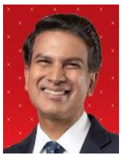
MACRO INSIGHTS

Cost of the Iran war

25 May 2026



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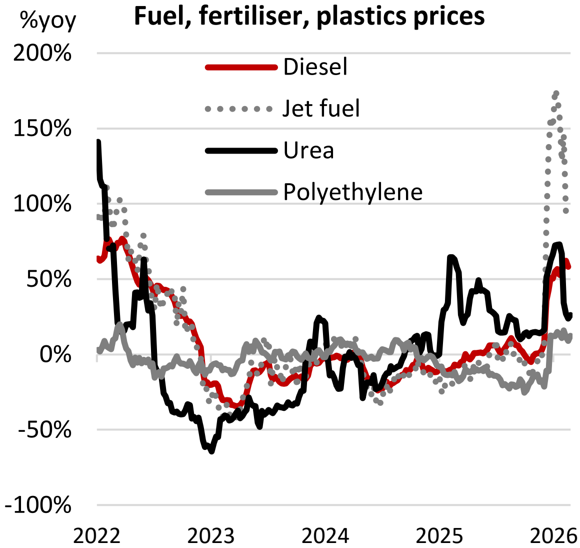
- *Iran deal hopes may calm markets briefly, but war-driven energy, shipping, and defence costs will keep inflation and fiscal pressures high, sustaining bond market stress and favouring short-duration bonds.*
- *An imminent deal may help sentiment, but war costs will continue to build.*
- *Energy infrastructure damage to keep oil and gas costs elevated for longer.*
- *Strait of Hormuz risk raises shipping volatility and energy premiums.*
- *Higher defence spending adds to already stretched public finances.*
- *Rising yields and refinancing risks favour short-duration bond strategies.*

CHART OF THE WEEK: COMMODITY PRICES IN PERSPECTIVE

Lingering uncertainty about the Iran war's geoeconomic outcome notwithstanding, commodity markets have gone past their state of panic. From energy to chemicals, prices peaked in early-April. While diesel prices have yet to decline, many other critical petrochemical products, including jet fuel, urea, and polyethylene, have underdone price declines. Ample crude supplies have materialised, strategic reserves have been deployed, and some conservation measures have been implemented. There is resiliency.



Source: Bloomberg, DBS

COMMENTARY: Cost of the war

Taimur Baig

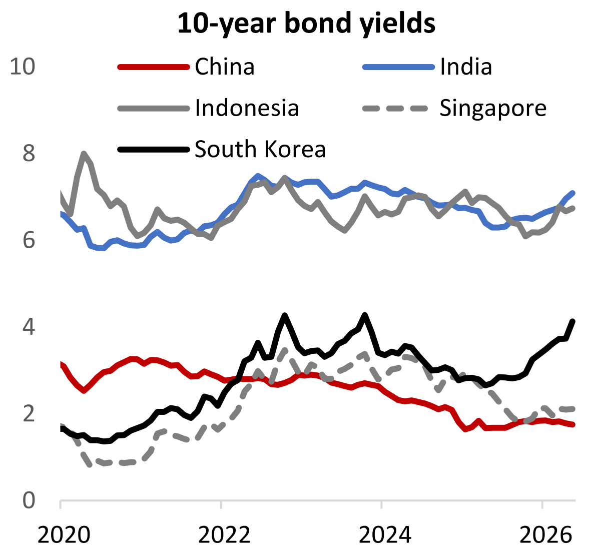
An Iran deal may be around the corner, but the cost of the war will likely continue to accumulate in the coming months. The most obvious cost is inflation, which won't dissipate even with an expeditious re-opening of the Strait of Hormuz. Oil/gas production/refining facilities in the region have been affected substantially, which will continue to constraint the supply of petroleum products. Regardless of the contour of the deal, we think perceptions regarding the shipping of products through the Strait have shifted fundamentally, and a degree of volatility around safe passage would persist. Globally, nations would diversify energy suppliers and build larger strategic reserves, all adding to the cost of energy for years to come.

Then there is fiscal. The war has led to profound questions not just about energy security, but also about the reliability of ostensible allies to protect national security. Defence spending will likely rise as countries look to secure their backyards further.

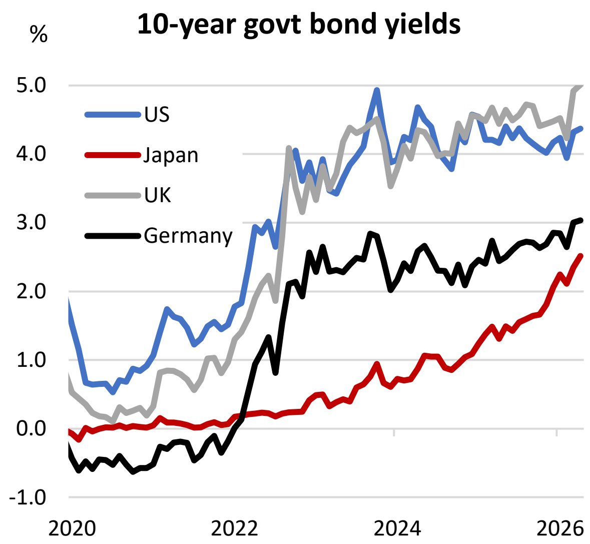
The bond market is not taking these developments kindly. Public sector debt burdens have been on an uptrend through this decade, fuelled by global responses to the pandemic. Global government debt as a share of GDP has risen from a pre-pandemic level of 82% to 94% by end-25, with the IMF forecasting 100% by 2029. Public debt interest payment alone is heading toward 3% of global GDP presently.

These figures, already uncomfortable, are now looking particularly disconcerting as there is no visible sign of fiscal consolidation among the large indebted economies around the world, with the ongoing crisis making the task of taming debt even more onerous. Debt market selloff is unsurprising, with the mountain of long-duration papers up for refinancing for years to come.

Bond yields of major EM and DM economies have risen through this year, with two notable exceptions. Among high income economies, Singapore's debt yield has in fact rallied; among EM economies, the same holds for China. But for the rest, there has been little respite from servicing an ever more expensive public debt burden. An announcement of an Iran deal may buoy markets, but only marginally, in our view. This war's bills have to be paid for a while by most governments. With respect to investment strategy, that leaves us only with short-duration bond strategies.



Source: CEIC, DBS.



Source: Bloomberg, DBS

Taimur Baig

FX: USD'S RISKS FROM PEACE HOPES AND FED AMBIGUITY

Philip Wee

Following a week of consolidation between 99 and 99.5, the USD Index (**DXY**) **will likely break lower in the final week of May**. The US Treasury 10Y yield eased to 4.56% last Friday after hitting a 2.5-year high of 4.69% on May 19. The Sri Lankan Rupee surged 4.6% last Friday and recovered more than 60% of its May sell-off. USD bulls have retreated amid hopes of a US-Iran agreement to end the conflict and reopen the Strait of Hormuz, which in turn will relegate inflation to the transitory camp.

On Saturday, President Donald Trump announced that a peace agreement had been "largely negotiated" following intensive, Pakistan-led mediation and high-level calls with Middle Eastern allies and Israel. However, in a follow-up statement on Sunday, Trump instructed his negotiators not to rush the deal, saying, "Time is on our side." He emphasized that the US naval blockade on Iranian ports will remain in full force until a final text is signed and certified. **US officials are hinting that a formal announcement could come very shortly if Washington and Tehran resolve their differences on the final details of the agreement.** Both WTI and Brent crude prices are below USD100 per barrel this morning.

Meanwhile, Kevin Warsh was sworn in as the 17th Fed Chair at the White House on May 22. While stating that Warsh would "do his own thing" in upholding the Fed's independence and interest rates, President **Trump did not hide his desire for Warsh to start lowering interest rates. Warsh's acceptance speech focused on leading a "reformed-oriented"** Fed by moving away from backward-looking and economic dogmas, pursuing a dual mandate that can simultaneously achieve lower inflation with stronger growth, reducing the Fed's balance sheet, and pivoting away from forward guidance dot plots and heavily parsed press conferences.

Instead, **Warsh may abstain from providing his interest rate forecasts in the June Summary of Economic Projections**, aligning with his disdain for forward guidance that locks the FOMC into pre-emptive policy paths. Doing so will allow Warsh to either prevent a rift with Trump over a hawkish projection or avoid losing credibility with the market through a dovish forecast. Instead, Warsh's debut FOMC meeting on June 17 could be the start of a phase to downplay the dot plot's significance as a policy roadmap. However, if this Thursday's PCE inflation data comes in hot. Warsh's strategy may create friction with the market and his Fed colleagues.

Meanwhile, **more European Central Bank governing council members are leaning towards a 25-bps hike in the deposit facility rate to 2.25% at the June 11 meeting**. ECB President Christine Lagarde is particularly attentive to the second-round effects of energy-driven price pressures. Lagarde warned that inflation projections will likely be revised in June despite the Eurozone's long-term inflation expectations staying "broadly well anchored" to the 2% target. Hence, **EUR/USD will likely set its sights higher again after failing to break decisively below 1.16 last week**.

In Asia, markets are also wary about record-low currencies pulling back, like the LKR. Apart from FX interventions, oil-dependent countries such as India, Indonesia, and the Philippines have stepped up measures to stabilize their currencies. Following last month's 25-bps hike in the Philippines and last week's surprisingly large 50-bps hike in Indonesia, markets have fully priced in a hike in India on June 5. Over the past two months, markets also increased the odds from 20% to 80% for the Bank of Japan to lift rates to 1% at its June 16 meeting. Hence, the risk-reward has skewed from the USD posting new highs towards correcting lower against the JPY, INR, IDR, and the PHP, alongside its Asian peers.