

# How bad can it get? Gauging the Iran conflict's impact on the U.S. economy and markets

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The key question for investors: Will the oil price shock lead to Fed rate hikes and/or a recession? Historically, that's the painful scenario for risk assets.

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## KEY TAKEAWAYS

- While major economies are much less oil intensive than in the 1970s, this year's disruption could rival that era. The effective closing of the Strait of Hormuz presents a major threat to the global economy and markets.
- Higher oil prices can significantly impact the U.S. and global economy through three main transmission channels—inflation, consumer saving behavior, and fiscal effects. Equity markets can withstand an oil shock assuming no recession or significant Fed policy rate hikes, which investors will closely monitor as twin risks.
- In past asset market sell-offs driven by oil price shocks, investors found protection in gold, emerging market debt, energy equities, and macro hedge funds.
- The Gulf countries have been a growing force in the global economy. Their continued ability to project soft power now hangs in the balance.

## Introduction

As headlines shift and markets move, how can we assess the macroeconomic fallout from the conflict in Iran? In this report, we focus on the potential impact on the U.S. economy. Higher oil prices affect the economy through three main transmission channels: Inflation (as higher energy prices reduce real income), consumer saving behavior and fiscal (through the Treasury term premium). While the United States and other major economies are far less oil intensive than they were in the 1970s, the potential oil and gas supply disruptions could rival or

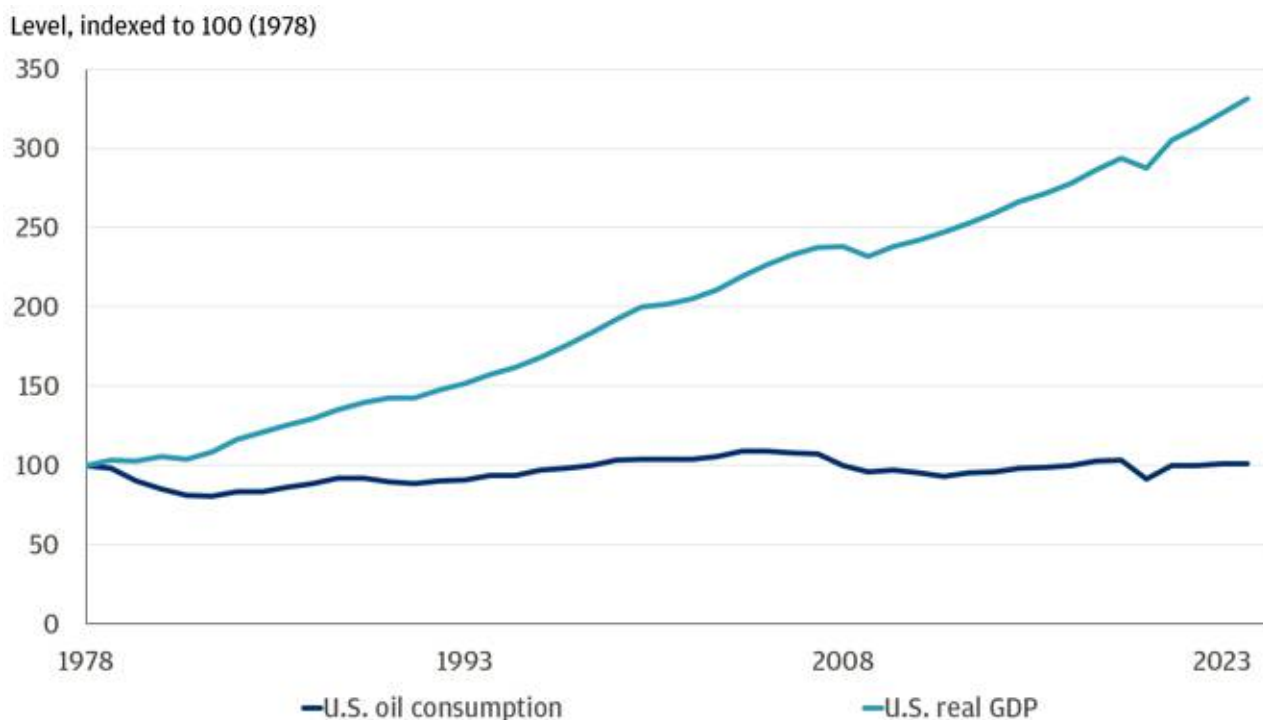
even exceed the 1970s.

Investors are asking: Will this oil price shock lead to Federal Reserve (Fed) policy rate hikes and/or a recession? Historically, those are when risk assets sell off. In the downside scenario, the compounding effect of sustainably higher oil prices (over \$120/barrel) and a bear market in equities would intensify the hit to growth. Investors will also recall the asset class lessons of past geopolitical conflicts: gold, energy, utilities/infrastructure and emerging markets debt have tended to outperform.

## History as a starting point

We begin with an analysis of an economy's oil intensity. Oil consumed per dollar of real GDP has fallen dramatically, down 73% since 1978. Vehicles have become more efficient. Cheaper natural gas has displaced oil in many uses and renewables are now achieving scale. More broadly, the transition from an industrial economy to a services economy (which we have [previously discussed](#)) significantly lowered the U.S. economy's overall oil intensity.

### The U.S. economy is far less oil intensive than it was in the 1970s



Source: Energy Institute, Haver Analytics. Data as of 2024.

Despite the economy's diminished oil intensity, the scale of today's oil market disruption could potentially prove greater than its 1970s precedent.

When OPEC (the Organization for Petroleum Exporting Countries) embargoed oil exports in 1973 to nations supporting Israel during the Yom Kippur war, the global oil supply fell by less than 10%. By contrast, tankers passing through the Strait of Hormuz prior to the outbreak of the current conflict carried one-fifth or more of world oil flows.

As this is written, the maritime artery is effectively closed. A prolonged shutdown of the Strait would affect shipments from multiple Gulf producers. And today's just in time logistics and sophisticated financial linkages, through hubs such as Dubai, create fragilities in the global economy that didn't exist in the 1970s.

## The inflation channel: Higher prices, lower real incomes

We turn now to the three channels through which higher oil prices impact the economy.

The first channel is inflation. We think the primary economic effect from higher oil prices occurs through rising prices, which have a dampening impact on Americans' real incomes. Energy prices pass through quickly to retail fuels and freight costs. Transportation fuel demand is inelastic—it doesn't change quickly. In the short term, higher prices at the pump function like a tax: Real disposable income is squeezed and households' spending shifts from the discretionary to the necessary.

To quantify this effect, we rely on the Federal Reserve's publicly available large-scale macroeconomic model. It tells us that when the oil price rises \$10 above its equilibrium price, U.S. inflation increases by about 30-35 basis points (bps). We then assume that roughly 70% of that increase in inflation will act as a tax that depresses GDP growth.

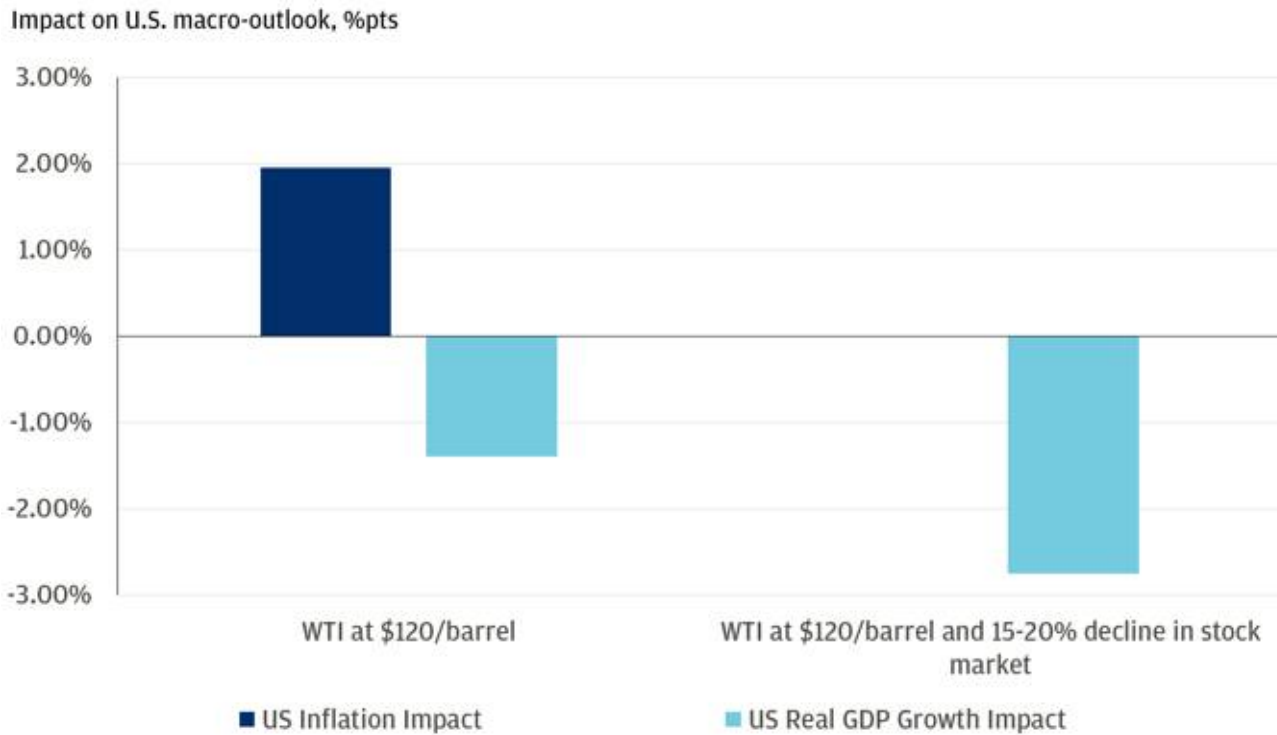
If, for example, West Texas Intermediate (WTI) oil were to double from its equilibrium price of \$60/barrel to \$120/barrel, that would likely lead to an inflation impact of about 2 percentage points (ppts) and a real GDP growth drag of about 1.4%ppts. Crucially, the model assumes that the changes in oil prices are maintained over an extended period. If oil were to jump above \$120/barrel, but then quickly fall back down in a matter of a week or two, then the ultimate impact on inflation and growth would be a fraction of these estimates.

At the time of writing, WTI oil has risen about \$35 above its equilibrium price to \$95/barrel. If that increase is sustained, it would result in 1.1%ppt of higher inflation and a hit to growth of about 0.8%. Although that would be a meaningful jump, in our view, it would not in itself spark a recession, given that the U.S. economy was trending at about a 2.25% real GDP growth rate before the conflict in Iran.

But here's the nuance of the current moment, which investors need to consider: the U.S. economic outlook would change if higher oil prices were to combine with deteriorating financial conditions and, specifically, lower stock prices. In a downside scenario, the compounding effect of sustained higher oil prices and a material drop in the stock market would amplify the hit to growth.

We follow this basic rule of thumb: Every 10% decline in the stock market depresses consumer spending by about 1%. Put simply, if oil were to rise above \$120/barrel and stay there, while the stock market declined by 15%-20% or more, the combined hit to growth would be comparable to what we would typically see in an average U.S. recession.

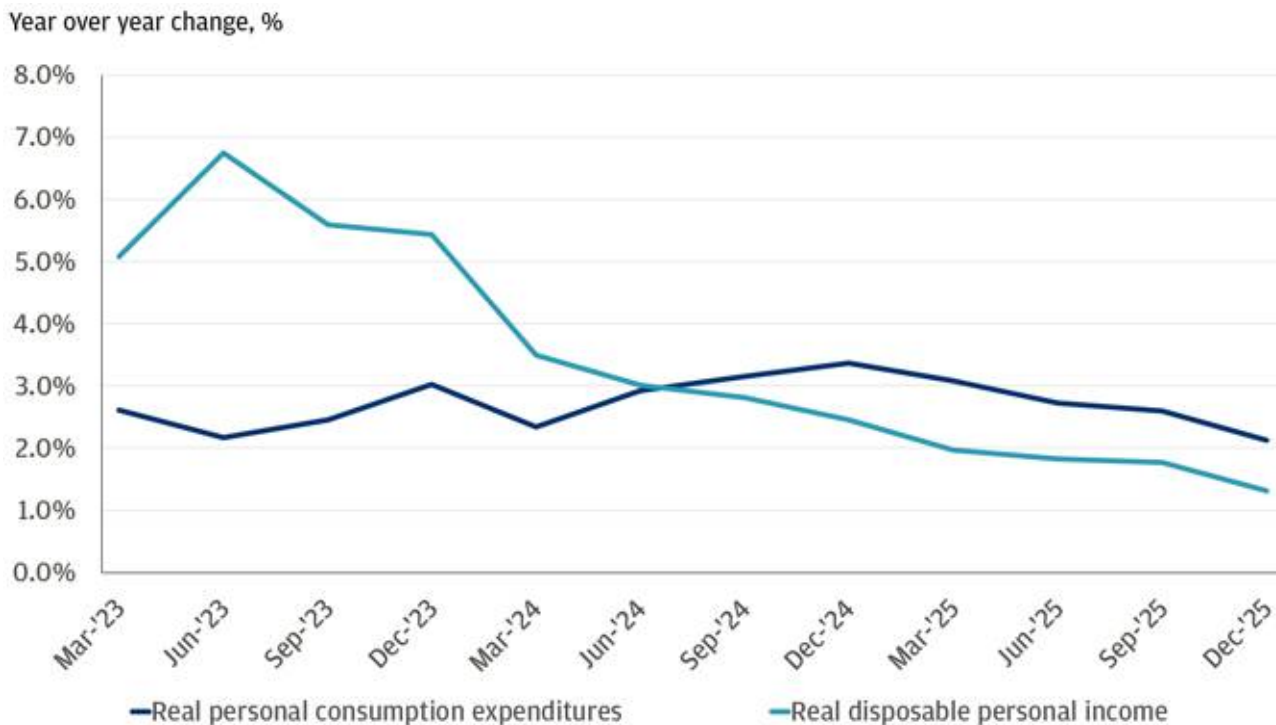
### Sustained higher oil prices and stock declines could pack a one-two punch



Source: J.P. Morgan Private Bank. Forecasts as of March 16, 2026.

U.S. consumer spending appears particularly vulnerable today. That's because personal income growth has been lagging consumer spending. This suggests that recent household outlays have been supported by wealth effects that could quickly reverse in the event of a stock market decline.

### Consumer income growth has been below spending

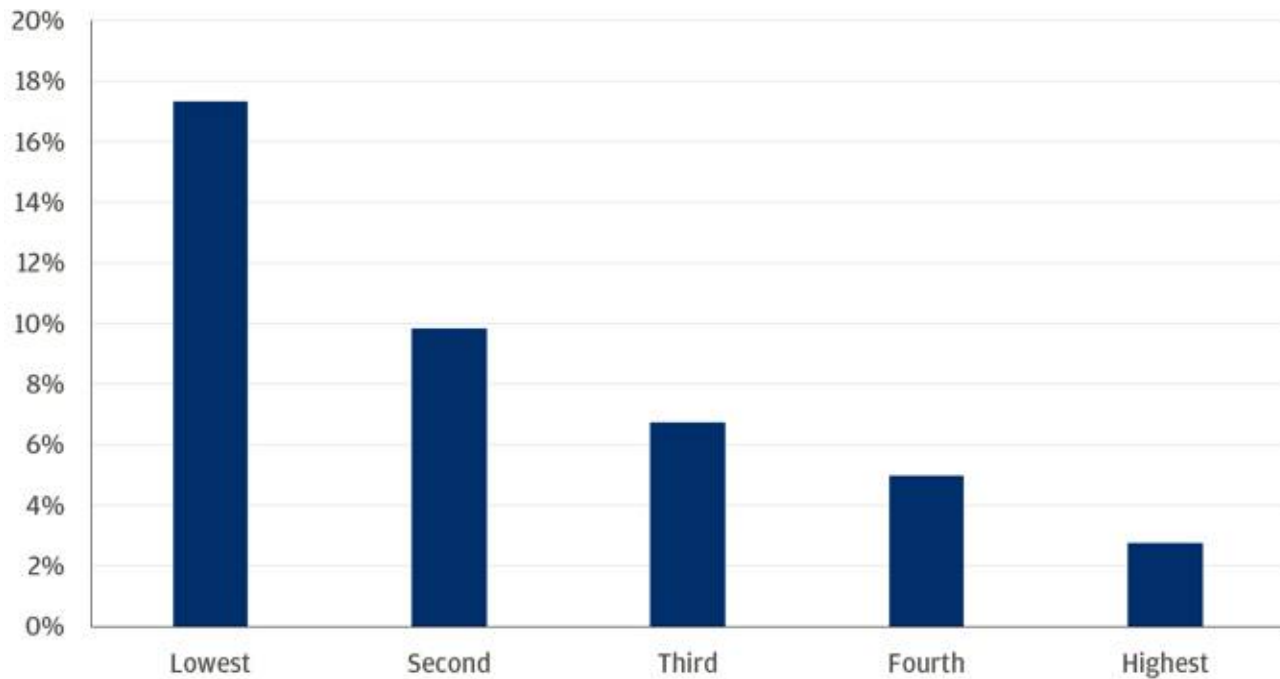


Sources: Haver Analytics, BEA. Data as of December 31, 2025.

The burden of higher oil prices is not evenly shared. Lower income households devote a much larger share of their total spending to energy and transportation compared with their higher income counterparts. When gasoline and diesel prices surge, these households reduce nonessential outlays more sharply, increasing the drag on overall retail spending.

## Lower income households suffer more from higher energy costs

U.S. household energy expenditures by quintile of income, % of pretax income, 2024



Sources: BLS, Haver Analytics. Data as of 2024.

## The household saving channel and the effects of consumer caution

The second transmission channel relates to household saving behavior. Consumers do not typically adjust their saving habits in response to geopolitical shocks. But when a crisis is severe, global and open ended, people rethink their job security and future income in ways that trigger higher precautionary saving. In other words, they hunker down.

The pullback appears first in big ticket and lending sensitive categories—such as autos, appliances, home improvement and travel. Other categories feel the fallout if the shock persists and/or adverse wealth effects from market declines make consumers even more cautious.

As of now, we see no clear sign of a shift in household saving tendencies. However, we know that past severe global geopolitical shocks, such as World War II and the Covid-19 pandemic, led to large and sudden jumps in household saving rates. This channel will be important to monitor closely the longer the conflict in the Middle East persists.

## Some past geopolitical shocks have caused sudden spikes in household saving rates

U.S. household personal saving rate, %



Sources: BEA, Haver Analytics. Data as of 2025.

## The fiscal channel: Defense spending and Treasury term premiums

The third transmission channel is fiscal. A key data point is the Treasury term premium, the additional compensation investors demand for holding longer dated Treasuries.

Here's the broader context: Before the start of the Iran conflict, the U.S. fiscal situation (the country's considerable debt and deficit) was already challenging. Mandatory entitlement programs, notably Social Security and Medicare, and interest on the U.S. debt, were already absorbing a large and growing share of federal spending.

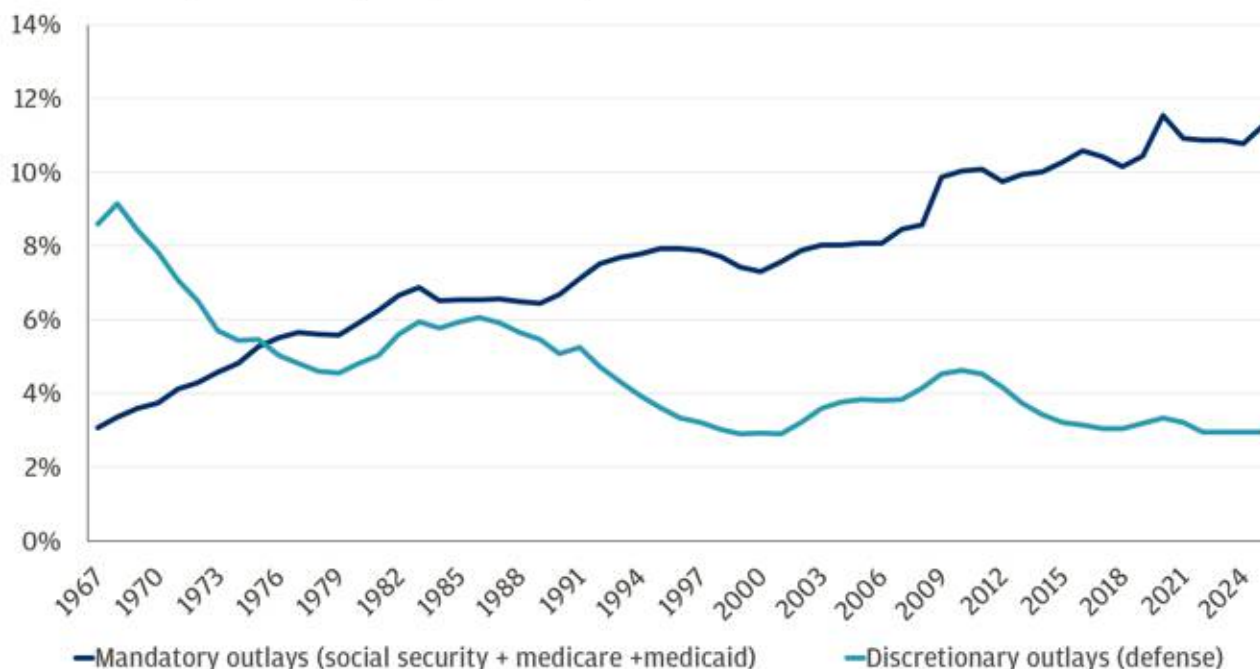
Then came the U.S. and Israel attacks on Iran. Conflicts are expensive. A significant government defense spending ramp-up funded via the government bond markets would increase the supply of Treasury bonds that investors would need to absorb. The term premium (and thus the yields on those longer-dated government bonds) could rise, amplifying any tightening in financial conditions associated with the spike in oil prices.

A higher term premium filters through the economy, pushing up mortgage rates and corporate borrowing costs and raising the discount rates used in investment decision-making (for example, in a company's capital expenditure plans). If sustained, a higher term premium can crowd out private investment and weigh on rate sensitive sectors, independent of any immediate action by the Federal Reserve.

President Trump has called for an emergency defense spending appropriation of \$50 billion for the military action against Iran. This equates to about one-third of what the U.S. government has spent to support Ukraine in the wake of the Russian invasion. Prior to the Iran conflict, President Trump called for a 50% increase in the Pentagon budget, to \$1.5 trillion. If enacted, U.S. defense would then amount to nearly 5% of GDP, up from the current 3% level. While defense spending reached upwards of 8% of GDP in the 1960s, overall entitlement spending then was a fraction of what it is today.

### Higher entitlement spending claims a growing share of the U.S. federal budget

Select mandatory vs discretionary outlays as % of GDP, %



Sources: Congressional Budget Office, Haver Analytics. Data as of 2025.

We monitor the term premium by comparing the 10-year Treasury yield priced in the market to market participants’ expectations for what the Fed policy rate will likely average over the coming decade. Using this measure, the last term premium shock was during August 2023–October 2023. Treasury debt issuance was unexpectedly high and investors feared a “higher for longer” rate environment. During that time, the S&P 500 fell by just over 10%, peak to trough. After the Treasury significantly changed its debt issuance strategy, the term premium shock subsided and equity markets recovered<sup>1</sup>.

1. <https://www.federalreserve.gov/econres/notes/feds-notes/the-treasury-tantrum-of-2023-20240903.html>

## Term premium shocks can be severe--and reverse fairly quickly



Note: Term premium proxied by the difference between the U.S. 10 year yield and the 10 year avg. appropriate FFR point prediction (median) in Survey of Market Expectations. Sources: FRB, FRBNY, Haver Analytics. Data as of January 31, 2026.

## When does an oil price shock lead to a significant market sell-off?

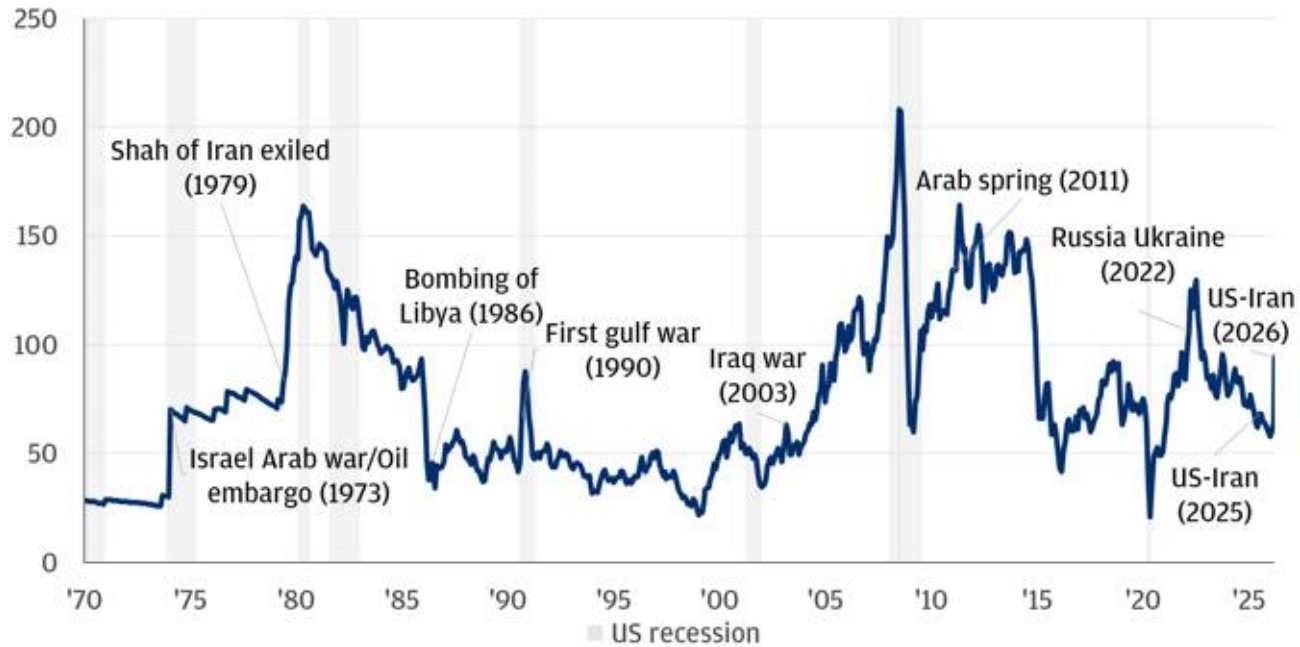
As we consider the economic and market outlook, it's helpful to recall the modern history of oil shocks.

Prior to the 1970s, oil prices were largely fixed by the oligopoly known as "the Seven Sisters," a group of two European and five American multinational oil companies. However, as governments nationalized the commodity and formed OPEC in the 1960s, oil prices were increasingly set by the global marketplace. This exposed oil prices to more region-specific shocks, laying the groundwork for the 1973 OPEC embargo, for example.

We identify nine geopolitical events since the 1970s that led to an oil price shock, which we define as a rise of greater than 20% in crude oil prices beginning one month prior to, and extending three months after, the event.

## Since the 1970s, markets faced nine conflict driven oil shocks

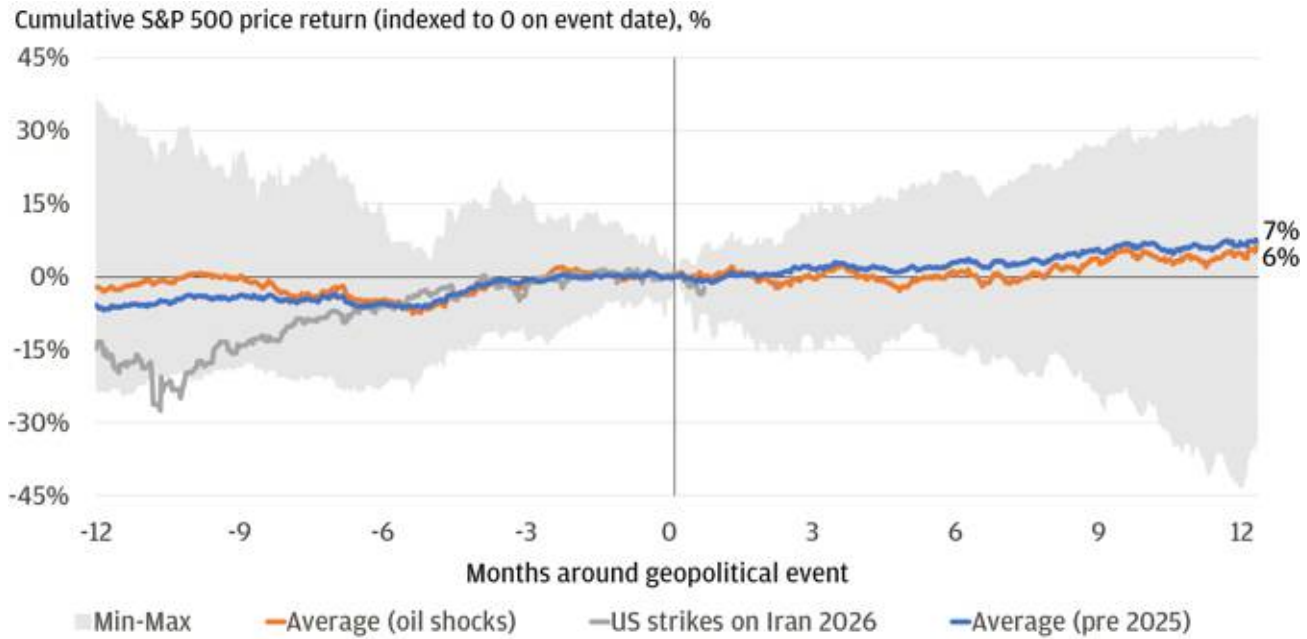
Oil prices in real terms, \$ per bbl



Note: Grey shading is a U.S. recession. Monthly Oil prices deflated by US CPI less energy. Labels isolate geopolitical events with a >15% rise in oil prices. Source: Haver Analytics; Bloomberg Finance L.P.; NBER; EIA; BLS; Chicago Mercantile Exchange. Data as of March 6, 2026.

While geopolitical events tend not to have lasting impacts on markets, they are associated with lower overall S&P 500 returns. On average, in the 12 months following a geopolitical shock, the S&P 500 returned 7%. When the geopolitical shock coincided with an oil price shock, the return was even lower, at 6%. These 6%-7% returns notably trail the annual 11%-12% return the S&P 500 has averaged since 1924.

## Geopolitical events tend not to have lasting market impacts



Note: Oil shocks defined as >20% rise in oil over the 1m prior to 3m post the event. Events: Israel Arab conflict/Oil embargo (10/16/1973); Shah of Iran exiled (1/16/1979); Iranian hostage crisis (11/4/1979); Invasion of Grenada (10/25/1983); Bombing of Libya (4/15/1986); First Gulf conflict (8/2/1990); Kosovo bombing (3/24/1999); 9/11 attacks (9/11/2001); Iraq conflict (3/20/2003); Arab spring (Egypt) (1/25/2011); Crimea crisis (3/1/2014); Intervention in Syria (9/22/2014); Airstrike on Syrian airbase (4/7/2017); Russian invasion of Ukraine 2022 (2/24/2022); Israel-Hamas conflict (10/7/2023); US strikes on Iran 2025 (6/22/2025); US strikes on Iran 2026 (2/28/2026) Source: Bloomberg Finance L.P.; J.P.Morgan. Data as of March 6, 2026.

Of the nine oil price shocks referenced above, four led to a material sell-off in risk assets, with an S&P 500 drawdown greater than 10% in the three months surrounding the shock. In each of those four cases, oil prices rose more than 50%. During the current Middle East conflict, oil prices have already risen more than 50%.

Oil shocks alone do not lead to material sell-offs in risk assets. Market history shows that such sell-offs have historically coincided with one of two conditions:

- A recession in the six months following the oil shock
- Over 50 bps of Fed rate hikes in the six months following the oil shock

## Equity markets can withstand oil shocks—assuming no recession or significant rate hike

Geopolitical event	Date	Market close date	SPX max drawdown (1m prior to 3m post)	Spike in Arabian light arab crude oil (1m prior to 3m post)	Spike in brent crude oil futures (1m prior to 3m post)	Change in Fed funds rate after 6m (bps)	US recession 6m post? (1=yes, 0=no)
Israel Arab war/Oil embargo	16-Oct-73	15-Oct-73	-17%	287%	#N/A	100	1
Iranian hostage crisis	4-Nov-79	2-Nov-79	-10%	44%*	#N/A	-400	1
Bombing of Libya	15-Apr-86	14-Apr-86	-8%	21%	#N/A	-137	0
First Gulf War	2-Aug-90	1-Aug-90	-20%	223%	153%	-125	1
Iraq war	20-Mar-03	19-Mar-03	-6%	12%	22%	-25	0
Arab spring (Egypt)	25-Jan-11	24-Jan-11	-6%	37%	36%	0	0
Russian invasion of Ukraine 2022	24-Feb-22	23-Feb-22	-16%	52%	48%	225	0
US strikes on Iran 2025	22-Jun-25	20-Jun-25	-2%	21%	23%	-75	0
US strikes on Iran 2026	28-Feb-26	27-Feb-26	-3%	73%	56%		

Note: Daily data used when available. Only looking at geopolitical events which led to a rise of >20% in crude oil prices beyond the 1970s given partial price fixing prior. Kosovo bombing in 1999 excluded given the oil market was recovering from a crash. Red shading for >10% S&P 500 drawdown; >70% spike in crude oil prices; >50bps rise in fed funds rate; a U.S. recession. \* Total rise in oil through the full shock was 150%. Source: J.P.Morgan. Haver Analytics; Bloomberg Finance L.P. Data as of March 6, 2026.

What would it take for this oil price shock to cause Fed policy rate hikes or a recession?

Given the reduction in oil intensity of GDP, an oil shock alone seems unlikely to be able to push the U.S. economy into a recession. The consensus view of economists projected 2.2% GDP growth in 2026 prior to the Iran conflict.

Outside of oil, we are closely watching three economic factors that could have spillover effects leading to an equity market sell-off. (In this way we gauge the risks we have discussed relating to the U.S. consumer and the Treasury bond market). All three factors can be monitored with high frequency data (daily/weekly):

*Rising inflation expectations.* Core PCE U.S. inflation is running ahead of the Fed's 2% mandate, at ~3% (~2.5% ex tariffs <sup>2</sup>). Inflation expectations are somewhat elevated at 2.4% (5year5year inflation swaps) in the wake of the 2022 supply chain shock. Higher inflation expectations raise the risk that the Fed will have to raise rates in the context of the current oil price shock. The rise in longer-dated inflation expectations in 2022 provided early signals of a more prolonged and severe S&P 500 drawdown.

2. Note: Ex-Tariff inflation St Louis Fed - <https://www.stlouisfed.org/on-the-economy/2025/oct/how-tariffs-are-affecting-prices-2025>

## When longer-dated inflation expectations rose in 2022, it signaled a prolonged S&P 500 drawdown



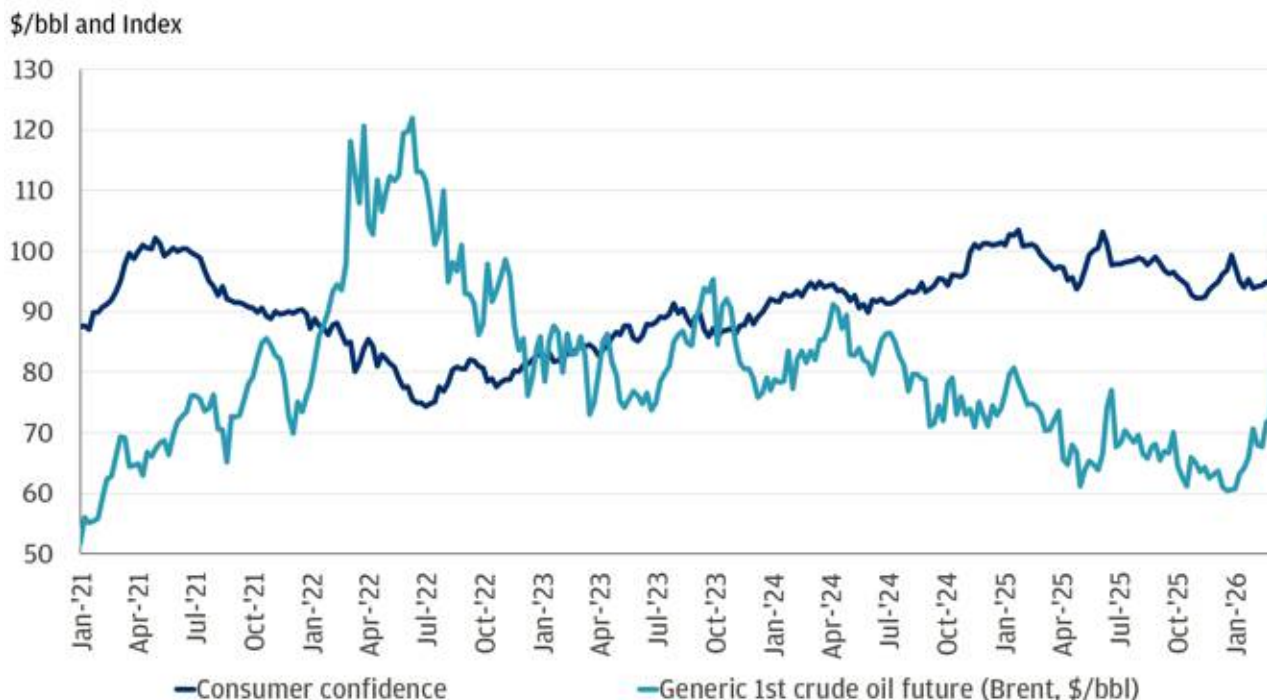
Source: Bloomberg Finance L.P. Data as of March 13, 2026.

For now, however, we do not believe longer-dated inflation expectations have reached a level that would be concerning to the Fed. In other words, they would not require the Fed to shift its recent focus away from supporting the labor market toward dealing with inflation through more restrictive monetary policy. Will inflation expectations change in the coming weeks? It's an important question for investors.

*A confidence shock.* As mentioned, U.S. consumer spending growth has exceeded growth in personal income. That gap reflects the positive wealth effect that comes from above-average stock market returns over the past three years and the willingness of those wealthier households to spend. Daily data on consumer confidence has begun to soften, although the decline has been more modest than it was during the oil price rise in 2022 .

A prolonged oil price rise would also erode the confidence of manufacturing company executives, given the importance of energy inputs to manufacturing. Thus investors will need to closely track manufacturing sentiment indicators.

## High frequency consumer confidence data shows early jitters, but no precipitous fall



Note: Consumer confidence proxied by US Morning Consult Consumer Sentiment (ICS) daily 5 day moving average. Source: Bloomberg Finance L.P. Data as of March 15, 2026.

*Broader disruption in supply chains.* When oil prices spiked in 2022, global supply chains were already under pressure. Today's supply chains look less vulnerable. While the New York Federal Reserve tracks supply chain pressures monthly, pressure in freight rates is priced weekly and daily. So far, these indicators do not point to a broader supply chain disruption. Indeed, the Baltic Dry Index recently dropped to a one-month low on March 10.

Beyond oil, commodity prices have risen more modestly. Agricultural and industrial commodities rose 5%–6%, far below the 40%–plus rise in energy since the Iran conflict began.

Yet global supply chains now face a separate risk—what amounts to an ongoing trade conflict between the U.S. and its trading partners. If one of those partners were to implement new restrictions on global trade—if China, say, were to reduce its exports of the rare earth elements crucial for high tech applications—it could intensify pressure on supply chains beyond energy markets.

## The impact of higher oil prices varies across sectors



Note: Uses Bloomberg sub-indices. Source: Bloomberg Finance L.P. Data as of March 16, 2026.

## A reduction in China's rare earth exports would pressure global supply chains



Sources: General Administration of Customs China, Haver Analytics. Data as of December 12, 2025.

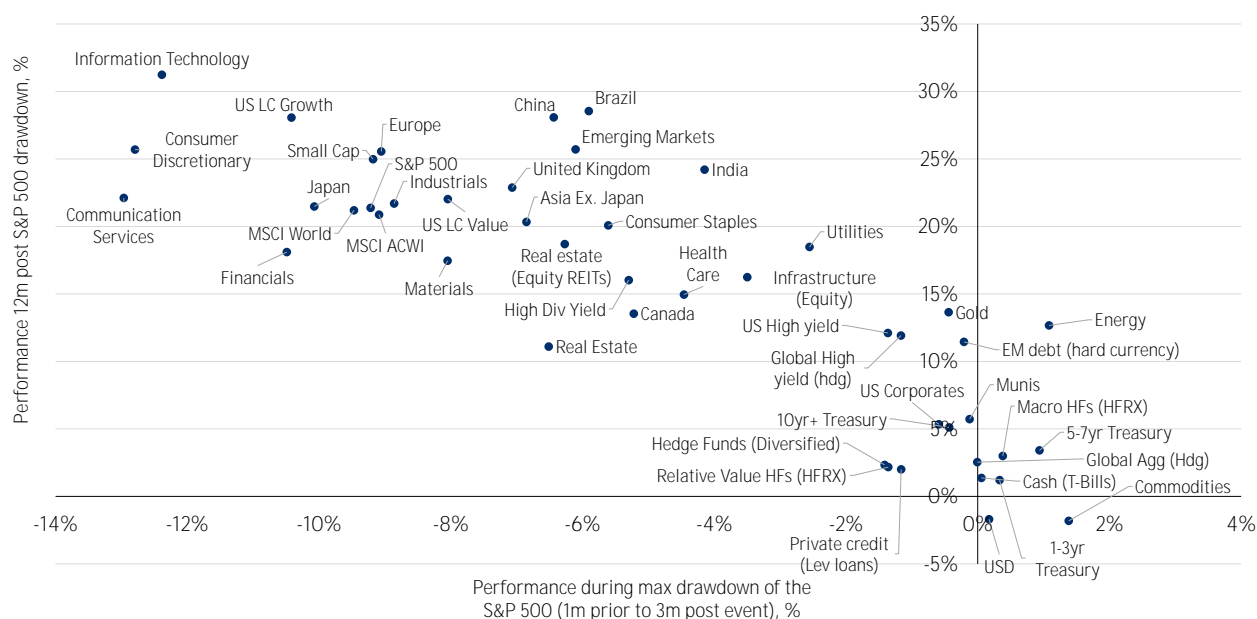
## How vulnerable is asset pricing to a geopolitical oil shock?

Overall, these three factors (inflation expectations, confidence levels, disruption in global supply chains) do not yet signal an impending sell-off in risk assets. But we see a persistent downside risk so long as the Middle East conflict continues and the global oil supply remains impaired.

Thus, it is prudent to assess the vulnerability of asset pricing to a geopolitical oil shock. To do so, we review the equity market drawdowns that followed the three most recent geopolitical events that led to an oil price shock (the Iraq conflict in 2003, the Arab Spring in 2011 and Russia's invasion of Ukraine in 2022). We examine cross-asset pricing through the event and in the 12 months that followed.

We focus in particular on how different sectors and assets performed during the equity market drawdown and in the 12 months that followed the market bottom. During the drawdowns, assets such as gold, emerging market debt, energy equities and macro hedge funds performed well. In the months following the market bottom, risk-on was the dominant theme, and growth-oriented equities did well.

### Sensitivity to oil price shocks varies across asset classes, sectors and markets



Source: Bloomberg Finance L.P. Data as of March 11, 2026.

## The Gulf states' role in the global economy: Hard capital and soft power

As we consider the economic and market forces that will be in play over the coming months, we note the important role of the Gulf Cooperation Council (GCC). (The GCC is the union of Bahrain, Kuwait, Oman, Qatar, Saudi Arabia and the United Arab Emirates (UAE).) Once seen mainly as an energy supplier, the GCC now acts as a central force in the global economy, using its soft power to shape outcomes on

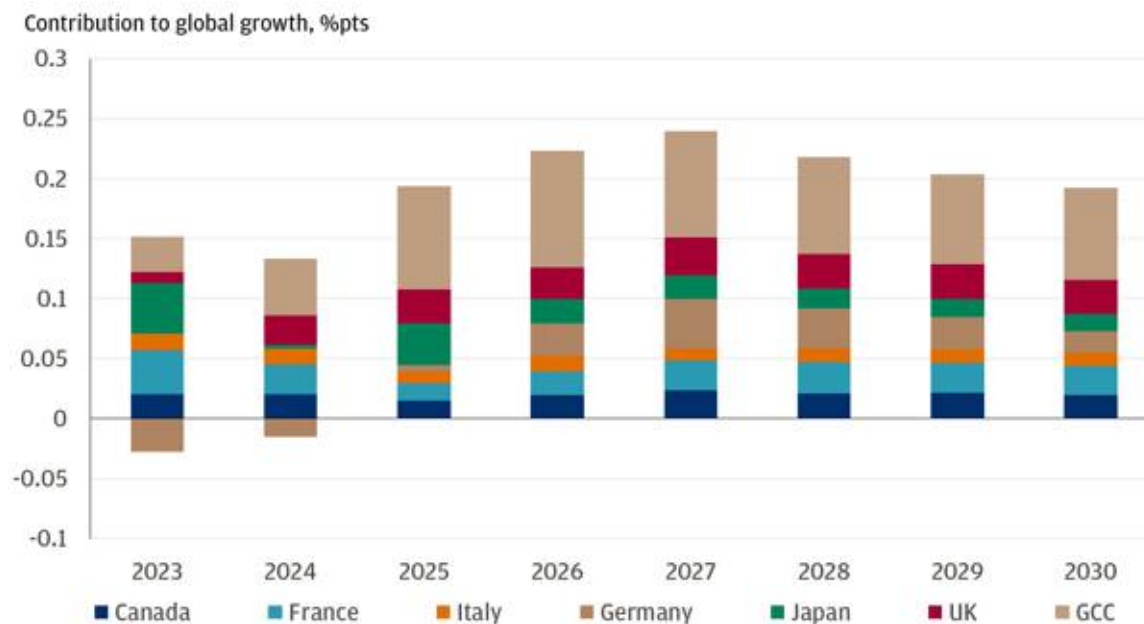
the world stage, and thereby meaningfully contributing to global growth<sup>3</sup>. Its soft power is chiefly manifest on two fronts: tourism and sovereign investment.

Tourism in the region has accelerated in recent years. According to the latest statistics, as of 2024, the GCC captured 5.2% of global international tourist arrivals (72.2 million visitors), trailing only France, Spain and the U.S. It received 7.5% (around \$120 billion) of global tourism revenue, pointing to per-visitor spending about 50% higher than the international tourist average (~\$1,600 for GCC countries vs \$1,100 internationally). Yet the GCC's gains transmit economic growth well beyond its borders. The GCC's sovereign wealth funds (SWF), which manage about \$6 trillion in assets, are an expression of soft power. Backed by persistent current account surpluses, these funds recycle capital into global investments and fuel global growth. In contrast, other surplus economies house their capital, in effect mitigating the contribution to global growth<sup>4</sup>.

As of 2024, GCC sovereign wealth funds controlled around 4% of global institutional assets (and roughly 38% of all global SWF assets). In 2025, the funds accounted for 43% of all capital invested by state-owned investors globally. The U.S. economy remains a primary recipient of GCC capital, with over 35% of total GCC SWF assets invested in USD markets.

By any measure, the GCC has become an important source of global capital, and a growth engine for the global economy. Indeed, the bloc's contribution to global growth has begun to outstrip the G7 (ex-U.S.). Prior to the Iran conflict, market participants expected this outperformance to persist. Now that assumption is being questioned.

### Gulf state capital is driving global growth



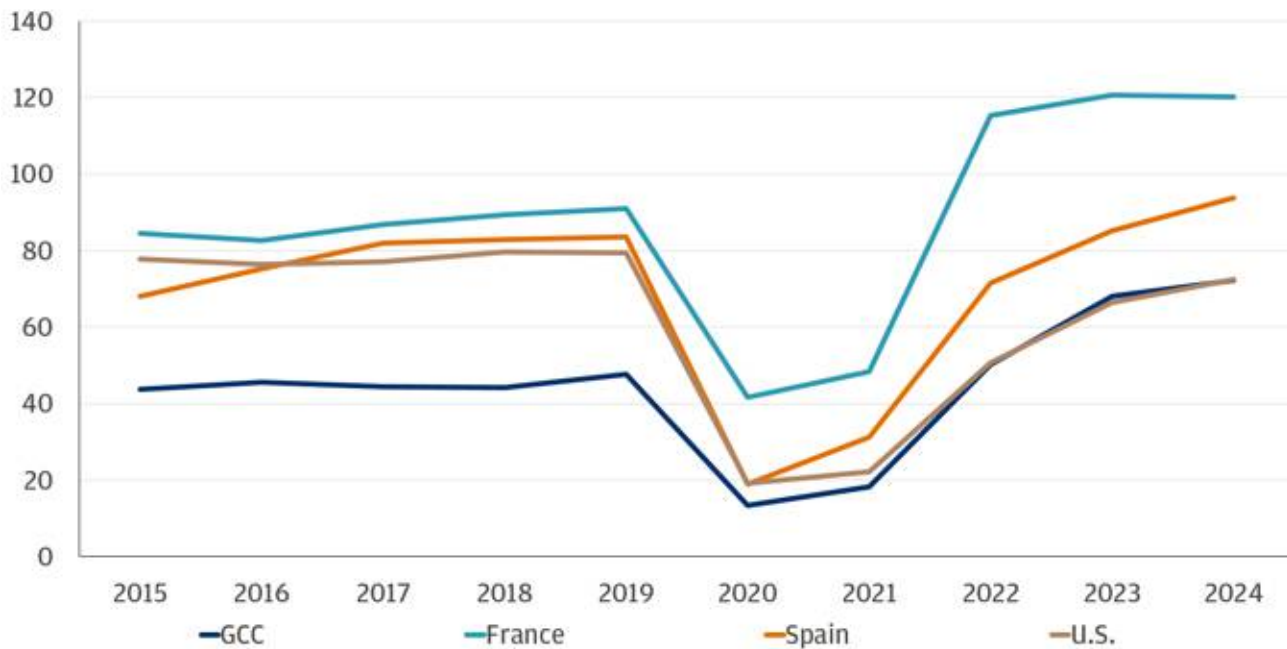
Source: Haver Analytics, IMFWEQ. Data as of 2025.

3. Soft power is defined as country's ability to influence others without resorting to coercion or military means and operates through cultural appeal, political values, foreign policies and economic investments.

4. Critics argue that while China's contribution to global GDP is mathematically significant, it is largely substitutive, often displacing industrial growth elsewhere. This contrasts with GCC countries, which are viewed as providing the essential energy and capital that serves as a genuine catalyst for broader global expansion.

## GCC countries among the top tourist destinations

Tourist arrivals, millions



Sources: Our World in Data, Haver Analytics, GCC Statistical Center. Data as of 2024.

Not surprisingly, perhaps, the factors that make the GCC a global economic powerhouse also make it a significant potential stress point for the global economy amid U.S.-Iran tensions. A significant increase in regional instability over the medium term would severely impact the GCC's tourism sector first, causing a ripple effect through global aviation and services.

More critically, a growing conflict could interrupt the infusion of GCC capital into the global economy. If the GCC's surplus is diverted toward security needs, or if their SWF investments are pulled back, it could meaningfully depress global growth.

For now, these are tail risks. Our base case scenario anticipates an eventual resolution to the U.S.-Iran conflict within a couple of months, at most. But of course the situation in the Middle East is volatile and investors need to be prepared for a range of outcomes. As always, portfolio resilience is key.

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