

Israel-Iran conflict: the macro, geopolitical and oil market fallout

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The Israel-Iran conflict has continued to escalate. This *Update* summarises how our views on the macro impact have evolved over the past few days and answers the most frequently asked client questions that we have received.

What have we learnt in the past few days?

We provided our initial response to the Israeli strike on Friday [here](#), and on-demand recording of our Drop-in is available [here](#). One thing that's become very clear since Friday is that this stage of the conflict is much more intense than the tit-for-tat strikes that we saw in April and October last year. Those were limited in scope and seemed calibrated to avoid (a sharp) escalation.

These strikes have gone on for longer and Israel's attacks have moved beyond Iran's oil infrastructure to its broader security apparatus and domestic infrastructure (e.g. Iran's domestic energy). Israel is clearly emboldened by its recent successes against Iranian proxies, Hamas and Hezbollah, and is seeking to remove the threat posed by Iran.

And while on Friday it appeared that scheduled US-Iran nuclear talks in Oman, scheduled for Sunday, could provide an off-ramp to de-escalate the conflict,

those were cancelled. The short point is that it looks like the conflict could continue for some time.

What would be the triggers for the conflict to escalate?

There are lots of actions that Israel itself could take to escalate the situation (e.g. more explicitly targeting regime change in Iran – something PM Netanyahu doesn't seem to have ruled out). For the rest of the world, one important question is whether other countries get involved.

As we've [argued for some time](#), the risk of the Gulf states getting dragged into the conflict seems very low given both their strong ties to the US and the rapprochement with Iran. But it's possible that Western powers could get involved were Iran to attack their interests in the region – whether intentionally or through miscalculation. After all, Iran threatened to target US, French and UK military interests if they helped Israel block Iranian missiles.

Otherwise, the key escalation risk for the global economy is if energy infrastructure to supply the global market – in Iran or elsewhere – is affected, most notably via the Strait of Hormuz. (More below.)

How could disruption to the Strait of Hormuz play out?

The risk of a “closure” of the Strait of Hormuz is more nuanced than some might suggest, not least because Iran relies on the Strait to export its energy flows. (For context, the Strait is a key pinch-point in the flow of energy from the Middle East, carrying about 25% of seaborne crude exports and around 20% of global LNG flows.)

It seems unlikely to us that Iran would attempt to mine and Strait to cause long-term disruption to the shipping channel, not least because it would not just disrupt the west but also Iran's allies including China. Meanwhile, despite the potential for substantial near-term disruption to energy flows, long-term damage would incentivise exporters such as Saudi Arabia and Iran to expand existing pipelines and alternative export facilities that bypass the Strait.

In any case, the key point is that the closure of the Strait is not a “binary” risk; indeed, recent reports indicate that oil tanker companies have already become reluctant to accept contracts using the Strait. At best, this could push up insurance premia/tanker rates for energy shipments from the Middle East; at worst, if sustained, this could constrain the supply of oil into the global market.

Where does this leave the oil market?

With the extent of damage over the weekend to Iran's energy infrastructure confined to energy for domestic use, the fundamentals in the global oil market have broadly been unchanged so far. So long as oil exports of producers in the region remain unaffected, the global oil market is set to be well supplied over the next few months on the back of OPEC+'s well-documented pivot towards a faster unwinding of voluntary output cuts.

Crucially, this has ensured that the ~8% rise in the price of Brent crude has occurred from a low base – the price is still ~11% down year-on-year – and that the increase in the oil price has purely been due to a rise in the risk premium. Judging by implied volatility in options markets, the expansion in the risk premium is on par with the two previous bouts of missile exchanges between

Israel and Iran last year, but is well short of where it was around the beginning of Russia's invasion of Ukraine.

Which countries will be caught in the middle of the conflict?

A lot of focus of the spillovers of the past few days has been on global energy markets and worries about oil infrastructure in the Gulf but, as we have noted, the thawing of relations between the Gulf and Iran has eased those risks. If anything, the Gulf economies benefit for the time being from higher production and oil prices.

The greater negative impact will be felt on the economies of Egypt and Jordan. Houthi-led attacks on ships in the Red Sea since the war in Gaza began in late 2023 caused ships to divert away from the Suez Canal – traffic via the Canal is 65% lower than pre-7th October levels. This has led to a loss of key FX receipts to Egypt and driven the widening of the current account deficit to 6.2% of GDP in 2024, its largest shortfall since 2017.

And in Jordan, the tourism industry normally contributes around 10-15% of GDP. In 2024, visitor arrivals from outside of the region were down a third. With missiles flying directly over Jordan, those security fears will persist weighing on both Jordan's GDP and its external position.

What impact will this have on Israel's economy?

Israel's air defence systems appear to have been very effective. But there will still be a negative shock for Israel's economy as residents remain indoors, and both households and businesses postpone spending decisions. At the risk of stating the

obvious, the scale of this impact will depend on the length of the conflict with Iran.

If it lasts for a few weeks (as some Israeli policymakers have suggested), we think the impact would be small. Israel's economy has largely adapted to a war footing and the risk of Iranian attacks. And unlike the (land-based) war with Gaza, conflict with Iran is largely aerial and shouldn't lead to significant disruptions to the labour market. We suspect that most lost output should be recouped once conflict eases, although there will be some sectors that suffer longer-lasting losses (e.g. tourism).

There will be a fiscal cost in the form of higher military spending which comes against a backdrop of a still-wide budget deficit (~5%) of GDP. Relatively low borrowing costs mean a temporary widening of the deficit should be manageable. But the key question for Israel's fiscal health lies in the longer-term ramifications of its conflict with Iran – does it remove the threat and allow Israel to dial back military spending or does Israel require a permanently larger military footprint to keep the threat from Iran in check?

What does this mean for the Abraham Accords?

After the last expansion of the Accords in 2020 between the UAE, Bahrain, and Israel, the hope was that Saudi Arabia would eventually restore ties with Israel too. In principle, a weakened Iran could lift a major barrier to the expansion of the Accords – Hamas documents reportedly showed that its attack on Israel in October 2023 had the intention of derailing Saudi-Israel talks on normalising relations. However, Saudi Arabia has reiterated its demands for the end of

Israel's occupation of Gaza and a two-state solution for this normalisation to happen.