

As Middle East Tensions Rise, Will Inflation Follow?

Rate markets initially spiked, but the long-range economic impact hinges on the war's duration.

Recent hostilities in the Middle East have primarily affected fixed-income markets through energy prices, inflation expectations, and broader risk sentiment rather than through an immediate deterioration in corporate fundamentals.

At the time of writing, energy markets have reacted sharply, with oil and gas prices moving higher as geopolitical risk premiums¹ have expanded. Importantly, markets had already priced in a meaningful geopolitical premium prior to the escalation, suggesting the price action reflects an amplification of existing concerns rather than a fundamentally new shock. Our base case remains that any supply disruption is short-lived, and that energy risk premiums should recede as conditions stabilize.

Macro/Rates

The economic impact of the current conflict in the Middle East hinges primarily on energy markets and uncertainty effects. The most acute risk is potential damage to transport infrastructure or disruption in the Strait of Hormuz, through which oil is transported. These events would materially weigh on global growth and risk assets through a sharp rise in oil prices, which acts as a tax on consumers and disproportionately hurts discretionary spending. At the same time, elevated uncertainty could delay investment if the conflict deepens or persists.

Rates markets initially rallied on risk aversion but quickly reversed, with US Treasury yields now higher across the curve. Short-dated inflation measures rose more than would typically be implied by the energy move alone, suggesting markets are assigning higher odds to a near-term inflation impulse. The US Federal Reserve (Fed) is likely to closely monitor inflation expectations and OPEC's response to determine how persistent the energy shock may be and whether policy needs to adjust accordingly. Futures markets are currently pricing two interest-rate cuts in 2026, compared to one cut as of the Fed's most recent projections.

Credit Markets

Credit spreads² have widened modestly across both investment-grade and high yield. However, the primary drivers of spreads have recently been technical rather than geopolitical. Heavy supply, sector-specific repricing, and markdowns in private-credit portfolios have played a larger role in spread movements than conflict-related fundamentals. While geopolitics may add volatility at the margin, any de-escalation is not likely to serve as a catalyst for sustained spread tightening, in our view.

Emerging Markets

In emerging markets (EMs), the impact of higher energy prices is more nuanced. Persistently higher oil prices would weigh on global growth, lift inflation, and constrain central banks' ability to ease policy, pressuring energy-importing EMs across Asia and parts of Europe. Conversely, several commodity-exporting

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Key Points

- Middle East tensions are influencing markets mainly through energy prices, inflation expectations, and risk sentiment—not corporate fundamentals.
- Energy markets amplified existing geopolitical premiums, with disruptions expected to be temporary as supply conditions stabilize.
- Credit and emerging markets face selective pressures, driven mostly by technical factors. Near-term impacts may remain contained if geopolitical disruptions are limited.

EMs in Latin America and Africa could benefit from higher prices or a shift in production away from the Middle East. Overall, while near-term impacts may remain contained if disruptions are limited, a prolonged or wider conflict could increase downside risks for EM asset prices and macro stability.



A prolonged or wider conflict could increase downside risks for emerging-market asset prices and macro stability.

If you're concerned about the impact of geopolitical events on your portfolio, please reach out to your financial professional.

¹ Risk premiums are the investment return an asset is expected to yield in excess of the risk-free rate of return.

² A credit spread is the difference in yield between two debt securities with different credit quality but the same maturity.

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