

GLOBAL MACRO VIEWS

The oil shock: From higher inflation to lower growth

The Middle East conflict has created one of the most complex macro environments in recent memory. Oil prices have surged, central banks face conflicting inflation and growth signals, and the investment implications depend critically on how the situation evolves. Rather than anchoring to a single outcome, the ongoing uncertainty warrants mapping out a spectrum of scenarios, from rapid resolution to stagflation, to ensure resilient portfolios.

The investment challenge: a complex and rapidly evolving shock

The current shock presents a range of outcomes, each with materially different investment implications. In contrast to 2022's energy shock, real rates are considerably higher, inflation is closer to targets, fiscal capacity is more constrained and European energy dependency on Russian supply has been substantially reduced. These differences mean the transmission mechanism from energy prices to inflation and growth is neither straightforward nor predictable.

As long as the conflict persists, we expect prices to remain elevated and economic activity to drag lower. Oil prices around \$100 per barrel through year-end could boost U.S. headline inflation by about 0.9 percentage points (ppt) and lift core by 0.4ppt, while trimming 2026 U.S. GDP growth to approximately 1.7%. In Europe, energy dynamics could shave around 50 basis points off GDP, compounded by weakening manufacturing activity, deteriorating fiscal positions and negative sentiment. Earlier stimulus tailwinds could help prevent a euro area recession, though downturn risks are rising as supply chain disruptions continue. It is also possible that central banks respond to inflationary signals while underpricing the growth drag.



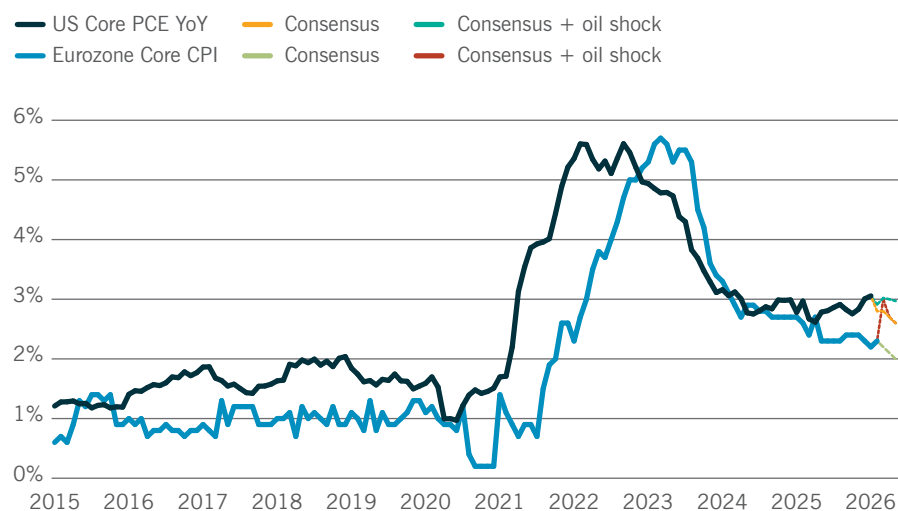
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The portfolio response should be sized for a wider range of outcomes

Figure 1: Energy shock to lift inflation in the U.S. and Europe in 2026



Source: Bloomberg, as of 27 March 2026

A rational but fragile equilibrium

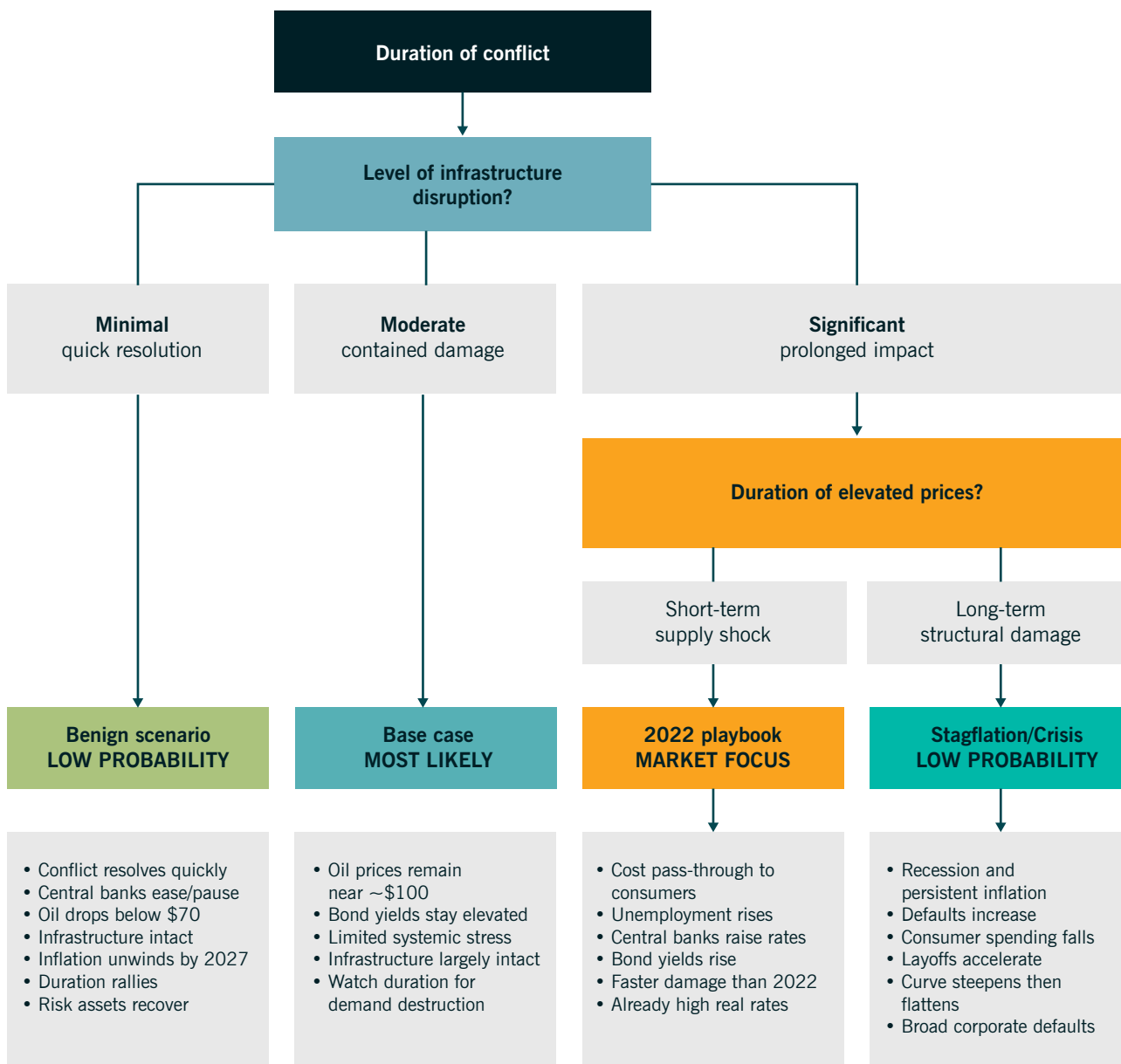
Brent crude priced at \$95–105 per barrel captures the uncertainty surrounding the shock. Markets are not expecting an acute escalation, but nor are they expecting enough progress in the Strait of Hormuz to unwind the remaining risk premium. Even under a tentative ceasefire agreement, such an environment argues for maintaining optionality rather than conviction in any single outcome.

Different scenarios, different playbooks

Our base case sits between energy prices remaining elevated at current levels and a de-escalation by end-April, with moderate energy infrastructure damage. But the portfolio response should be sized for a wider range of outcomes, particularly when history cautions that traditional 60/40 equity and bond diversification fails in a supply-driven inflation shock, as experienced in 2022. Figure 2 describes the range of scenarios that investors could face.

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Figure 2: Different scenarios, different playbooks



Source: Nuveen

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Central banks face a difficult and potentially mistake-prone path

Central bank meetings in March illustrated how differently policymakers are reading the challenge. The broad direction was hawkish, but the degree varied considerably with markets initially overestimating the tightening impulses, in our view.

All nine Monetary Policy Committee members at the Bank of England (BoE) voted to hold, a pivot from their earlier stance guiding towards policy easing. The subsequent gilt repricing was aggressive, and likely excessive against any future, more fragile economic backdrop. We lean into the BoE taking an extended pause to assess the shock with policy rates already restrictive, the economy stalling ahead of the shock and fiscal risks remaining.

The European Central Bank (ECB) is also hawkish but with more balanced nuances. Inflation forecasts were revised higher, with a range of scenarios depending on the persistence of the shock. A spring rate hike looks increasingly likely as policymakers signal the need to keep inflation expectations anchored. Having underestimated 2022's price rises, policymakers could be more proactive, increasing the risk of a policy mistake by tightening into an economic slowdown.

The U.S. Federal Reserve (Fed) was the most measured, with its inflation forecast upgraded by only 0.2pppts and continuing to signal one cut this year. While rate cuts appear untenable against an inflation shock, easing remains a possibility later in 2026 should inflation risks subside and the labour market stall.

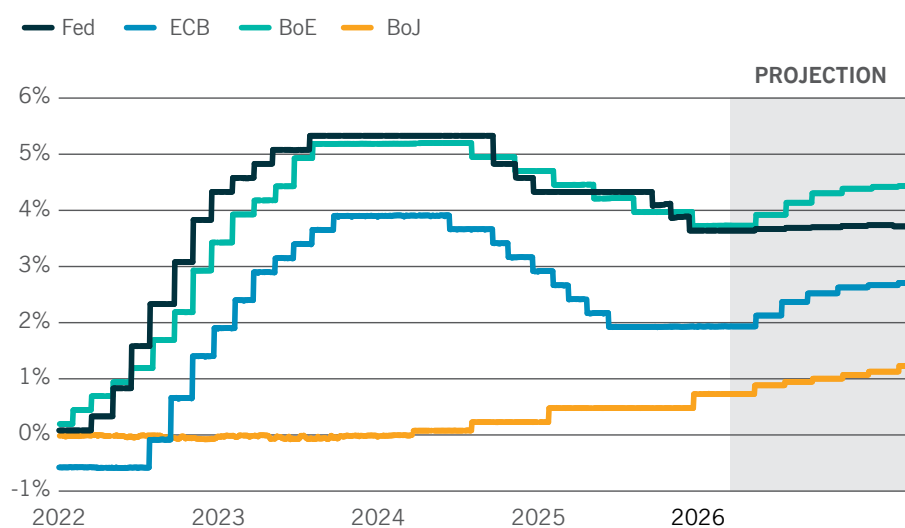
The Bank of Japan (BoJ) was among the least hawkish in response to the shock, recognizing that it weighs on the country's growth relatively more than it boosts inflation, leaving our two rate hike 2026 view intact. Elsewhere, aggressive rate hike pricing for 2026 appears premature across several G10 economies, including Canada, New Zealand and Australia.

Policymakers' hawkish rhetoric can tighten financial conditions and keep inflation expectations anchored at the margin. But premature hikes are likely to do more damage than the last cycle given the higher starting point for real rates. In a stagflation scenario, central banks face a challenging tradeoff and the probability of a policy error is highest. Across all scenarios, current rate pricing across most major economies looks stretched.

Spreads still have room to widen as growth disappoints

Importantly, supply chain disruptions mean that even a de-escalation in oil prices may not fully unwind inflationary pressures. Disruptions already risk record aluminum prices across manufacturing from aerospace to solar panels; fertilizer shortages come as the northern hemisphere planting season gets underway; and rare earths and critical mineral supply chains risk is being reassessed. It is a tricky tradeoff for policymakers who can do little to curtail a supply shock, leaving the risks towards tightening into a growth slowdown.

Figure 3: Markets ramp up rate hike expectations



Source: Bloomberg, as of 25 March 2026

Navigating fixed income in the oil shock

Within credit, quality has driven performance so far, with investment grade and leveraged loans outperforming high yield and emerging markets (EM) debt.

Spreads still have room to widen as growth disappoints, making broad credit exposure less attractive, instead favouring defensiveness, higher quality and active security selection. Floating rate exposures are likely to hold up across scenarios. Senior loans offer structural immunity to inflation risk, attractive yields and diversification opportunities. Investment grade CLOs provide a more conservative expression of the higher-for-longer theme with negligible default history. Securitised credit offers broader diversification with shorter duration.

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Companies with pricing power that can defend margins across the different scenarios are likely to be rewarded

The structural case for EM debt remains intact as well. Its diversification value, yield premium and improving country-level fundamentals have not been impaired. However, valuations do not yet compensate enough for the elevated uncertainty. A selective approach in commodity-exporters with attractive yields is prudent. Should the conflict de-escalate, however, EM debt more broadly stands to benefit from a re-ignition of the global diversification trend.

Equity rotation could stall with selectivity key

A prolonged inflation shock could push leadership back toward the Mag-7 and U.S. tech. This is because the defensive characteristics of resilient profitability and healthy balance sheets look increasingly valuable when growth disappoints, rather than a new AI narrative.

According to our U.S. equity colleagues, a barbell approach makes sense. Consider upstream energy companies with the capacity to deleverage quickly on one side, and downstream businesses with inelastic demand and strong margin defence on the other. Second-order earnings effects are already becoming visible across fertilizers, chemicals, airlines and building materials. This is likely to continue as the shock extends. Companies with pricing power that can defend margins across the different scenarios are likely to be rewarded.

In Europe, earnings pressure is building with 2026 expectations still upbeat despite rising costs and a macro backdrop less supportive than even a month ago. However, sector dispersion is widening. Energy, utilities, defence and industrials with cut genuine infrastructure exposure offer opportunities in our view.

Near-term dollar gains as uncertainty extends

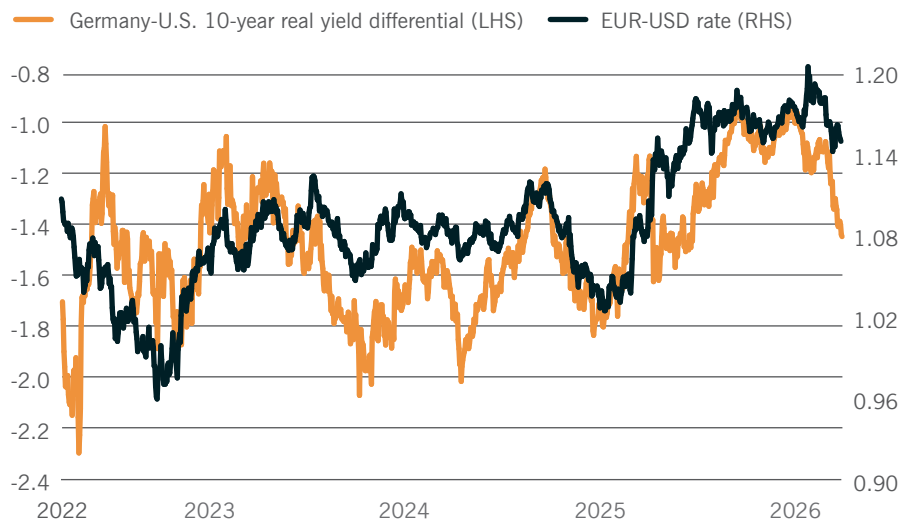
The dollar is likely to remain supported in the near-term owing to the U.S. real rate advantage, renewed AI-driven exceptionalism and rotation away from U.S. assets stalling.

Even if the ECB tightens policy this spring, the euro-dollar is unlikely to recover materially until the geopolitical situation recovers. A modest improvement in ECB rate differentials is insufficient while the uncertainty premium on European assets persists. Increasing euro exposure ahead of a confirmed resolution would be premature, in our view.

Elsewhere against the US dollar, the Aussie dollar reflects balanced risks with limited near-term conviction: commodity tailwinds are offset by demand uncertainty and a softer domestic growth outlook. The Swiss franc and Japanese yen continue to struggle despite safe-haven properties though intervention risk likely cap the downside from here.

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Figure 4: Euro pressure remains as growth risks build



Source: Bloomberg, as of 27 March 2026

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Endnotes

Sources

All market and economic data from Bloomberg, FactSet and Morningstar.

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