

Market wisdom still holds that the conflict will be brief, but there is an asymmetric risk: stagflation may finally burst the 'complacency bubble' that has defined recent times .

The current events represent an acute risk to both growth and inflation. Macro forecasting is predominantly regime dependent - Positive equity bond correlations in both “hot” inflation and “stagflation” regimes suggest that the persistence of inflation rather than a slowdown in growth is the primary risk.

Oil prices act as a real-time indicator of the market’s expectations about the duration of the conflict. The swings show lack of clarity on the ultimate impact of conflict , as markets struggle to assess and debate as to whether higher energy prices will be transitory or represent a sustained shock.

The clearest parallels are the 1980s. Back then, Reagan dispatched largest naval convoy to Hormuz to protect merchant shipping during Iran-Iraq war, in what became known as the “tanker war”,

Transitory impact ? Higher energy prices, triggered by Middle East happenings were the underlying factors in recessions in 1973, 1979 and 1990. But energy intensity -consumption of energy per unit of economic output - has fallen by about 70% since mid-1970s.

Despite being rattled, the fall in global financial markets remains relatively muted as there are hopes that the fallout can still be contained- Trump’s tariff threats in April last year had a much bigger impact.

Sustained Shock ? It is equally important to note that global economy is far more interconnected than the previous era .With globalisation and just-in-time supply chains, global trade in goods and services has swelled from 42% of world GDP in 1980 to nearly 68% now.

Even if it has slipped from headlines,Tariff uncertainty is resurfacing.Following the imposition of Sec 122 tariffs, reopening and expansion of Sec 301 investigations signal an effort to preserve the existing tariff wall. The transition will renew concerns around goods prices & risk of higher inflation and higher Yields

However, the markets are currently “at the mercy of war”. There are moments when one must come near the edge to remember why one must not go over it. We may be at one of those moments.

All said and done , stronger Dollar and higher yields and lower equities remain as the central theme so long the conflict stays in the headlines - prefer to stay aside .

