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“Is the tightrope finally giving away?”: Westminster Asset Management Investment Strategist Peter Lucas discusses the impact of the ongoing war in the middle east and global macro implications. Peter believes the likely inflationary impact of the war will pull forward various structural issues he has long highlighted.



The global environment has evolved broadly along the lines I described in my 2014 presentation, *Passing through the Eye of the Storm*. The framework rested on several pillars: rising political populism, the gradual erosion of globalisation, increasingly expansionary fiscal policy, structurally high debt levels and the risk that inflation would eventually re-emerge as the dominant macroeconomic problem.

Over the past decade events have steadily validated that framework. Politics has deserted the centre ground and populism has taken root across much of the developed world. Fiscal policy has become more expansionary, and governments are running persistently large deficits. Global relations have deteriorated and supply chains - once optimised for efficiency - have proved far more fragile than previously assumed. Meanwhile the global debt mountain has continued to climb into the stratosphere.

The story has taken longer to unfold than I expected, but it is a mistake I have made before. Even so, there have been clear moments of acceleration. COVID was one such moment. The war involving Iran may prove to be another.

The disinflationary forces that dominated the global economy for three decades are reversing. Globalisation, abundant cheap labour and ever-expanding supply chains helped suppress inflation from the early 1990s onwards. Today those forces are weakening or going into reverse as geopolitical tensions rise, and governments prioritise resilience and security over efficiency.

Spot WTI Crude Index, with trendlines



Source: Bloomberg, Westminster Asset Management

Against this backdrop the current conflict has triggered a sharp rise in oil prices. In the 1970s, loose US policy combined with an oil shock to produce stagflation – high inflation alongside weak or negative economic growth. Fifty years on there are uncomfortable parallels with that difficult period of economic history. Fiscal deficits are

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large, energy prices have surged and monetary policy is unlikely to prove sufficiently restrictive to offset the inflationary impulse.

There is, however, one critical difference between then and now: leverage throughout the global economy is vastly higher. If inflation expectations were to become unanchored in the way they did in the 1970s, policymakers would have little room for manoeuvre. Any attempt to protect growth – and thereby sustain the debt burden – through easier policy could provoke a backlash in bond markets and rapidly rising debt-service costs. But equally, a genuine Volcker-style tightening of monetary policy would place intolerable strain on public finances, households, and highly leveraged sectors of the economy. Policymakers are therefore trapped between two uncomfortable choices.

In practice this means that central banks have been walking a narrowing tightrope between the two disaster scenarios of deflation and inflation. Conscious of the destructive consequences of deflation, they have been erring on the side of inflation while still attempting to preserve policy credibility. So far, they have just about succeeded.

The Iran conflict and resulting energy shock mean that this balancing act has become significantly harder. The longer oil prices remain elevated, the greater the drag on economic growth. At the same time, any policy response designed to cushion that slowdown risks accommodating the inflation shock and unsettling inflation expectations. Attempts to suppress bond yields through explicit or implicit yield control could prove equally inflationary. The most likely outcome in such an environment is a gradual drift toward financial repression — a combination of higher inflation, rising nominal interest rates and policies designed to prevent debt-service costs from destabilising the system.

From an investment perspective, this would represent a decisive break from the regime that dominated financial markets for much of the past generation. Falling inflation, declining interest rates and expanding globalisation supported a long bull market in bonds and richly valued financial assets. A world characterised by persistent inflation pressures, geopolitical fragmentation and financial repression would look very different. Real assets and commodities would regain importance, while the returns available from long-duration financial assets could prove far more uncertain.

Technical analysts will also have noticed an important development in the oil market. After spending several years correcting the sharp rise seen between 2020 and 2022, crude oil has recently broken through a major resistance level. Whatever happens in the near term, this suggests oil may have begun a new structural uptrend. It is also worth remembering that prior to the recent geopolitical shock oil was historically cheap relative to many other commodities – a point I made in a November article and again in January.

In short, the global economy appears to be entering a more unstable phase. The structural forces that suppressed inflation for much of the past generation are weakening, while the policy tools available to governments and central banks are increasingly constrained by very high levels of debt.

Central banks have spent years attempting to steer a course between the opposing dangers of deflation and inflation. The geopolitical shock now emanating from the Middle East suggests that the tightrope they have been walking for so long may finally be giving way beneath them.

Peter Lucas – March 2026

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