

The Hormuz Depression: End of the Dollar Empire

v4.8 — March 4, 2026 (Day 5 of Operation Epic Fury) Independent strategic analysis. All market data as of March 3, 2026 close. Probability estimates reflect the author's judgment informed by historical precedent, not model outputs.

Executive Summary

The US-Iran war that began February 28, 2026 has functionally closed the Strait of Hormuz. The key numbers:

- **16 million barrels/day removed** from global supply (80-90% of 20M b/d Hormuz throughput)
- **3.6x the 1973 Arab embargo** — the largest energy supply disruption in history
- **Oil: \$150-200/barrel** projected within 30 days (from \$81.40 pre-crisis)
- **Global GDP: -3 to -5%** if sustained beyond 3 months (comparable to 2008-09)
- **USD reserve share: 56.3% → below 50%** within 12 months (IMF COFER baseline)
- **Hormuz also carries 20% of global LNG and 40-50% of seaborne urea trade**

This report argues that the crisis is not cyclical but structural: the US cannot exit the conflict, cannot negotiate its way out, and cannot sustain the military and economic cost of continuation. The most likely resolution is Chinese-brokered ceasefire — China already brokered the Saudi-Iran rapprochement in March 2023, establishing the precedent — and a Chinese security guarantee for the Gulf, which effectively ends American hegemony.

The economic consequences — global depression, reserve currency erosion, EU fracture, capital controls, and financial market fragmentation — are not speculative. They are the logical sequence of a 20% supply shock to an integrated global economy with no historical parallel.

Part 1: The War Is Unwinnable and Unexitable

The Military Trap

Air power alone has never forced a state to capitulate. Not Vietnam, not Serbia (78 days of bombing), not Iraq (required invasion). Iran is 4x Iraq's size, 3x the population, with mountain terrain that makes Afghanistan look flat.

Ground invasion is off the table. Iran has 600K active military + 40M+ military-age males. The US would need 500K+ troops and full mobilization. Trump's own base would revolt.

The munitions asymmetry: Iran fights a \$10,000 war (mines, drones, indigenous coastal missiles). The US fights a \$4,000,000 war (Tomahawks at \$2M each, interceptors at \$3-12M each). Tomahawk production: 60/year (Reuters, Feb 2026). Iran's mine stockpile: 2,000+ (Strauss Center). Every interceptor fired at a \$50K drone is a net loss. At these ratios, the US runs out of weapons before Iran runs out of targets.

"Declare victory and leave" isn't an option because the US cannot leave without reopening Hormuz first. This is the real trap.

If the US withdraws while Hormuz is still closed, it abandons every energy-dependent ally simultaneously — Japan, South Korea, Europe, the Gulf states themselves. The entire US alliance system is built on implicit security guarantees: "align with us and we protect your trade routes." Walking away from Hormuz while tankers sit idle is proof that the guarantee is worthless. Every US alliance unravels in parallel:

- **Japan/Korea:** If the US can't keep Hormuz open, why host US bases? Why not cut a bilateral deal with China for energy security?
- **Gulf states:** If the US can't protect the waterway 50 miles from its Fifth Fleet headquarters, the alliance is theater. Saudi/UAE pivot to China immediately.
- **Europe:** NATO's credibility collapses. If the US won't secure energy flows, what exactly does the alliance provide?
- **Taiwan:** Every Chinese strategist notes: "They couldn't keep a strait open against Iran. They'll keep the Taiwan Strait open against us?"

So the US must reopen Hormuz before any withdrawal. But reopening Hormuz requires either (a) defeating Iran's asymmetric denial capability — which means years of minesweeping, coastal suppression, and permanent naval presence in a shooting gallery, or (b) a negotiated agreement with Iran — which loops back to the trust problem: Iran has no reason to negotiate with a power that assassinated its leader during talks.

The US is trapped between "stay and bleed" and "leave and lose the empire." There is no option that preserves both American lives and American hegemony.

Decentralized Command = Harder to Fight, Harder to Negotiate

Every leadership kill decentralizes Iranian command further. The Interim Leadership Council (President Pezeshkian, Chief Justice Mohseni-Eje'i, Guardian Council's Araf) replaced Khamenei within 48 hours via constitutional process. Three targets in three locations instead of one.

Each killed commander is replaced by someone younger, more radical, with a personal blood debt. The IRGC's structure is designed for this — guerrilla resilience, not hierarchical fragility.

The more decentralized, the harder to negotiate. Even if the Council wants a ceasefire, do rogue IRGC coastal commanders comply? You create the ISIS problem: no single authority can deliver a binding agreement.

Civilian Casualties as Strategic Backfire

The Minab incident (115-165 civilian deaths including children) functions as a radicalization accelerant. Iran's 2022-2023 domestic protest movement — a fractured society — has reunified against external attack. The Amiriyah shelter bombing (1991, 408 dead) unified Iraqi opinion behind Saddam for 12 years. Same mechanism, larger population.

Negotiation Is Structurally Impossible

The sequence: - Jan-Feb 2026: Oman mediating. Iran showed willingness to engage. - Feb 27: Oman announced framework for talks. - Feb 28: US launched Operation Epic Fury. Killed Khamenei.

Iran now believes the US used diplomatic channels as cover for a decapitation strike. Whether true or not, it's what every Iranian believes. Combined with the JCPOA withdrawal (2018), this is two consecutive betrayals.

Any future Iranian leader who proposes talking to the US faces two accusations: (1) traitor to the martyrs, (2) fool who trusts a proven liar. The trust deficit is structural, not personal — Iran will assume ANY US government will betray agreements. This takes a generation (20-30 years) to rebuild.

The US Has Nothing to Offer

- **Sanctions relief?** Iran has survived maximum sanctions since 2018. Trades with China, India, Russia.
- **Security guarantees?** The US assassinated their supreme leader during negotiations.
- **Nuclear deal?** The US broke the last one and bombed Natanz.
- **Reconstruction?** After bombing schools?

The only things Iran wants are things the US cannot give: guarantee this never happens again (can't credibly commit), accountability for civilian deaths (will never

accept), removal of US military from the Gulf (domestically impossible), nuclear sovereignty (the exact thing the US went to war to prevent).

No zone of possible agreement exists.

Part 2: Hormuz Stays Closed

Why 10-20% Throughput Is the New Normal

Currently at ~14% of normal traffic (86% reduction per Windward/Anadolu).
Approximately 700 ships sitting idle on either side.

The insurance mechanism: Iran doesn't need a physical blockade. The combination of (1) credible threat + (2) confirmed hits on 4+ commercial vessels + (3) insurance withdrawal = de facto closure. P&I clubs collectively insure ~90% of world's ocean-going tonnage. All issued 72-hour cancellation notices. Coverage formally expires March 5, 2026.

The Joint Maritime Information Center elevated the threat to CRITICAL and stated: *"insurance availability may now act as a primary gating factor for transit decisions independent of formal navigational closure."*

The strait isn't closed by Iran. It's closed by insurers.

Trump's DFC insurance doesn't reopen it. Government-backed war risk insurance changes the math for hull loss — but it doesn't change the math for the shipowner. A modern VLCC costs \$120-150M. A modern LNG carrier costs \$250M. No shipowner sends a \$150M asset through a shooting gallery because the government promises to pay replacement value. Replacement value doesn't cover: 2-3 year newbuild wait time, lost revenue during replacement, reputational damage, crew liability. The only ships that transit under DFC insurance are scrapyard-grade vessels worth \$5-15M — ships where total loss is the business model, not the risk. This means Hormuz "reopens" at 5-10% capacity with the oldest, smallest, most dangerous vessels afloat, crewed by the most desperate sailors. It's not a shipping lane — it's a junkyard lottery.

Iran's cost to maintain closure: mines (\$10,000 each), drones (\$20,000-50,000 each), coastal anti-ship missiles (indigenous production). Iran can sustain this indefinitely.

US cost to contest closure: carrier strike group \$6-7M/day, Tomahawks ~\$2M each (hundreds fired per week), interceptor missiles \$3-12M each. Total: \$25-50B/year in direct military cost.

The Trump Insurance Gambit

Trump ordered the US Development Finance Corporation (DFC) to provide "political risk insurance" for all Gulf shipping (March 3). The Navy would escort tankers "if necessary."

Reality: Lloyd's List reports the Navy privately told tanker executives there is "presently no availability" for escort missions. The DFC is a development finance agency that has never underwritten maritime war risk.

The moral hazard: At DFC insurance prices, the rational trade is to buy a \$5M scrapyards tanker, insure it at \$40M replacement value, send it through Hormuz, and collect \$35M if it sinks. 700% ROI. Owners would send their oldest, worst ships crewed by the most desperate sailors. The US government becomes the world's worst insurance company: adversely selected into a book of aging vessels sailing through a shooting gallery.

Expected DFC losses: \$10M/day in premiums against \$50-200M/day in expected claims. Loss ratio: 500-2000%.

The Tanker Fleet Math

Even without sinkings, rerouting around Africa adds 6,000 nautical miles to Europe, 3,000 to Asia. A VLCC round trip goes from 30 to 45-55 days. This alone removes 30-40% of effective carrying capacity.

- Lose 10-15 VLCCs (1.5% of global fleet): freight rates double
- Lose 30-50 VLCCs: physical inability to move enough oil even if Hormuz reopened
- Lose 1-3 LNG carriers (\$250M each, 3-4 years to replace): LNG market breaks

Iran doesn't need to sink tankers. Damaging 3-5/month means drydock repairs (6-12 months each), crews refusing to sail, and the effective fleet shrinking steadily.

Fertilizer: The Depression Multiplier

40-50% of global seaborne urea trade transits Hormuz (Agriculture.com, Mar 3 2026). Three of the top 10 global urea exporters sit in the Gulf. Disruption to fertilizer supply hits global crop yields within one growing season, compounding the depression via food price inflation. The 2022 Russia-Ukraine partial disruption drove food prices up 30%. Hormuz is total.

Part 3: Only China Can End This

Requirements for a Mediator

A mediator needs: (a) credibility with Iran, (b) economic leverage over Iran, (c) military capability to guarantee an agreement, (d) motivation to resolve the crisis, (e) ability to deliver something the US can't.

Why China — and Only China

Precedent: China already did this. In March 2023, China brokered the Saudi-Iran rapprochement — the most significant Middle East diplomatic achievement in decades.

Beijing succeeded where Washington could not because it had credibility with both sides and no ideological agenda. The Hormuz crisis is a larger version of the same problem, and China is the only actor that has already proven it can solve it.

- **Credibility:** China has never attacked Iran. Buys Iranian oil. Vetoed UN sanctions.
- **Economic leverage:** China is Iran's largest trade partner. Chinese investment = Iran's economic future.
- **Military:** PLA Navy is a blue-water force. Base in Djibouti. Can guarantee Gulf security.
- **Motivation:** China imports 70%+ of its oil by sea, half through Hormuz. Xi is bleeding.
- **Unique offer:** Security guarantees from a power that hasn't betrayed Iran, economic integration via BRI, UN Security Council veto protection, and a peer-power guarantee against future US attack.

Why No One Else Can

- **Russia:** Credibility with Iran but no economic leverage, overstretched in Ukraine, can't project naval power to the Gulf. Benefits from chaos (high oil prices). Low motivation.
- **Turkey/Oman/Qatar:** Can mediate but can't guarantee. No military capability. Oman channel already burned (US attacked during active mediation).
- **India:** Plays both sides but isn't trusted deeply by Iran (voted against Iran at IAEA under US pressure). Lacks Gulf naval presence.
- **EU:** Zero military capability in the Gulf. Can't agree on a common energy policy.
- **UN:** The US is the belligerent. The UN cannot mediate a conflict when one party has a Security Council veto and is using it to block ceasefire resolutions. The UN also has no enforcement mechanism — even if a resolution passed, who enforces it in the Gulf? The UN doesn't have a navy.

The US Acceptance Curve

- **Year 1 (2026):** Absolute refusal. Hawks dominate.
- **Year 2-3 (2027-2028):** Costs mount. Oil \$100+. First op-eds on "negotiated settlement."
- **Year 3-5 (2028-2030):** Reserve currency erosion visible. Alliance fraying. Gulf states quietly signing with China.
- **Year 5-7 (2030-2032):** New president inherits quagmire. Accepts Chinese mediation as "partnership." Everyone knows it's retreat.

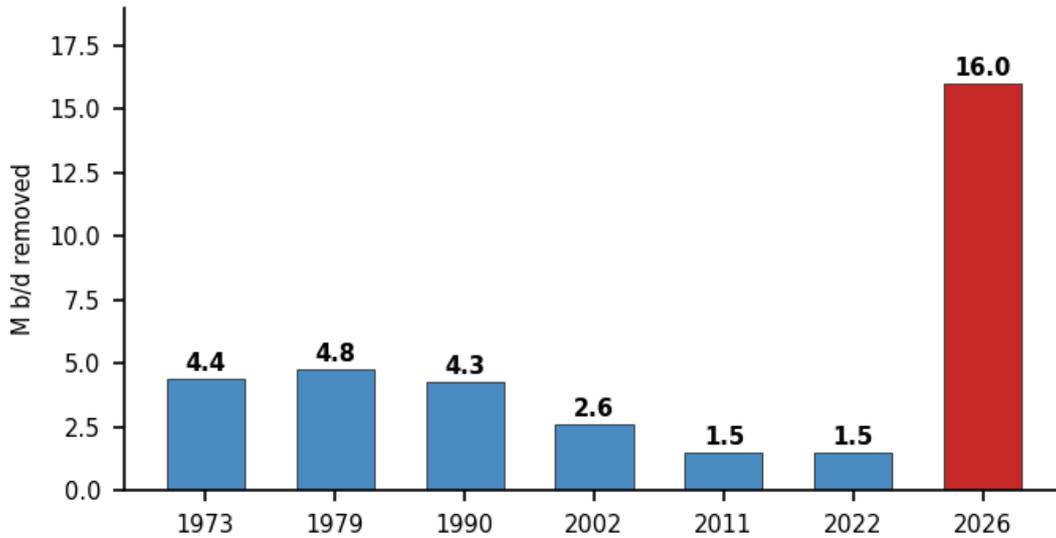
Historical parallel: British withdrawal from "East of Suez" (1968-1971). Not defeated militarily — couldn't afford it anymore.

Part 4: The Economic Cascade

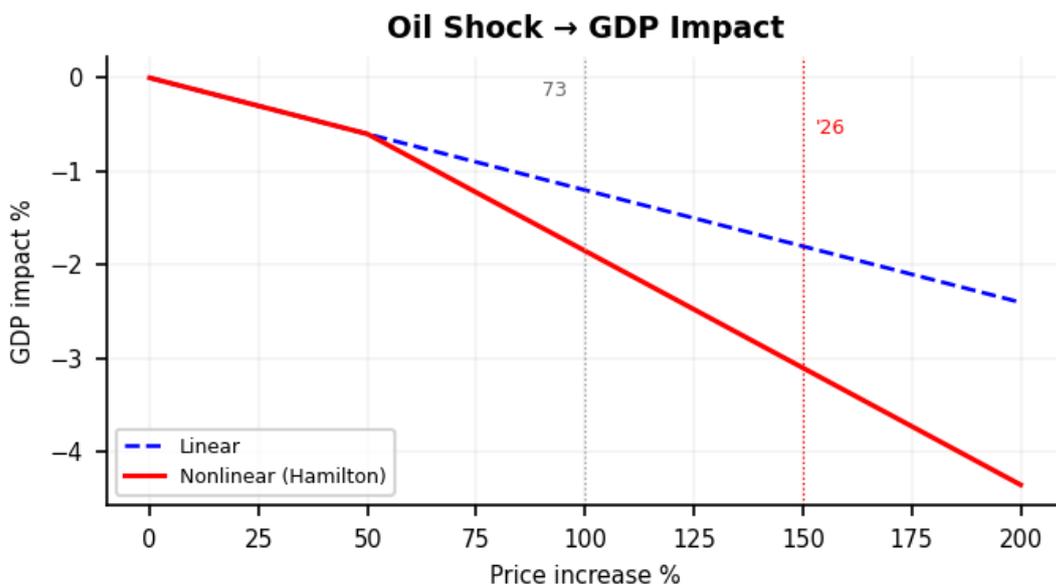
Sourced Baseline Numbers

- 20M b/d removed at 80-90% disruption (EIA, "Strait of Hormuz," todayinenergy #65504)
- Bypass pipeline capacity: ~3.5M b/d unused — offsets <20% (Saudi East-West 5M b/d capacity, ~2.5M unused; UAE ADCOP 1.5M b/d) (LongYield, citing IEA)
- Net supply shock: ~13-15M b/d — largest in oil market history
- Historical comparison (Hamilton, 2011, "Historical Oil Shocks," UCSD):
 - 1973 Arab embargo: 4.4M b/d (7% of global supply) → 300% price increase
 - 1979 Iranian Revolution: 4.8M b/d (7%) → 150% price increase
 - 1990 Gulf War: 4.3M b/d (6%) → 100% price increase
 - 2022 Russia-Ukraine: ~1.5M b/d (1.5%) → 50% price increase
 - **2026 Hormuz: ~16M b/d (16%) → no historical precedent**
- GDP rule: 0.1-0.2% contraction per \$10/barrel increase for developed economies (CNBC, citing IMF WEO; confirmed by Fed DSGE model, Aug 2024)
- Nonlinear amplification: Hamilton (2003, "What Is an Oil Shock?", J. Econometrics) showed GDP response to oil shocks is asymmetric and nonlinear — large shocks have proportionally greater impact than small ones. Standard linear elasticity models underestimate by 40-60% for shocks >50% price increase.
- Closure >30 days → 75%+ recession probability (LongYield model, Feb 2026)
- 3-month closure → 1.5-3.0% GDP contraction for major importers (Zero Carbon Analytics; JPMorgan severe scenario)
- Global inflation acceleration: +2-4 percentage points (IMF WP/22/173, "Second-Round Effects of Oil Price Shocks")
- Global SPR: ~1.5B barrels = 75 days coverage for disrupted volume (IEA Oil Market Report)
- Bob McNally (Rapidan Energy, former Bush NSC energy advisor): "A prolonged closure of the Strait of Hormuz is a guaranteed global recession" (CNBC, Mar 2026)

Oil Supply Disruptions (M barrels/day)



Historical Oil Supply Disruptions



Oil Price → GDP Impact: Linear vs Nonlinear

Phase 1: Acute Shock (Month 1-3, Mar-May 2026)

Oil: \$80 → \$150-200/barrel. The 1973 shock was 7% supply loss = 300% price increase. A 20% supply loss produces a non-linear price response — standard elasticity models underestimate.

Inflation: +2-4 percentage points globally within 60 days. Supply shock, not demand-pull. Central banks face the stagflation trap: raise rates → crush economy, hold rates → inflation de-anchors.

GDP impact by actor (first 3 months, annualized):

- **US:** -1.0 to -1.5%. Energy-independent but not price-independent. Gas at pump \$7-9/gallon. Fed paralyzed. Stock market -15-25%.
- **Europe:** -2.0 to -3.5%. Gas +200-400% if Qatar stays offline. German industrial collapse. ECB stagflation trap.
- **Japan:** -1.5 to -2.5%. 90% energy import dependent. 15% of LNG from Qatar. Yen collapses further. BOJ out of tools.
- **China:** -1.0 to -2.0%. 50% crude through Hormuz but 1B barrel SPR buffer. Survives best. Uses crisis to buy assets cheap.
- **South Korea:** -2.5 to -4.0%. Gas at 5-year low. KOGAS contracts voided. Worst-positioned major economy.
- **Emerging markets (Thailand, Pakistan, Bangladesh, Egypt):** -4 to -8%. Currency collapse, food crisis, political instability.

Air freight: 18% of global capacity removed (Flexport CEO). Airspace closed over Bahrain, Kuwait, Iran, Iraq, Israel, Oman, Qatar. Partially closed over Jordan, UAE, Syria, Saudi Arabia. Emirates/Etihad suspended all normal flights.

Phase 2: Depression Sets In (Month 3-12, Jun 2026 - Feb 2027)

SPR releases buy 2-3 months, then run out. Oil stabilizes at \$120-160. Damage is structural.

Global GDP: -3 to -5% (comparable to 2008-2009 or worse).

SPR depletion math (per CRUDEOIL231): - US SPR: 400M barrels - China: 1B barrels (400-500M state reserves) - Japan: ~600M barrels (gov + private) - Germany, Korea, France, Italy, Spain: thin

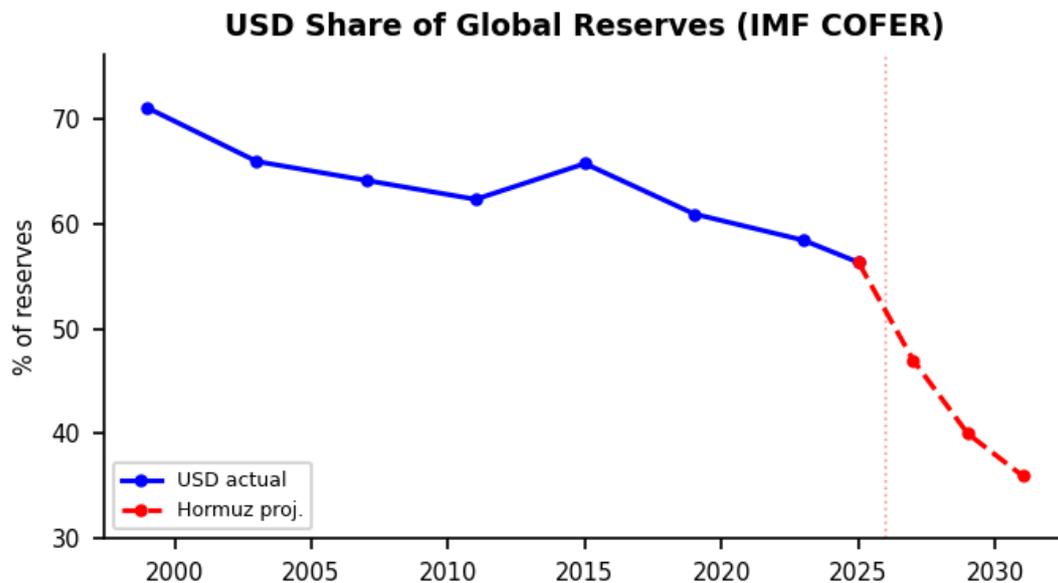
US — The Fiscal Trap: - Federal deficit: \$2.5-3T/year (military + stimulus + falling revenue) - Interest payments on \$36T debt: \$1.5-2T/year (up from \$1T) - Unemployment: 6-8% - Inflation: 8-12% - Real wages collapse 10-15% — the threshold for social cohesion breakdown

The Dollar Inflection (Month 6-9): - Saudi Arabia begins accepting yuan for oil - Gulf states accelerate de-dollarization under Chinese security umbrella negotiations - Central banks sell Treasuries to fund energy imports at \$150/barrel - Dollar share of reserves: 56.3% (Q2 2025, IMF COFER) → below 50% within 12 months - The dollar has already declined from 71% (1999) to 56.3% (2025) — a 15pp drop over 26 years. Hormuz compresses the next 15pp decline into 3-5 years. - **Sterling precedent — the mechanism is identical:**

Stage	Sterling (1945-1971)	Dollar (2026-)
(a) Military overextension	Suez 1956, East of Suez	Iran/Gulf 2026, global basing
(b) Fiscal crisis	Post-war debt 250% GDP	\$36T debt, \$2.5T deficits
(c) Ally repatriation		Japan, Gulf sell Treasuries

Stage	Sterling (1945-1971)	Dollar (2026-)
	Australia, Canada exit sterling	
(d) Capital controls	UK controls 1947-1979	IET precedent, IEEPA
(e) Reserve share collapse	87% → 12% in 25 years	56% → target <40%

(Eichengreen, Mehl & Chițu, 2018, “How Global Currencies Work”; “Zombie International Currency: The Pound Sterling 1945-1971,” J. Economic History, 2024)



Reserve Currency Decline: USD vs Sterling

Europe — The Fracture Begins: - Gas rationing by summer 2026 - Germany: deepest recession since reunification (-4 to -6% GDP) - Italy/Greece/Spain: sovereign spreads blow out. ECB forced to choose: save periphery or fight inflation - First serious capital controls discussion

Japan — The Repatriation Trigger: - Japan holds \$3.1T in net international investment position (largest creditor nation) - Japanese institutional investors begin selling US Treasuries to fund energy imports - This pushes US rates higher → worsens US fiscal position → accelerates dollar decline - Second-order effect more damaging than the direct energy shock

Phase 3: Capital Controls & Financial Fracture (Year 1-2, 2027)

Every country with large external investments faces the same dilemma: protect domestic stability or honor international capital flows.

The Repatriation Cascade:

Japan moves first. GPIF (\$1.7T, world’s largest pension fund) ordered to reduce foreign bond holdings. Life insurers (\$2T+ in foreign bonds) begin selling. BOJ

introduces “guidance” on foreign investment — soft capital controls. Yen strengthens violently as money flows home.

Germany follows. Bundesbank repatriates gold. Insurance/pension sector ordered to increase domestic allocation. Bilateral trade agreements with China outside EU framework.

US responds with financial repression. “Temporary” measures to discourage foreign selling. The playbook already exists: - **Interest Equalization Tax (1963-1974):** When the US faced capital outflows threatening the dollar peg, Kennedy/Johnson imposed a 1% tax on foreign bonds sold in US markets. In effect for 11 years. (Richmond Fed, “A Look Back at Financial Repression,” 2021; Coalition for a Prosperous America, IET analysis) - **IEEPA (International Emergency Economic Powers Act):** Allows the president to freeze any foreign-owned assets during a declared national emergency. Used against Russia (\$300B frozen, 2022). Legal infrastructure already tested and validated. - **CFIUS expansion:** Blocks foreign acquisitions under “national security” — defined ever more broadly. - **Fed monetization:** Fed buys Treasuries that foreigners sell. This is the inflation mechanism — printing money to replace foreign demand.

The US will never call these “capital controls.” They’ll call them “national security measures,” “temporary stabilization,” “anti-manipulation provisions.” The effect is identical.

France — The EU Detonator. Debt/GDP 90%+. Rising rates hit French OATs hardest. France imposes capital controls on outflows — violating EU treaty Article 63 (free movement of capital). Southern Europe follows: Italy, Spain, Greece. ECB cannot maintain common monetary policy with different national capital regimes.

The Euro doesn’t die from a vote. It dies from capital controls that make it meaningless.

The confiscation spiral: 1. Japan sells Treasuries → US rates rise 2. US rates rise → fiscal position worsens → dollar weakens 3. Foreign holders sell MORE Treasuries to avoid currency losses 4. US introduces restrictions → foreign investors panic → stop buying NEW Treasuries 5. US must monetize (Fed buys everything) → inflation → dollar weakens further → loop

This is the exact mechanism that destroyed the British pound’s reserve status (1945-1971). Sterling balances were gradually liquidated despite British capital controls (1947-1979). It didn’t save the pound — it slowed the decline while making London less relevant.

The Russian asset freeze (\$300B) was the proof of concept. Every non-Western sovereign wealth fund now knows Western-held assets can be confiscated unilaterally under IEEPA. The only question was what triggers the repatriation cascade. Hormuz is that trigger.

Phase 4: The New Financial Geography (Year 2-5, 2028-2030)

Western capital markets are broken. The concept of “risk-free rate” (US Treasuries) is dead. Each bloc prices risk against its own sovereign.

Emerging Alliance Blocs & Financial Centers:

1) China + Gulf + Iran + ASEAN + Africa - Centers: Shanghai, Hong Kong, Singapore (pivots), Riyadh - Currency: Yuan-denominated trade, gold settlement for commodities - Payment: CIPS replaces SWIFT for this bloc. CIPS is already operational: processed RMB 175.49 trillion (\$24.5T) in 2024, up 42.6% year-over-year. Daily volume: \$91B across 30,500 transactions. 1,683 participants across 124 countries (Wikipedia/CIPS data, Jun 2025). Transaction fees: 0.01% vs SWIFT’s 0.05-0.1% (ADB, 2024). CIPS is not a future possibility — it’s a running system that doubles annually. - Size: ~40% of global GDP, ~60% of population

2) US + Anglosphere + remnant NATO - Centers: New York, London (diminished), Toronto, Sydney - Currency: Dollar (weakened, bloc currency not global reserve) - Payment: SWIFT (now a bloc tool, not global) - Size: ~30% of global GDP, shrinking

3) EU remnant (if it survives) - Centers: Frankfurt or fragments to national centers - Currency: Euro (if it survives) or national currencies - Most likely: two-speed Europe. Northern core keeps Euro. Southern periphery leaves. - Size: ~15% of global GDP

4) India + non-aligned - Centers: Mumbai, Dubai (pivots from Western to neutral) - Currency: Bilateral local currencies, rupee internationalization - Size: ~10% of global GDP

No global financial hub emerges until trust is rebuilt — which requires a generation of stable multi-polar coexistence. The pre-Bretton Woods world (multiple competing centers, no single reserve) is the historical norm. The dollar era was the anomaly.

Phase 5: US Internal Stress (Year 2-7, 2028-2032)

Sustained inflation (10-20%, not hyperinflation). The US has massive productive capacity (agriculture, energy, tech). True hyperinflation requires productive collapse. More likely: Argentina/Turkey-level sustained inflation for 3-5 years. Middle class savings erode. Social Security becomes worthless in real terms.

Functional fragmentation (not formal secession). Texas has economic viability (\$2.4T GDP, energy-independent, own grid). Formal secession unlikely (nuclear weapons problem). But functional autonomy — states ignoring federal mandates, creating parallel economic structures — is already happening and accelerates under fiscal crisis. The US becomes the HRE: nominally united, functionally fragmented.

Low-to-medium intensity civil conflict. Not armies. Sustained political violence, institutional breakdown, armed standoffs. 1968-1975 (assassinations, bombings, Watergate) with social media, AR-15s, and weaker institutions.

Most likely single outcome (35%): managed decline. Dollar drops 30%, stabilizes as bloc currency. Living standards drop 10-15%. US becomes Western Hemisphere hegemon, not global one. The UK 1950-1980 path. Painful but survivable.

Part 5: The EU Death Sequence

The mechanism:

1. Energy crisis triggers industrial recession (Germany, Italy hardest)
2. ECB raises rates to fight inflation → crushes Southern debt sustainability
3. Sovereign spreads blow out: Italy 10yr 500bp+ over Bunds. France 200bp+.
4. France is the detonator — too big to bail, too big to fail, too proud to accept austerity
5. France imposes capital controls → violates EU treaty Article 63
6. Italy, Spain, Greece follow
7. ECB faces impossible choice: monetize Southern debt (angers Germany) or let them default (breaks Euro)
8. Northern states prepare parallel payment systems
9. Emergency EU summit. “Temporary suspension” of monetary union.
10. Northern states reintroduce hard currencies. Southern states devalue 30-50%.

The EU survives as political structure but without monetary union, it's NATO with more paperwork.

Timeline: First cracks 2026-2027. Formal fracture 2028-2029.

Why the EU can't survive this when it survived 2010: - In 2010, the threat was Greece (2% of EU GDP). Now it's France (15%) + Italy (13%) + Spain (9%) simultaneously. - In 2010, Germany was strong and could bail out the periphery. In 2027, Germany is in industrial collapse from energy loss. - ECB's backstop tools (TPI) require “sound fiscal policies.” France at 5%+ deficit doesn't qualify. - The Euro is a monetary union without a fiscal union. This worked during good times. In a depression, each country needs its own monetary policy. The Euro prevents this.

Part 6: Japan — The Pivot

Japan is the most vulnerable major economy (80% of crude through Hormuz, 95% from the Middle East, 87% of total energy imported) but also the most consequential defector from the US alliance.

Japan will eventually realign toward China. Not because it wants to — Sino-Japanese relations are at their worst since 2012 (the Takaichi Taiwan remarks froze diplomatic contact in late 2025). But because the logic is overwhelming: China is Japan's largest trade partner, the only power that can broker Hormuz open, and the

future security guarantor of the Gulf. The US alliance is simultaneously causing Japan's energy crisis AND stripping its neighborhood defenses (THAAD/Patriot redeployment to the Middle East). The alliance is a net negative.

Japan has a first-mover advantage — but the window closes. Japan holds \$1.19T in US Treasuries (Dec 2025, TIC data) and \$3.66T in net foreign assets. These assets have value NOW. If Japan begins repatriating while Treasuries are still liquid and dollar is still functional, it preserves capital. If it waits until Germany, South Korea, and the Gulf states are all selling simultaneously, it sells at fire-sale prices. The Baltic parallel applies: Estonia moved first out of the Soviet bloc and is now 8x richer per capita than Tajikistan, which stayed loyal.

The complexity is real. Japan can't flip overnight — it hosts 54,000 US military personnel, depends on the US nuclear umbrella against China/Russia/North Korea, and has deep anti-China public sentiment. The path is ambiguity: publicly loyal, privately diversifying. GPIF shifts allocation. Life insurers sell foreign bonds under "prudential guidance." Backchannels open with Beijing. Nuclear restarts accelerate (15 reactors online today, 33 GW capacity — the crisis does what 15 years of policy debates couldn't). Japan doesn't announce a pivot — it executes one gradually, while its Treasury holdings still have value.

Paradoxically, this is a realignment with trade reality. China is already Japan's largest trade partner. The US alliance required Japan to maintain a strategic posture misaligned with its economic geography. Hormuz corrects this.

Why This Analysis Could Be Wrong

1. "The US reopens Hormuz faster than expected." The US Navy could develop effective convoy escort + minesweeping operations within 3-6 months. Historical precedent: the 1987-88 Tanker War (Operation Earnest Will) successfully escorted reflagged Kuwaiti tankers. **Counter:** In 1987, Iran's asymmetric capability was rudimentary — no advanced anti-ship missiles, no drone swarms, no sophisticated mine warfare. Today's threat is qualitatively different. And the US had 594 ships in 1987 vs 296 today. But this is the strongest counter to the main thesis.

2. "Oil markets adapt faster than assumed." Saudi Arabia's East-West pipeline + UAE ADCOP provide 3.5M b/d of bypass capacity. US shale can ramp 1-2M b/d within 6-12 months. Global demand destruction from recession reduces the supply gap. SPR covers the interim. **Counter:** Even with full bypass + shale ramp + demand destruction, you're still short 8-10M b/d — enough for a severe recession. And LNG has no bypass at all.

3. "The dollar is more resilient than sterling was." The dollar has deeper capital markets, more liquid bond markets, and network effects that sterling never had. De-dollarization has been predicted for 20 years and hasn't happened. **Counter:** This is true for peacetime erosion. But Hormuz isn't peacetime erosion — it's a structural break combined with the Russia precedent (asset confiscation). The question isn't

whether the dollar is resilient. It's whether it's resilient enough to survive simultaneous military failure, fiscal crisis, and ally defection. Sterling wasn't.

Appendix A: Alternative Scenarios

A1: Iranian Nuclear Breakout (25% probability)

Iran announces a bomb within 12-18 months. Opens Hormuz voluntarily (no longer needs it as leverage). Shortens crisis duration but accelerates geopolitical shift. A nuclear Iran under Chinese umbrella is worse for US hegemony than a conventional war. Oil drops to \$90-100 but trust damage and capital controls already in motion.

A2: US Domestic Politics Forces Partial Withdrawal (10%)

Trump declares "mission accomplished" mid-2026. Pulls back air campaign. But Iran keeps Hormuz disrupted for leverage. Oil \$100-120. Slower version of main scenario — same destination, longer timeline (10-15 years instead of 5-7).

A3: China Brokers Early (15%)

China moves faster than expected — within 6-12 months. Xi calculates that prolonged Hormuz disruption hurts China more than the geopolitical gains are worth (50% of Chinese crude transits the Strait). Offers Iran security guarantee + economic package in exchange for Hormuz reopening and nuclear freeze. US is sidelined but Hormuz reopens. Oil drops to \$90-100. The structural shift still happens — China is now the Gulf's security guarantor — but the economic damage is contained to a severe recession rather than a depression. This is the "best case" scenario and it still ends US hegemony in the Gulf.

Appendix B: Key Sources

Academic / Research

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- IMF WP/22/173 (2022). “Second-Round Effects of Oil Price Shocks.” — Inflation pass-through elasticities, wage response.
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- IMF WP/17/15. “Oil Prices and the Global Economy.” — Oil demand elasticity with respect to GDP.
- IMF WP/23/67. “Capital Controls in Times of Crisis – Do They Work?” — Historical effectiveness of crisis-era capital controls (1930s, 1990s, GFC).

Data Sources

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- IMF COFER (Q2 2025). — USD share 56.32% of allocated reserves, down from 71% in 1999.
- US Treasury TIC Data (Dec 2025). — Japan holdings \$1,185.5B; China \$683.5B; total foreign \$9,270.9B.
- LongYield Substack (2026). “\$200 Oil Shock.” — GDP modeling, bypass capacity, SPR coverage calculations.
- Zero Carbon Analytics (2025). — Hormuz closure modeling, Brent \$130 scenario, Asian vulnerability ranking.
- S&P Global (Aug 2025). — Japan Middle East crude dependency >95% in H1 2025.

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- Strauss Center: Iran mine stockpile 2,000+, Soviet/Western/indigenous designs.
- USNI News (Mar 2, 2026): “Iranian Naval Forces are Major Target in Operation Epic Fury Strikes.” Asymmetric force description.
- Army Recognition (Mar 2026): Iran’s “magazine-drain” strategy — layered mines, missiles, submarines, swarm tactics.

Fertilizer / Food Security

- Forbes (Mar 1, 2026): “Beyond Oil: The Strait of Hormuz and the Global Food Risk.” Iran 5M MT urea/year (10% global trade).
- AgWeb (Mar 3, 2026): 3 of top 10 global urea exporters in Persian Gulf; 3 of top 10 anhydrous; 1 of top 5 phosphate.
- Agriculture.com (Mar 3, 2026): ME accounts for 40-50% of seaborne urea trade volume.
- Kpler (Jun 2025): “Global fertiliser dependency on Gulf exports.”

Real-Time / Journalistic

- Rapidan Energy (Bob McNally, CNBC): “Prolonged closure = guaranteed global recession”
 - Maritime Executive: Navy told tanker executives “no availability” for escorts
 - gCaptain: P&I clubs 72-hour cancellation; Joint War Committee expanded high-risk zones
 - Windward Maritime Intelligence: 4 commercial tankers struck in 36h, traffic down 86%
 - Lloyd’s List: war risk premiums 5x in days
 - Flexport (Ryan Petersen): 18% global air freight capacity removed
 - Flexport (Sanne Manders): “closed as far as global shipping was concerned”
 - Al Jazeera: death toll 787+, Minab school bombing 115-165 dead
 - Chosun Daily / anews.com.tr: THAAD/Patriot redeployment from South Korea
 - Seoul Economic Daily: US depleted 20%+ of THAAD stockpile in June 2025
 - CRUDEOIL231 (X/Twitter): KOGAS panic, SPR, THAAD, air defense asymmetry
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This analysis assumes the conflict continues without resolution for 6+ months. If a ceasefire occurs within 30 days (currently assessed at <5% probability), the economic cascade described in Phases 2-5 would be significantly attenuated though not fully prevented — the trust damage and alliance restructuring are already underway.