Energy Shock and Central Bank Caution

The Iran war tests the soft-landing narrative

→ The Iran war has shifted the early-2026 macro-financial debate from disinflation and rate cuts toward energy security, inflation risk and financial resilience.

→ The Fed and the ECB have both responded with caution, keeping rates broadly unchanged, while markets absorb higher oil prices, disrupted energy flows and uncertainty over the Strait of Hormuz.

United States: Powell's last meeting, a Fed pause, and Warsh on deck
The Federal Reserve kept the federal funds target range unchanged at 3.50%–3.75% at its late-April meeting, extending the pause that followed the rate cuts delivered in late 2025. The decision reflects a more complex policy environment. Growth remains resilient, but the Iran war has lifted energy prices and revived inflation risks.

This was also Jerome Powell's final FOMC meeting as Chair, although he also announced that he will remain as a governor at the Fed. Powell emphasized continuity, reiterating that policy would remain data-dependent and that the Fed is well-positioned to respond if risks materialize in either direction. Markets are already preparing for the arrival of Kevin Warsh, whose appointment signals a new phase in the Fed's leadership and potentially a recalibration of its communication style.

For the Fed, the key dilemma is that the energy shock is both inflationary and potentially growth-negative. Cutting rates too early could entrench inflation expectations; maintaining a restrictive stance for too long could amplify the drag from weaker real incomes and confidence.

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Euro Area: ECB holds again in April as energy risks reshape the outlook
The ECB also maintained its policy stance at its late-April meeting, keeping the deposit facility at 2.00%, and reinforcing its "wait-and-assess" approach. However, the tone of the meeting marked a subtle but important shift compared to earlier in the year.

While inflation remains relatively close to target, the Governing Council explicitly acknowledged that the escalation of the Iran conflict has reintroduced upside risks to inflation via energy prices, while simultaneously weakening the growth outlook. In this sense, the ECB faces a renewed stagflationary trade-off, albeit milder than in previous cycles.

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Communication in April suggested that the ECB is now less confident about the timing of any near-term rate cuts. What had been seen as a likely easing move in Q2 has become more conditional, dependent on whether the energy shock proves temporary or persistent.

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The euro area's structural exposure to imported energy makes it particularly sensitive to developments in the Strait of Hormuz. Rising oil and LNG (Liquefied Natural Gas) prices are already affecting cost structures and external balances, especially in more energy-dependent economies. As a result, the ECB is likely to prioritize policy credibility and inflation anchoring, even at the cost of weaker short-term growth. For this reason, depending on the Iran conflict developments, the next ECB meeting in June could even potentially see an increase in interest rates.

Global markets: Initial shock followed by surprising resilience except in energy markets

Financial markets reacted negatively at first to the escalation in Iran and the threat to Gulf energy routes. Oil prices surged, volatility increased, and equities sold off in the immediate aftermath However, by late April and early May, stock markets have shown notable resilience. U.S. indices recovered quickly, supported by strong corporate earnings, particularly in technology, and by investor expectations that the conflict may remain contained. European equities have also stabilized, despite greater exposure to energy shocks.

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This resilience is striking but fragile. Markets appear to be pricing in a scenario in which disruption to the Strait of Hormuz remains limited. That assumption is now central. A prolonged or full closure would have far more severe implications for inflation, global trade and financial stability.

Energy markets remain the primary transmission channel. Oil prices have risen significantly and remain highly sensitive to geopolitical developments, while natural gas markets are tightening again. Precious metals continue to benefit from safe-haven demand, and currency markets reflect a balance between risk aversion and shifting monetary expectations.

A soft landing under geopolitical stress

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The May 2026 environment is no longer just about monetary normalization. It is about whether central banks can maintain credibility while navigating a renewed supply shock. The Iran war has reintroduced supply-driven inflation risks at a time when growth was already moderating. Both the Fed and the ECB are therefore likely to remain cautious, delaying further easing until there is greater clarity on the persistence of energy price pressures.

Markets, for now, are betting on resilience, supported by contained disruption, stable policy, and continued earnings strength. But the equilibrium is delicate. The key uncertainty remains the Strait of Hormuz. If tensions ease and energy flows normalize, the soft-landing narrative could survive. If not, 2026 may quickly shift toward a more challenging scenario, where inflation and growth tensions re-emerge simultaneously, testing both markets and monetary policy frameworks once again.