

### Iran: inflation, interest rates, investments 23 March 2026

The Iran conflict has expanded across the Middle East. In an unpredictable situation, we see good ways of mitigating risks and protecting portfolios.

This article was written on the morning of Monday, 23 March.

#### What does the rise in energy prices mean for inflation?

If these are sustained, they'll push inflation noticeably higher in most countries – but not close to the 2022 peak, after Russia's full-scale invasion of Ukraine.

In the UK, energy prices at current levels will add around 2 percentage points (pp) to CPI inflation by the third quarter of this year, probably taking it to around 4%. Indirect price pressures are also likely to build up over the course of the year, for goods and services where energy commodities are key inputs – most notably, food.

But accurately predicting the magnitude and timing of these indirect effects is difficult. And there may be offsetting effects, reducing overall increases in

#### Quick take:

- If the rise in energy prices is sustained, inflation will be higher in most countries – but not close to 2022 levels.
- Interest rate cuts across the world are now off the table, but we don't see large increases.
- The Iran conflict strengthens our conviction in shorter over longer-dated bonds, diversifying assets, and some defence and energy stocks.

inflation, as higher energy bills suppress consumer spending elsewhere.

In the US, the direct impact should be smaller, at closer to 1pp, taking inflation there to around 3.5%. Most of that comes from the impact of higher oil prices on road fuel.

Average gasoline prices have already risen from \$3 to almost \$4 a gallon so far this month. But the US will still face indirect inflationary pressures in areas like food and air fares.

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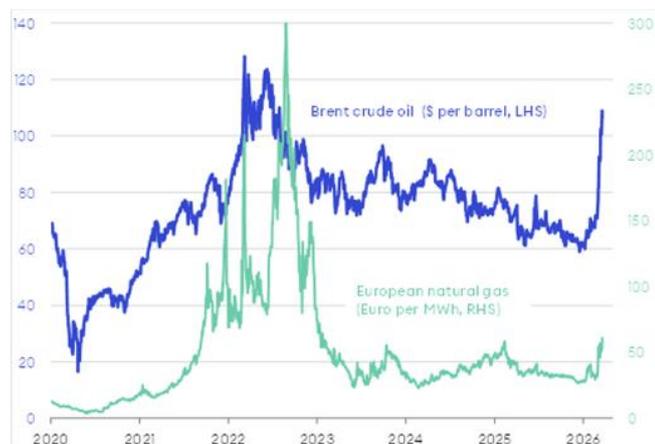
### What difference will the Iran conflict make to interest rates?

The key question for investors is this: is a repeat of 2022 on the cards?

Russia's full-scale invasion of Ukraine could hardly have happened at a worse time for inflation and interest rates. It took place as a perfect storm of broader inflationary conditions was brewing. But that's not the case now.

In early 2022, demand in the global economy was extraordinarily strong. Fiscal policy was extremely supportive of that demand: the US had passed two spending packages of over a trillion dollars, the previous year.

### Oil and gas prices haven't reached their 2022 peaks



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Monetary policy was highly supportive too: central banks had barely begun to withdraw the exceptional accommodation they provided during the depths of the Covid pandemic.

Moreover, households were spending the extra cash accumulated during lockdowns.

Meanwhile, labour markets were the tightest in a generation as firms scrambled to find workers after the pandemic peaked, fuelling rapid wage growth.

And goods supply chains were under intense strain to provide what people wanted. That raised prices, too.

Taking all this together, price pressures posed a serious problem prior to the invasion. It's often forgotten that inflation was above 7% in the US and rising before Russia attacked, and above 6% in the UK.

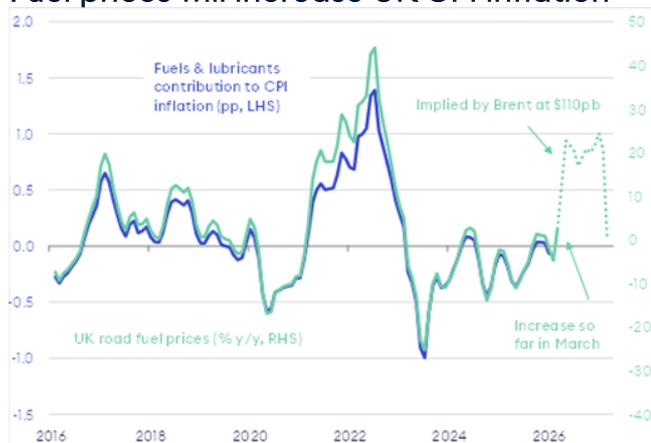
Sharp increases in interest rates would have been needed regardless of the invasion.

In the end, rates rose by 5pp or more in both the US and UK within the following year-and-a-half.

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The current context is very different. Inflation has been falling – it’s down to 2.4% in the US and 3.0% in the UK. Central banks had, before the conflict, been on track to lower interest rates a little further from restrictive levels – levels that rein in rather than boosting the economy. Now, those cuts are off the table, and financial markets are now even pricing in, for the UK, small increases in interest rates of about 0.75pp. That might happen. But substantially larger increases, as seen in 2022, seem highly unlikely.

### Fuel prices will increase UK CPI inflation



### How will the Iran conflict affect economic growth?

Higher energy prices will hurt economic growth, and generally by more in countries like the UK that are net energy importers.

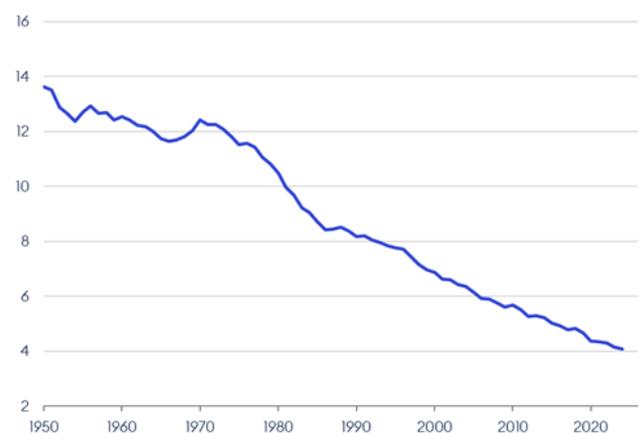
But the damage from the increase in prices that has happened so far should be manageable. They’re likely to reduce

global GDP growth this year, forecast at around 3% before the conflict, by perhaps 0.1-0.2pp. As explained above, interest rates shouldn’t need to rise as they did in 2022-23. That makes a huge difference. It’s also notable that Europe has reduced its gas consumption since 2022 by 16%. That reduces its vulnerability.

In the 1970s, two major oil shocks contributed to deep recessions. But oil prices rose a great deal more than they have so far – by more than 200%, compared to about 80% up till now. And the global economy was far more dependent on oil, back then. The energy intensity of US GDP, for example – the energy used for every dollar of economic output – was about three times greater.

### The US needs much less energy than before, for every dollar in output

*The chart shows energy use per dollar of US GDP (millions of thermal units)*



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That meant higher oil prices did far more damage.

This assessment is, of course, dependent on what happens to energy prices.

### What could happen to energy prices next?

Let's think through the key risks.

As long as the Strait of Hormuz remains impassable for most tankers, global oil supply may be 10-15% lower than usual. Around 20m barrels of oil per day (20% of global supply) ordinarily transit the Strait. Reports suggest that 2-3m barrels per day of Iranian oil exports have continued, and a handful of shipments from other countries have been allowed to pass through too. Additionally, analysts estimate that there are 3.5-5.5m barrels per day of spare capacity in pipelines that allow oil producers to bypass the Strait.

Meanwhile, around 20% of global liquefied natural gas (LNG) exports, almost entirely from Qatar, also transits the Strait. There are no alternative routes for this LNG and there's limited spare unsanctioned capacity elsewhere.

Developments in the Strait will therefore be the primary determinant of what happens to energy prices next. At present, we think oil and gas markets are pricing in

disruption to shipping of between one and three months. If traders think disruption could last longer than that, prices could rise further. Much longer disruption could push the benchmark Brent crude price as high as \$150 a barrel.

A sustained rise above \$150, as some have speculated, seems unlikely. The case for \$150 requires some very unfavourable assumptions about how much any given level of supply shortage would affect prices, and/or an even larger hit to supply.

It's worth remembering that US President Donald Trump has strong incentives to reduce energy prices ahead of the Congressional midterm elections in November, given the high political salience of inflation, even if the cost is an embarrassing climbdown on Iran or the commitment of vast military resources to protecting the Strait.

There are also strong incentives for Europe, China and most Gulf states to force a resolution to the Strait's closure.

That said, even if the Strait was reopened, prices would remain high for a while. After all, it will take time to restart shuttered oil production. It will also take time to unwind the disruption to refinery supply – some have been damaged by the attacks. But we'd expect prices to fall meaningfully from current levels.

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### What does this mean for investment strategy?

We're wary of knee-jerk reactions, based on strong assumptions about how highly unpredictable events will unfold.

That includes the assumption by some people of worst-case scenarios.

We have an evidence-based framework to guide us, which should also help to identify if significant investment opportunities emerge from the volatility.

Looking at different assets:

- Even before the conflict, we favoured shorter-dated bonds, since these are hit less than longer-dated bonds by increases in inflation and inflationary expectations. The current conflict only increases our conviction. Since the start of March, the return for the FTSE index of 10+ year gilts is -5.6%. For 1 to 5-year gilts, the fall is only 1.8%. As well as short-dated bonds in general, we like index-linked bonds. These are bonds whose coupon – the interest payment made by the debtor – is linked to inflation. Short-dated index-linked gilts have delivered positive returns in March.
- We like diversifying assets, including actively managed strategies. So far during the conflict, index-linked gilts

have held up better than equities and long-dated gilts.

- Even before the conflict, we saw strong potential in some defence and energy companies – and the case for them is now stronger.
- We favour companies with 'quality' characteristics: strong competitive positions and balance sheets. They should be better positioned to cope with economic volatility, and have performed better since the conflict began.

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