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Impact of the Israel-Iran Conflict on Global Stock and Bond Markets

Introduction

The armed conflict between Israel and Iran, which began on June 13, 2025, with Israel's airstrikes on Iranian nuclear and military targets, has introduced significant volatility into global financial markets. As of June 18, 2025, the ongoing exchange of missile and drone attacks has heightened investor uncertainty, particularly due to the conflict's potential to disrupt Middle Eastern oil supplies and exacerbate inflationary pressures. This report examines the short-term and potential long-term effects of the conflict on global stock and bond markets, drawing on market data and expert analyses to assess investor sentiment, sectoral impacts, and macroeconomic implications.

Stock Market Impacts

Initial Market Reaction

Global stock markets experienced sharp declines following Israel's initial strikes on June 13, 2025. The S&P 500 fell 1.1%, the Nasdaq Composite dropped 1.3%, and the Dow Jones Industrial Average declined 1.8%, marking the worst single-day slide in nearly a month (Reuters, 2025a). European markets, including Germany's DAX and France's CAC 40, fell over 1%, while Asian indices like Japan's Nikkei and South Korea's Kospi dipped 1.3% and 1.1%, respectively (The Guardian, 2025). Middle Eastern markets were also affected, with Egypt's EGX 30 index plummeting 7.7% and Israel's Tel Aviv 35 index falling 1.5% (Al Jazeera, 2025).

By June 16, however, markets began to recover as fears of an all-out regional war subsided. The S&P 500 and Nasdaq rose approximately 1% and 1.5%, respectively, driven by reports that Iran was open to restarting nuclear talks (Bloomberg, 2025). European and Asia-Pacific markets also saw gains, reflecting investor optimism that the conflict might remain contained (CNBC, 2025). This rebound suggests markets are pricing in a scenario where the conflict avoids significant disruptions to global energy supplies, particularly through the Strait of Hormuz, a critical chokepoint for 20% of global oil flows (The Guardian, 2025).

Sectoral Performance

The conflict has led to divergent sectoral performances. Energy and defense stocks have outperformed, with companies like Halliburton (+5.5%), APA Corp (+5.3%), Lockheed Martin (+3%), and BAE Systems (+3%) seeing gains due to rising oil prices and heightened geopolitical tensions (Investopedia, 2025; The Guardian, 2025). Conversely, cyclical sectors such as airlines, travel, and consumer discretionary have faced pressure. Delta Air Lines (-3.8%), United Airlines (-4.4%), and American Airlines (-4.9%) declined due to fears of rising fuel costs and airspace closures in the Middle East (Reuters, 2025b).

Risks of Prolonged Conflict

Analysts warn that a prolonged or escalated conflict could drag global equities lower. RBC Capital Markets estimates that a sustained conflict could push the S&P 500 down to 4,800–5,200, implying a 20% drop from current levels, driven by higher oil prices fueling inflation and limiting Federal Reserve rate cuts (Business Insider, 2025). David Roche of Quantum Strategy cautions that markets may be underpricing the conflict's duration, predicting a lull followed by further escalation (CNBC, 2025). Such scenarios could erode investor sentiment, particularly if consumer and CEO confidence, already at multi-year lows, continues to decline (Business Insider, 2025).

Bond Market Impacts

Safe-Haven Demand and Yield Dynamics

The conflict has driven demand for safe-haven assets, including U.S. Treasuries, though the impact on bond yields has been mixed. On June 13, U.S. 10-year Treasury yields rose 5.6 basis points to 4.413% as markets priced in inflationary risks from surging oil prices (Reuters, 2025a). However, a flight to safety has also pushed yields lower in some instances, creating volatility in fixed-income markets (Reuters, 2025a). Longer-maturity Treasuries have lagged, with a $13 billion sale of 20-year bonds on June 16 drawing expected yield levels, stabilizing after a prior selloff (Bloomberg, 2025).

Inflation and Monetary Policy Concerns

Rising oil prices pose a significant risk to bond markets by fueling inflation, which could constrain central banks' ability to cut interest rates. Brent crude surged 7% to $74.23 per barrel on June 13, with earlier spikes exceeding 13%, while West Texas Intermediate rose 7.62% to $72.98 (Reuters, 2025a). RBC estimates that Personal Consumption Expenditures inflation could reach 4% if oil prices remain elevated, potentially limiting the Federal Reserve to just two rate cuts in 2025 (Business Insider, 2025). Higher inflation expectations could push bond yields upward, reducing bond prices and impacting fixed-income portfolios (Investopedia, 2025).

Regional Considerations

In the Middle East, bond markets face heightened risk aversion. Foreign direct investment into the region may decline if tensions persist, increasing borrowing costs for regional issuers (Asian Chemical Connections, 2025). Globally, sustained geopolitical uncertainty could lead to prolonged demand for safe-haven bonds, though inflationary pressures may counteract this trend, creating a complex environment for bond investors (Allianz Global Investors, 2025).

Macroeconomic Implications

The conflict's primary macroeconomic impact stems from its potential to disrupt oil supplies, particularly if Iran attempts to block the Strait of Hormuz, through which 20–30% of global oil and 20% of liquefied natural gas pass (The Guardian, 2025; Northern Trust, 2025). A closure could push oil prices to $90–$130 per barrel, triggering stagflation risks by combining higher inflation with slower economic growth (Allianz Global Investors, 2025; Northern Trust, 2025). Such a scenario would exacerbate existing pressures from U.S. tariffs and immigration policies, further challenging central banks' policy flexibility (The New York Times, 2025).

Mohamed El-Erian of Allianz warns that a prolonged conflict could slow global economic growth and limit monetary policy options, particularly if inflation accelerates (CNBC, 2025). However, OPEC's spare capacity and recent production increases could mitigate oil price spikes, capping Brent crude below $80 per barrel if the conflict remains contained (The Guardian, 2025). Markets are also closely monitoring U.S. involvement, as any escalation could amplify economic disruptions (Al Jazeera, 2025).

Conclusion

The Israel-Iran conflict has introduced significant volatility into global stock and bond markets, with initial selloffs giving way to cautious recoveries as of June 18, 2025. Stock markets have shown resilience, with energy and defense sectors outperforming, but risks of a prolonged conflict could lead to substantial declines. Bond markets face competing pressures from safe-haven demand and inflationary risks, with oil price dynamics playing a critical role. The conflict's trajectory, particularly regarding oil supply disruptions and U.S. involvement, will determine its long-term market impact. Investors should maintain diversified portfolios and monitor geopolitical developments closely.

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