

CIO View:

Impact on the Global Economy and Financial Markets in the Wake of US and Israeli Attacks on Iran

Nomura Asset Management Co., Ltd. Published March 2, 2026

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The U.S. and Israel launched "Operation Epic Fury" against Iran on Feb 28, reportedly killing Supreme Leader Ayatollah Khamenei. Uncertainty over the operation's duration and talks with Iran's interim leadership raise geopolitical risk. Short-term effects include higher oil prices (resulting from an effective blockade of the Strait of Hormuz), a stronger risk-off sentiment, and divergent sectoral impacts—positive for energy and defense but negative for oil importers and consumer sectors. Global bond yields face mixed pressure from safe-haven demand versus inflation risk; the dollar may strengthen initially. Credit concerns have risen after recent lender failures; we will continue to closely monitor developments and market impacts to carefully manage our investment portfolios.

US and Israeli Attacks on Iran and Its Recent Developments

On February 28, the United States and Israel launched a military operation against Iran. The operation, named "Operation Epic Fury," struck numerous facilities across multiple regions, including the capital, Tehran, and Iranian state media confirmed on March 1 that Supreme Leader Ayatollah Khamenei was killed in the attack.

US President Donald Trump said the operation was intended to eliminate security threats. He stated that Iran has, over roughly the past 50 years, repeatedly carried out hostile acts against the U.S. and asserted that Iran did not possess nuclear weapons. After the U.S. attacked nuclear-related facilities in June last year, it warned Iran not to resume nuclear weapons development and sought talks; President Trump expressed strong dissatisfaction that Iran had not abandoned its development efforts.

A key question is how long the military operation will last. President Trump's statements on this point have been inconsistent, at times saying about four weeks and at other times suggesting a shorter timeframe. Calls for caution have also come from within the Republican Party and among its supporters. With midterm elections scheduled for November, there is added uncertainty: while President Trump appears unwilling to prolong the operation, he also seems to seek results that will appeal to voters.

First, attention should be paid to the outcome of talks between the U.S. and Iran's provisional leadership body — the Interim Leadership Council — formed after the Supreme Leader's death.

On March 1, President Trump said he had agreed to hold talks, but no details on timing have been disclosed, leaving the situation unclear.

Regarding the impact of the worsening Middle East situation on the global economy, at least in the short term, a supply shock is likely. In particular, we expect upward pressure on crude oil prices. It has been reported that the Strait of Hormuz, a key chokepoint for oil transportation, has effectively been closed. The longer the closure persists, the greater the upward pressure on oil prices will be.

If these conditions continue, financial markets are likely to become concerned about stagflation — a simultaneous slowdown in growth and a rise in inflation — which would tend to prompt risk-averse behavior. With heightened uncertainty ahead, we will closely monitor the effects on each asset class.

Impact on the Japanese Equity Market

The Tokyo stock market fell on March 2 amid instability in the Middle East and broader international political and economic conditions. The market had risen sharply year-to-date, and we believe some profit-taking and position-unwinding selling is occurring.

Of particular concern is a possible closure or blockade of the Strait of Hormuz. The impact will depend on how long the current military operation lasts. Amid overall inflationary concerns, rising oil prices could benefit energy-related and commodity sectors, while higher input and transportation costs would weigh on sectors sensitive to such cost increases. As a result, sector performance is likely to diverge.

We will also monitor whether expanded geopolitical risk, centered on the outlook for Iran's new leadership, affects global equity valuations. The Japanese stock market may, therefore, continue to undergo short-term adjustments.

Impact on the Global Equity Market

In response to rising geopolitical risk following US and Israeli attacks on Iran, we expect risk-off sentiment to intensify in the short term. If oil prices rise sharply and the uncertain situation persists, downward pressure is likely to continue on oil-importing economies and on consumer-related sectors such as tourism. At the same time, energy sectors benefiting from higher oil prices and defense-related sectors could attract capital inflows amid heightened geopolitical risk. The stance of Iran's provisional leadership and the US administration's response will require close attention.

Impact on Bonds and Foreign Exchange Markets

Yields on government bonds of major advanced economies are likely to come under downward pressure from risk-off flows and concerns about a slowing economy. However, if inflation picks up, it could hinder monetary easing and push yields higher.

In the foreign exchange market, we initially expect the US dollar to strengthen, but over time attention is likely to shift to assessing the impact of stagflation on various economies.

In the previous week, we also saw reports such as the collapse of UK mortgage lender Market Financial Solutions. We will continue to monitor such and other events that have heightened concerns in the credit market and their possible impact on the market.

The commentary is based on personal views and does not necessarily reflect the house view.

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