

## Geopolitics and tariffs: a new twist for economic resilience

After a January filled with a range of emotions (Venezuela, Greenland, etc.), the first quarter of the year will close with new changes in the tariff landscape, following the US Supreme Court's decision to invalidate the legal path used by the Trump administration to redesign a significant portion of the tariff framework and, above all, with the intensification of tensions in the Middle East following the outbreak of the military conflict in Iran. This new twist in the geopolitical landscape will once again test the resilience shown by the business cycle in recent years, amid a spike in energy prices and uncertainty in the short term.

Considering Iran's importance as an oil producer (3.3 million barrels per day) and its ability both to restrict maritime traffic through the Strait of Hormuz, through which 20% of maritime oil and gas transport passes, and to damage regional energy infrastructure, the immediate responses of the markets have reflected investors' concerns about the economic and financial effects of a new supply shock. The rise in oil prices during the first week of hostilities, as well as natural gas prices in particular, highlights the sensitivity and disruptive capacity of the energy channel, despite the slack that existed in the market before the conflict began. A second derivative is how the energy shock interacts with the trade channel, as the necessary diversion of shipping routes via the Cape of Good Hope and the increase in insurance costs (12 times more in the case of tankers passing through Hormuz) will result in higher transport costs and new distortions in value chains, which are already under strain from tariff noise and trade fragmentation. All this is occurring at a juncture where the widespread increase in uncertainty could be transmitted to the financial channel, especially considering the presence of stressed valuations in certain market segments and the rotation occurring in AI-related stocks.

In this challenging context, there are four key factors at play in the short term: (i) the duration of the conflict and, therefore, of the tensions in the energy market, (ii) the strategy of the new Iranian leadership and the possibility that the US will push for a solution similar to that of Venezuela (with the US midterms elections just around the corner), (iii) Iran's ability to structurally damage the region's energy infrastructure, maintain disruptions in Hormuz (tanker war) and extend the conflict considering the country's delicate economic situation, and (iv) the responses of monetary authorities to isolate the financial channel amid a potential increase in uncertainty and inflation expectations.

The time variable is key, as it will delineate the boundary between a controlled supply shock and a global stagflation scenario. Oil and gas futures traded during the week following the start of the air strikes were anticipating a moderate supply shock. With this change in the initial assumptions, the growth outlook for the euro area and Spain could be slightly lower than previously anticipated, while inflation could experience a temporary rebound of a few tenths of a percentage point that would not significantly alter the ECB's strategy. Such an impact would be manageable for the business cycle, considering the resilience shown in recent years and the structural reduction in energy intensity in production. From here, the situation would become more complicated in a scenario of persistently higher prices (oil above 100 dollars for several months), with risks of upward pressures on inflation expectations. In this context, we would see interest rate hikes, and combined with the negative effects on income this would bring us to the brink of stagflation, with distortions in capital flows, higher risk premiums and a general tightening of financial conditions.

Therefore, for the umpteenth time in recent years, we are yet again reminded of the fragility of economic and financial forecasts in the face of geopolitical shocks. This is a reality we will have to live with from now on, and a reflection of a neo-Westphalian world, with increasing rivalry between major powers, protectionism, division into hegemonic blocs and limited multilateral coordination. The recommendations to mitigate damage in this complex framework are largely common sense: strengthen balance sheets, diversify portfolios, increase flexibility and degrees of freedom in management, create firewalls capable of absorbing losses, and do not overreact amid the noise of daily events. That is easier said than done.

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March 2026