



Treading on eggshells

US-Iran conflict: rhetoric versus reality

Key points:

- **US-Iran conflict tensions:** the U.S. administration has signalled a desire for a swift exit from the Middle East conflict, whilst military build-up continues on the ground.
- **Strait of Hormuz closure impact:** oil and gas supply disruptions have persisted this week, with the strategic waterway remaining largely shut despite diplomatic efforts.
- **Core rates market shift:** bond markets have moved from peak inflation panic toward concerns about demand destruction and growth impacts from elevated energy prices.
- **Japan monetary policy dilemma:** the BoJ has faced pressure this week as yen weakness intensifies, whilst Tokyo CPI remains subdued and growth concerns mount.
- **Macro outlook uncertainty:** policymakers have revised inflation forecasts higher and growth lower, reflecting ongoing economic disruption from Middle East tensions and energy price shocks.

London, 2 Apr 2026: In a shortened Easter week here in London, events in the Middle East continue to dominate price action in financial markets.

Reminiscent of early last week, bonds and stocks have rallied sharply on a sudden swing in sentiment, on the view that the Trump administration is close to a more decisive exit in the US-Iran conflict. However, in his latest speech, Trump offered nothing new in terms of progress to a deal. On one hand, the rhetoric coming from the U.S. President (whilst somewhat incoherent) points toward a fairly swift end to U.S. involvement in the conflict, however, on the ground things are different as the U.S. continues to build up its military capabilities in the region.

With Iran continuing to deny progress in talks and pushing back on Trump's comments, you could argue little has changed, and investors remain in the lurch against a backdrop of conflicting messaging and signals. It remains difficult to predict the path the conflict will take in the near term, but two points are clear.

Firstly, the US administration would like to see a quick end to the conflict and the pain this is inflicting on the global economy, whilst simultaneously being able to declare a unilateral victory.

Secondly, that the Strait of Hormuz remains largely shut and missiles/drones continue to fly around the region, damaging oil and gas installations.

In that respect, a quick off-ramp at this juncture, where the flow of oil remains compromised, will continue to have lingering and uncertain economic and geopolitical ramifications.

It may be that the most likely outcome is some sort of messy compromise. The U.S. exits the fray, declaring a win in terms of the degradation of Iran's military and nuclear capability but leaving the situation in the Strait

of Hormuz unresolved and requiring messy deal-making between Asian and European countries and Iran to get ships flowing again.

Nevertheless, as with last year's April Liberation Day policy reversal, the investor community still feels desperate to buy the dip. However, an easy reversal will be much more difficult to expedite than in previous geopolitical episodes if the reality is one where oil and gas prices remain elevated and supply chain disruptions manifest as a result. This suggests there is plenty of scope for this complacency to be challenged to adjust to the new reality that comes into view.

In core rates markets over the week, it was interesting to observe how the market seems to be moving through peak panic with regards to the impact that higher inflation will have on central banks' activity.

Short-dated maturities have stabilised and there is potentially a switch from a myopic focus on inflation and how much central banks may need to hike rates – to concerns around demand destruction, the hit to consumption, growth, and labour markets, and therefore whether pricing rate cuts is warranted. The result is a shift from curves bear flattening to bull steepening.

In Japan, as with other economies, the move in oil will be bad for inflation and bad for growth. This week's data was mixed, with Tokyo CPI remaining well below 2%, while the Tankan survey remained robust on the prices side. Moreover, with the yen close to 160 versus the U.S. dollar, markets are currently pricing a coin flip for a BoJ hike later this month.

We know that PM Takaichi is very focussed on delivering growth, and from that perspective we can see an argument that she will want to push back on the BoJ normalising rates. However, a more dovish BoJ could lead to fears of a more extended inflation overshoot, which weighs on the curve. We remain bullish that the 10/30 JGB curve can flatten further in the medium term.

Looking ahead

What we do know is that the macro fog should start to lift relatively soon, once we know which direction events are moving in. At this point, we are positioned relatively close to neutral in terms of directional beta, and are in a good position to be able to adopt a more decisive stance when the dust settles.

From a fundamental perspective, higher oil and gas prices are already having an economic impact on a global basis, with policymakers revising inflation forecasts higher and growth lower as they reflect on the economic outlook because of the ongoing disruption.

Against a torrent of contradiction, separating signal from noise is not as straightforward as one might think it should be at the current point in time. Against this backdrop, it is understandable that markets feel like they are trading on something of a knife's edge.

Consequently, treading on eggshells appears the appropriate stance for investors for the time being. Speaking of eggs – we wish you a happy (and hopefully peaceful) Easter.

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