



No easy off-ramp

It may be the Iranian regime that decides when conflict will cease

Key points:

- **Middle East conflict: Iran** has the capability to close the Strait of Hormuz for an extended period through low-cost asymmetric warfare, potentially controlling when the conflict ends
- **Refined product shortage:** China has imposed export bans on refined products this week, with Korea and potentially the US considering similar protective measures.
- **Federal Reserve stance:** The Fed has kept rates unchanged this week, with Chair Powell confirming he will remain until DOJ investigations conclude.
- **European central banks:** The ECB has adopted a more cautious tone on inflation this week, whilst the BoE voted unanimously to hold rates steady.
- **Valuation risks:** We must guard against false dawns, as deeply ingrained 'buy the dip' behaviour creates a real risk of much deeper valuation corrections in markets.

London, 20 Mar 2026: Further escalation of the war in the Middle East has seen energy prices spike higher in the past week, in the wake of attacks on oil and gas infrastructure across the region.

A relatively muted reaction in risk assets suggests to us that markets have been keen to look through the conflict, on the hope that this may witness a relatively swift conclusion. However, we are much less confident that this will be the case.

Ultimately, it strikes us that Iran has the capability to effectively keep the Strait of Hormuz closed for an extended period through relatively cheap and low-tech warfare. The threat of drones, mines and small attack boats may prove difficult to eliminate along an extended coastline, in the absence of boots on the ground.

In this context, it may be the Iranian regime that decides when conflict will cease, rather than being contingent on some declaration of victory coming from the White House.

From an Iranian point of view, the current war is existential in the eyes of the regime and this makes surrender or negotiation difficult to foresee in the near term.

US hopes of a popular uprising in Iran have failed to materialize, after past protests have been mercilessly crushed and the notion that naval escorts could ensure safe passage through the Strait of Hormuz also seem over optimistic.

It is notable that the US navy is keeping a very safe distance and it has not been surprising that Trump's calls for 'allies' to commit their own vessels to the task were quickly rebuffed. Looked at from an Iranian point of view, it strikes us that there is a clear objective that at the end of any conflict, there needs to be sanctions relief.

Furthermore, there seems a clear desire that US presence and influence is eliminated from the Gulf and the broader Arab world. Although this may seem unrealistic, the price many of these countries are currently paying for the US / Israeli war is very significant.

It will be interesting to see how public opinion shifts in the region in the weeks and months ahead, as it is hard to think that the US action will have done much to improve its bilateral relationships within the region.

There is an increasing shortage in refined products, with gasoline and jet fuel prices rising much more quickly than crude. The reliance on Middle East refining capacity, which has effectively been shut off from the market for the time being, explains this change.

Consequently, China has issued an export ban on refined products as it seeks to protect domestic consumption.

Other countries, including South Korea, are considering similar steps and we would not be surprised if the US follows suit.

Such measures have prompted a widening of the spread between the Brent and WTI benchmarks over the past several days.

Meanwhile, Middle East benchmark crude has already moved above \$150 per barrel. In this respect the pain from higher oil prices is being felt much more acutely in Asia and Europe, than in the US.

Most exposed are those countries at the end of supply chains, many of whom have closed refining capacity as they sought to offshore carbon-intensive industries. Consequently, there is already talk of shortages in Australia and New Zealand, and other countries are also expected to feel the squeeze as the Strait of Hormuz remains closed.

This has prompted talk of rationing and enforcing work-from-home mandates in the hope of curbing demand. In this context, a prolonged conflict is likely to start to see economic downside and recession risks build in a number of the most affected economies.

This said, the economic outlook in the US continues to remain relatively constructive. As a country which benefits from energy and food security through domestic production, there is a sense that events in the Middle East are relatively remote to the USA.

However, higher prices will limit the ability for the Federal Reserve to lower rates in the near term and this is also likely a factor that will hurt Trump and the Republican Party at the midterms later this year.

This week's FOMC meeting was relatively uneventful, away from announcements that Chair Powell plans to remain at the Fed until the DoJ investigations into the organization have been completed.

With respect to monetary policy, the Fed highlighted elevated risks as a result of the broader macro backdrop.

However, we think it is unthinkable for now that the Fed will look to hike interest rates in the course of 2026, especially with the labour market continuing to show signs of softening as workers are replaced by AI agents.

With short-dated Treasuries trading above cash rates, we remain relatively constructive at the front end of the US curve. However, we are more cautious on longer-dated maturities as a result of additional inflation and fiscal risks.

As we may have expected this week, the ECB sounds more cautious with respect to monetary policy on higher inflation. As Eurozone yields have risen, two rate hikes are now discounted in futures markets during 2026.

Meanwhile, the Bank of England voted 9-0 to keep rates on hold with some even more dovish members indicating the heightened risks to price stability stemming from the conflict.

However, we eventually see the BoE operating with a different policy reaction function compared to the ECB and this makes UK rate hikes more unlikely in our view, with the policy rate already in restrictive territory and the output gap growing as the UK economy weakens.

Unlike 2022, when higher energy prices coincided with aggressive policy tightening, the economy in 2026 is in very different shape to where it was post-Covid and the pent-up demand coming from prior stimulus.

Additionally, in 2022, central banks were well behind the curve and coming from a zero-rate regime, whereas in 2026, the backdrop is very different.

Credit spreads have widened over the past week, but moves remain very orderly to this point, with equities also holding up better than might be imagined. We think that a cautious stance is warranted for now.

Flows have been supporting credit strategies over the past year at a time when there has been heavy levels of net new issuance. A risk to the market here is that if investors look to de-risk asset allocation, it is not clear that supply will retrench nearly as quickly.

In particular, the issuance from AI hyper-scalers is unlikely to be particularly price sensitive.

Elsewhere, private credit has been crying out for the relief from lower interest rates. With this unlikely to be forthcoming, building stress in private markets is also a factor that can weigh more broadly on credit asset classes.

In FX, the dollar continues to benefit from safe-haven flows. With the US more shielded from the growing energy price shock, this may continue to remain the trend in the short term.

However, as and when the conflict in the Middle East recedes, we would not be surprised that global investors may be more inclined to pivot away from US assets in the quarters to come. This may speak to a more bearish outlook for the dollar in the longer term.

This may be beneficial to Emerging Market (EM) assets in due course, though in the short term, investors in EM tend to sell first and ask questions later. Yet, we think that after de-risking occurs, there will be much more of a focus on relative winners and losers in EM.

In particular, it is notable that some energy exporting countries have seen asset prices drops as large as those dependent on energy imports. This focus on dispersion should lead to a number of active opportunities on a relative-value basis.

Looking ahead

In the short term, ongoing developments in the Middle East are likely to continue to dominate the investment outlook.

Ultimately, we know that this conflict will reach a conclusion and, as and when this becomes clear, this will mark a significant turning point in markets.

Having cut risk, the key test ahead will be determining the right time to re-engage.

Perhaps, some may be too eager to look for the turning point and it strikes us that away from rates markets there has been no material risk capitulation just yet. Should this occur, we are content that a low-risk position will make it easier to pivot more quickly and decisively.

But we need to be careful to avoid any false dawns in the process and understand that in a market where buying the dip is so deeply ingrained, there is a real risk of a much deeper correction in valuations.

This could occur if this approach is called into question and stop losses are triggered on a much more widespread basis than has been the case up to this point.

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