CIO View:

Middle East Tensions and Surging Oil Prices Hit the Global Economy and Financial Markets

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About 10 days have passed since the U.S. and Israel launched military operations against Iran on February 28, and the situation remains tense. U.S. and Israeli operations are ongoing, while Iran has carried out attacks on neighboring countries - there is currently no sign of de-escalation.

In Iran, following the death of Supreme Leader Ayatollah Khamenei in the attacks, his younger son, Mojtaba Khamenei, was selected as the new supreme leader. However, because the U.S. and Israel have expressed negative views toward Mojtaba, it is unclear whether the new leadership will lead to an improvement in the situation. In fact, the U.S. and Israel may increase pressure on Mojtaba and the new regime — especially if he is seen as taking a hard line toward the U.S. — raising the risk that the military campaign will be prolonged.

Under these circumstances, uncertainty over how long the operations will continue and how widespread their effects will be, has increased. In particular, the de facto closure of the strategic Strait of Hormuz has heightened concerns over oil transport and supply, and WTI crude futures exceeded $110 per barrel as of the morning of March 9 (JST). Prolonged disruptions to oil transport and supply would likely exacerbate stagflationary pressures on the global economy (a simultaneous slowdown in growth and upward pressure on inflation).

These uncertainties and concerns about the global economy have continued to drive risk-off moves in financial markets. We will continue to closely monitor the impacts across asset classes.

Impact on the Japanese Equity Market

The situation in the Middle East has further deteriorated, raising concerns that oil prices will rise and prompting a sell-off in Japanese equities; the Nikkei 225 has fallen into the 51,000-yen range throughout the trading hours on March 9 (JST). Reports that Mojtaba Khamenei — an anti-U.S. hardline conservative — has been chosen as the successor, have heightened uncertainty about when the current military operations might end; and this appears to be the primary reason for the market decline. While U.S. President Donald Trump has signaled his willingness to continue attacks until Iran's leadership is neutralized, Iran has continued strikes against neighboring countries, making it difficult to envisage a clear path toward normalization of conditions in the Strait of Hormuz.

In addition, the sharp rise in WTI crude futures is beginning to have tangible effects on economic fundamentals. Japan, which is highly dependent on oil imports, is particularly exposed; this helps explain the sharp drop in stock prices. Although views differ on how long the fighting will continue, we expect markets to remain volatile as investors wait for signs of de-escalation. At the same time, medium- to long-term prospects for Japanese corporate earnings for the next fiscal year remain solid, and governance improvements and stronger shareholder returns are expected to continue; we believe Japan-specific investment opportunities remain intact. Given persistent uncertainty over the impact on corporate earnings, a cautious portfolio stance is warranted for now. However, with the indices having fallen to attractive levels close to the end of last year in 2025, we also believe this will create selective investment opportunities.

Finally, heightened concerns about dependence on imported energy contributed to a broad sell-off across Asian markets at the start of the week; like Japan, markets in South Korea and Taiwan dropped sharply. As investors' risk-off stance intensifies, we will continue to closely monitor how U.S. and European equity markets react.

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