4.30	4.15	4.10	4.10	4.10	4.10	4.10
30-yr Govt. Bond Yield		4.88	4.59	4.78	4.73	4.84	4.88	4.90	4.70	4.60	4.60	4.60	4.60	4.60
10-yr-2-yr Govt Spread		0.51	0.34	0.52	0.56	0.71	0.51	0.60	0.75	0.75	0.75	0.75	0.75	0.75
Exchange rate to U.S. dollar														
Chinese Yuan	CNY per USD	6.82	7.26	7.16	7.12	6.99	6.90	6.85	6.80	6.75	6.70	6.65	6.60	6.55
Japanese yen	JPY per USD	159	150	144	148	157	159	159	158	158	157	156	156	155
Euro	USD per EUR	1.18	1.08	1.18	1.17	1.17	1.15	1.18	1.19	1.20	1.20	1.20	1.20	1.20
U.K. pound	USD per GBP	1.35	1.29	1.37	1.34	1.35	1.32	1.35	1.37	1.39	1.39	1.39	1.39	1.39
Canadian dollar	CAD per USD	1.37	1.44	1.36	1.39	1.37	1.40	1.38	1.37	1.35	1.33	1.33	1.33	1.33
Australian dollar	USD per AUD	0.72	0.62	0.66	0.66	0.67	0.69	0.70	0.71	0.71	0.71	0.71	0.71	0.71
NZ dollar	USD per NZD	0.59	0.57	0.61	0.58	0.58	0.57	0.59	0.59	0.60	0.60	0.60	0.60	0.60
Exchange rate to Euro														
U.S. dollar	USD per EUR	1.18	1.08	1.18	1.17	1.17	1.15	1.18	1.19	1.20	1.20	1.20	1.20	1.20
Japanese yen	JPY per EUR	187	162	170	174	184	183	188	188	189	188	188	187	186
U.K. pound	GBP per EUR	0.87	0.84	0.86	0.87	0.87	0.87	0.88	0.87	0.86	0.86	0.86	0.86	0.86
Canadian dollar	CAD per EUR	1.62	1.55	1.60	1.63	1.61	1.61	1.62	1.63	1.62	1.60	1.60	1.60	1.60
Australian dollar	AUD per EUR	1.64	1.73	1.79	1.77	1.76	1.68	1.68	1.68	1.68	1.68	1.68	1.68	1.68
NZ dollar	NZD per EUR	2.00	1.91	1.93	2.02	2.04	2.02	2.02	2.02	2.02	2.02	2.02	2.02	2.02
Exchange rate to Japanese yen														
U.S. dollar	JPY per USD	159	150	144	148	157	159	159	158	158	157	156	156	155
Euro	JPY per EUR	187	162	170	174	184	183	188	188	189	188	188	187	186
U.K. pound	JPY per GBP	215	193	198	199	211	210	214	217	219	218	217	217	216
Canadian dollar	JPY per CAD	115.9	104.2	105.9	106.2	114.4	114.0	115.6	115.9	116.8	118.1	117.6	117.1	116.7
Australian dollar	JPY per AUD	114.1	93.5	94.8	97.9	104.6	109.0	111.6	112.1	112.6	112.1	111.7	111.2	110.8
NZ dollar	JPY per NZD	93.7	84.9	87.8	85.8	90.2	90.8	93.0	93.4	93.8	93.4	93.0	92.7	92.3

F: Forecast by TD Economics, April 2026; Forecasts are end-of-period.

Source: Federal Reserve, Bloomberg.

Commodity Price Outlook															
Commodity	Price Apr-16	52-Week High	52-Week Low	2025				2026				2027			
				Q1	Q2	Q3	Q4	Q1	Q2F	Q3F	Q4F	Q1F	Q2F	Q3F	Q4F
Crude Oil (WTI, \$US/bbl)	91	113	55	72	64	65	59	72	95	84	80	75	73	72	72
Natural Gas (\$US/MMBtu)	2.78	30.72	2.64	4.20	3.19	3.03	3.76	4.62	2.70	3.30	3.75	3.80	3.80	3.80	3.80
Gold (\$US/troy oz.)	4817	5417	3177	2856	3284	3455	4150	4865	4750	4800	4900	4900	4900	4800	4700
Silver (US\$/troy oz.)	79.53	116.70	32.01	31.86	33.65	39.51	55.21	83.71	80.00	77.00	75.00	73.00	72.00	70.00	70.00
Copper (cents/lb)	598	613	414	423	432	444	505	582	590	610	590	575	580	585	590
Nickel (US\$/lb)	8.23	8.51	6.47	7.06	6.88	6.81	6.76	7.87	8.10	7.90	7.70	7.50	7.50	7.50	7.50
Aluminum (Cents/lb)	164	164	107	119	111	119	128	145	165	160	160	155	150	150	150
Wheat (\$US/bu)	7.61	8.66	6.42	5.65	5.34	4.88	5.13	5.50	5.90	5.80	6.00	6.10	6.20	6.30	6.40

F: Forecast by TD Economics, April 2026; Forecast are period averages; E: Estimate.
Source: Bloomberg, USDA (Haver).

Global Stock Markets					
Major Market Indexes	Price Apr-16	30-Day % Chg.	YTD % Chg.	52-Week High	52-Week Low
S&P 500	7,023	4.8	2.6	7,023	5,158
S&P/TSX Composite	34,156	3.9	7.7	34,541	24,009
DAX	24,227	2.8	-1.1	25,421	21,206
FTSE 100	10,633	3.1	7.1	10,911	8,249
Nikkei	59,518	10.7	18.2	59,518	33,920
MSCI AC World Index*	1,061	5.2	4.6	1,061	783

*Weighted equity index including both developed and emerging markets.
Source: Bloomberg, TD Economics.

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