US war on Iran to hit weak global economy and fragile financial system

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While major financial markets remained steady yesterday in the wake of the US war against Iran, there could be major effects in the days ahead as the war continues and deepens.

At this point the most significant impact on the global economy is the closure of the Strait of Hormuz, the narrow passage at the mouth of the Persian Gulf, through which one fifth of the global supply of oil passes as well as a fifth of liquified natural gas (LNG).

The price of Brent crude, regarded as the international benchmark, initially jumped by 13 percent to over $82 a barrel before coming down somewhat but could rise sharply again. Analysts at Bloomberg have warned that it could rise to as high as $108 per barrel.

The impact on LNG could be even greater than on oil.

European natural gas prices surged by 50 percent yesterday because of the cut in supplies from Qatar which are shipped through the Strait. The state-owned energy company said it had halted production of LNG and other products because of military attacks on two of its production facilities.

Reflecting widely held views, Joseph Capurson, the head of global economics at the Commonwealth Bank of Australia said: “Of all the possible Middle East scenarios, the current state of play is one of the worst for the global economy. We expect the situation to escalate before it de-escalates.”

Stock markets around the world, after some initial falls, remained basically steady. But there were indications of concerns about financial stability. The *New York Times* reported there had been a wave of “emergency buying” of the dollar in Asia sending down regional currencies including the Japanese yen.

At the same time, however, US bond prices fell in another indication that US government debt is no longer regarded as a “safe haven” in conditions of turbulence. As the *Financial Times* (FT) noted: “This forms yet another piece of anecdotal data suggesting that US Treasuries are losing their status as the world’s go-to asset in times of crisis—the result, investors say, of erratic geopolitical and economic policy and the erosion of institutions under Trump.”

Increasingly gold is considered the only safe asset. Its price rose to $5,400 to hit a new record yesterday. The gold price has risen 80 percent in the past year and by more than 54 percent in the past six months—an indication of the growing lack of confidence in the US dollar as the global fiat currency.

Analysts at the BlackRock Institute, cited by the FT, said the market reaction showed “long-term government bonds are not reliable portfolio ballast given the potentially stagflationary risks from an escalation of this latest Middle East conflict.”

The threat of stagflation arises from the prospect that if the oil price rises stay at elevated levels, then an inflation surge could result and central banks will start lifting, rather than reducing, their interest rates, hitting a weakening global economy.

The already fragile financial system is also threatened under conditions where increasing concerns about its stability have been voiced. These centre on whether the massive investments in AI data centres are going to pay off, what is the impact of developments in AI on whole areas of the software industry and how much this may affect private equity firms which have piled into the financing of these firms in recent years.

Then there are concerns about some of the riskier operations undertaken by private equity firms. Last October, when two companies in the US auto market, backed by private equity, went broke, JP Morgan chief Jamie Dimon noted that when you see one “cockroach” there are always more.

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Another emerged last week when Wall Street firms were counting the losses they had incurred on the billions of pounds they had lent to a UK-based mortgage provider, Market Financial Solutions, that collapsed amid accusations that it had been double-pledging its collateral.

The firms involved included Barclays, Jeffries, and Atlas SP Partners, a financing firm owned by Apollo Global Management which is estimated to have £400 million tied up in the bankrupt MFS. Barclays exposure is put at £600 million.

Dimon has followed his "cockroach" remarks with a series of warnings about the stability of the financial system.

Last month he warned that in the present financial conditions banks and financial institutions doing "dumb things" like taking on risky loans, that could lead to conditions recalling those that led to the 2008 crisis.

"There will be a cycle one day," he said. "I don't know what confluence of events will cause that cycle. My anxiety is high over it. I'm not assuaged by the fact that asset prices are high. In fact, I think that adds to the risk."

He noted that in the years immediately preceding 2008 it was "almost the same thing. The rising tide was lifting all boats, everyone was making lots of money, people leveraging to the hilt. The sky was the limit."

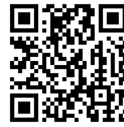
These warnings were underscored by the remarks of former Goldman Sachs chief Lloyd Blankfein in an interview with the FT. Blankfein, whose bank was at the very heart of the speculative and outright criminal activity that led to the 2008 crash and so has direct knowledge of what really takes place, warned that the longer the time between reckonings the more severe it would be.

"I'm not saying it's going to happen tomorrow or what direction it comes from. But when something goes off you're going to find all the assets that have been carried at prices that can't be realised in the market."

Dimon followed up on his previous warnings with an interview on Bloomberg yesterday in which he warned that the next downturn "will be worse than a normal one. It could be sparked by geopolitics or from factors such as layoffs and a reduction in consumer spending."

As well he noted there were credit risks across a range of lenders, including insurance companies, banks and private credit.

Those risks have been intensified to a major extent by the launching of the US war on Iran.



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