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Middle East Crisis, Again

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The Middle East: where antiquity meets modernity, where the three great Abrahamic religions converge, where the legacies of empire clash with the present exigency of ancient antipathy.

Into this bristling cauldron of religious, political, cultural and economic hostility, yet also mutual dependency, has marched one Donald J. Trump, seemingly without a plan other than to “move fast and break things.”

It is not possible to sugarcoat the consequences of this “little excursion,” to use the President’s words. The US did not telegraph this escalation, allies were not warned and markets, principally energy markets, were caught by surprise. As you will know, the prices of petrol and natural gas have jumped significantly, estimates of near-term inflation (though, interestingly, not long-term inflation) have risen, and sovereign yield curves across the term spectrum, most notably at the short end, have moved higher.

More simply, the first impact of the conflict is higher fuel costs and higher borrowing costs for us all. Reportedly, the UK’s key lenders have been scrambling to unwind current mortgage offers as their cost of capital increases.

The second-order consequence of the conflict is a rise in “risk premia” and a consequent fall in asset prices across the full spectrum: bonds, equities and commodities including gold bullion.

Essentially, markets have gone “risk-off.” Liquidity (that is, the ability to trade easily in large volumes) has dried up and Mr Market, to use Warren Buffett’s famous phrase, is offering “fire-sale” prices to those desperate enough or foolish enough to liquidate their assets.

Since the first attack on Iran, the language of the US Administration has been bombastic and far removed from the measured formulations of international diplomacy. Very mixed and often contradictory messages from the President, the Secretary of State and the Defence Secretary give the strongest impression that there was no considered plan, no comprehension that the Iranian regime would fight back, even at a very high cost to the Iranian people, and that the Strait of Hormuz is (and always has been) an obvious lever of Iranian retaliation. Even if the hint this week of a negotiation between the US and Iran to open safe passage through the Strait gains momentum, the lesson of the last two weeks is that 20% of the world’s oil supply and liquefied natural gas passes through that narrow stretch and a very solid truce will be required for normal volumes to resume.

What are the consequences?

In the short-run, asset valuations will make for painful reading. It will take time for markets to price-in the global impact of the war. Nonetheless, individuals, firms, governments and markets will adapt.

In recent times, markets have dealt with the impact of Covid, the Russian invasion of Ukraine, the disruption of the Suez Canal by Houthis rebels, and the weaponisation of trade via the “illegal” (see recent US Supreme Court judgment) use of tariffs by President Trump.

The key characteristic of market economies is this capacity to adapt, redirect investment and progress. It is unlikely that this time will be any different. Recent history demonstrates that markets can accommodate crises much more quickly than it appears at the time.

In the longer term, green technology is likely to become much more central to energy planning if only to remove the Damoclean sword of oil dependency from regional economies. In this sense, Trump has handed the future to China who are unquestionably world leaders in clean tech.

It is, nonetheless, difficult to see how the present belligerency of the US will help the cause of peace in the region. In a different context, the distinguished British historian A. J. P. Taylor was once asked if he thought there could ever be a solution to the “Troubles” in Northern Ireland. He flatly replied, no!

Turns out he was wrong. Perhaps, there are always grounds for hope.

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