Quarterly Outlook

Energy shock shifts market focus from growth optimism to inflation and downside risks

April 2026

Market developments and other events

Global equities posted gains early in the quarter, supported by resilient economic activity and moderating inflation, before reversing sharply as the conflict in the Middle East shifted market focus toward re-emerging inflation risks, a constrained monetary policy-path, and downside risks to growth. Markets exhibited heightened sensitivity to news-flow, with equity volatility rising alongside uncertainty.

Corporate credit spreads widened modestly across investment grade and high yield globally, retracing from historically tight levels, as inflation uncertainty increased, financial conditions tightened and growth expectations softened. The move was more pronounced in HY, consistent with a broader repricing of risk premia.

Long term rates rose across major economies, driven primarily by the energy-led upward pressure in inflation expectations, higher real yields, and a repricing of the expected policy path. The move was reinforced by a modest increase in term premia amid renewed fiscal concerns and an expected rise in debt issuance, although cross-country dynamics diverged.

Commodity markets surged over the quarter, led overwhelmingly by energy prices as conflict damaged regional infrastructure and effectively closed the Strait of Hormuz. Gold posted strong gains early in the quarter on safe-haven demand, before reversing sharply as the USD rallied and real yields rose.

Inflation declined across the US, euro area and UK through January and February, with the euro area briefly dipping below the ECB's target while the US and UK, despite meaningful progress, remained above their respective targets. The conflict in the Middle East sharply reversed the disinflationary trend, with surging energy prices erasing much of the earlier disinflation progress and pushing inflation expectations higher.

Outlook for growth, inflation, and interest rates

The outlook for global growth is moderate and below trend, as the energy-driven supply shock introduces additional downside risks in the near term, while increased global economic and geopolitical fragmentation weighs on global productivity in the medium term. A more constrained monetary policy backdrop and tighter financial conditions could further temper growth. At the same time, fiscal stimulus, sustained AI-driven investment, tech-related productivity spillovers and energy transition investments could provide near-term tailwinds.

Global inflation is expected to rise in the near term, led by the rise in energy prices directly feeding into headline inflation, and indirectly through second round effects of the supply shock into higher transport, input materials and food costs. Upside risks to inflation and its persistence crucially depend on the duration of the disruption of oil and gas flows. Over the medium term, inflation is expected to gradually moderate but remain somewhat above target, as persistent services inflation, fragmented supply chains and wage dynamics offset disinflationary pressures from tighter financial conditions and weaker growth.

The outlook for long-term interest rates is for a gradual upward drift across developed economies, driven primarily by a repricing of the expected policy path in response to the energy-shock feeding into more persistent inflation dynamics. Fiscal pressures and heightened uncertainty, feeding into higher term premia, add further upward pressure. For the US, the risk of fiscal dominance and softer labor markets raise concerns about the Fed's ability to tackle inflation, fueling higher for longer rate expectations.

Outlook for financial assets

Equity returns are moderately positive in the near-term, reflecting some upside potential from the negative sentiment shock. At the same time, the upside potential for equity markets is somewhat limited by rising commodity prices, heightened geopolitical risk, and negative investor sentiment.

The government bond return outlook improves modestly over the medium term, primarily driven by higher initial yields and improved carry returns. However, medium-term total returns may be constrained by persistent inflation uncertainty, fiscal pressures, and the risk of a higher-for-longer policy environment.

The outlook for corporate credit IG and HY returns is moderately positive, supported by a rise in credit spreads from historically tight levels and higher rates, translating to improved carry returns. However, medium-term total returns are likely to be capped as current spread levels are still relatively low, and performance remains sensitive to interest rate volatility and a repricing of risk premia.

The outlook for financial assets exhibits downside risks as the US-Israel-Iran conflict disrupts the gradual disinflation path and raises stagflationary risks, creating a challenging backdrop for monetary policy as slower growth and stickier inflation pull it in opposing directions. The distribution of outcomes remains wide, hinging primarily on conflict duration and whether energy price pressures feed through to broader inflation persistence and more widespread supply chain disruptions.

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