Weekly round up (Week 12)

Markets experienced another turbulent week, with geopolitical developments continuing to overshadow corporate earnings and economic data. However, we did get an initial glimpse of how central banks are assessing the conflict's impact on their economies, with eleven monetary policy meetings held over the course of the week.

Government bond yield curves have flattened significantly ("bear flattening") since the start of the year, as investors anticipate lingering fears linked to the last major shock—the Covid-19 pandemic—when central banks prioritized anchoring inflation expectations, even at the expense of growth. This dynamic has led to a sharp rise in short-term yields. Since the start of the year, the yield on the 2-year U.S. Treasury has risen by 44 basis points (bp), that of the British gilt by 90 bp, and that of the German Bund by approximately 52 bp. In contrast, 30-year yields have risen only slightly over the same period. Overnight index swap markets now anticipate that the Federal Open Market Committee (FOMC) will keep rates unchanged through 2026, while the European Central Bank (ECB) and the Bank of England (BoE) are expected to implement three 25-bp hikes. This marks a sharp reversal from the start of the year, when markets anticipated roughly two 25-basis-point cuts by the FOMC and the BoE, and no change in ECB policy.

In the corporate credit market, conditions remained orderly. All asset subclasses have posted slightly negative returns since the start of the year, with the exception of emerging market high yield, which benefits from geographic diversification, heavy exposure to the energy sector, and relatively low investor positioning.

The U.S. dollar weakened against G10 currencies this week, as interest rate differentials narrowed to its detriment. Elsewhere, the trends observed during the first two weeks of the conflict continued into the third; stock markets closed lower for the third consecutive week, and energy prices continued to climb. Brent crude is now up about 80% since the start of the year, while gas prices in Europe have risen by more than 100%.

The question on everyone's mind this week is simple: how much worse can things get? The uncomfortable answer is a Global Financial Crisis 2.0 (GFC 2.0). This may sound dramatic, but obvious parallels should not be ignored.

First, oil prices climbed to around $145 per barrel in 2008, driven by an almost perfect combination of supply constraints and strong demand. Rapid growth in emerging markets, particularly China and India, led to a sharp increase in global energy consumption. At the same time, non-OPEC supply was weakening, with declines in key regions such as the North Sea and Mexico's Cantarell field. This supply crunch was exacerbated by geopolitical disruptions in Venezuela, which halted sales to ExxonMobil, while Iraq suffered sabotage attacks on its export pipelines. In our bearish scenario regarding the outlook for oil prices, we forecast that prices could reach levels similar to those seen in 2008.

The next point of similarity concerns central bank policy. In 2008, the Federal Reserve (Fed) and the Bank of England (BoE) had both begun to ease their policies but paused for an extended period from the second to the fourth quarter of 2008. Policy makers found themselves caught between a rock and a hard place, facing rising inflation expectations—largely fueled by soaring oil prices—and an economic slowdown. The term "stagflation" became widely used at the time.

Fast-forwarding to last week's monetary policy meetings, the comparison is quite striking. Out of eleven meetings, nine central banks kept their rates unchanged, sending a consistent message: they stand ready to act if inflation expectations do not remain anchored. The two exceptions are the Reserve Bank of Australia (RBA), which raised its policy rate by 25 basis points to 4.10%, marking its second consecutive hike this year. This decision reflects increased upside risks to inflation, linked to the energy price shock associated with the conflict with Iran, as well as a tighter-than-expected labor market. Meanwhile, the Central Bank of Brazil (BCB), widely regarded as one of the most effective in managing the inflationary shock of the Covid era, cut its rates by 25 basis points to 14.75%. It should be noted that monetary policy in Brazil remains highly restrictive: the ex ante real rate fell only marginally, from 10.6% to 10.3%, which is still more than double the neutral rate estimated by the BCB, around 5%.

As for the BoE and the FOMC, both were confronted with increasingly concerning economic data. The Bank of England's Monetary Policy Committee had before it the January growth figures, which proved surprisingly stable (0.0% month-over-month), suggesting that economic activity may have stalled even before the recent geopolitical tensions. Meanwhile, the FOMC was confronted with an extremely weak nonfarm payrolls report for February, which showed a loss of 92,000 jobs and a rise in the unemployment rate to 4.4%, its highest level in nearly five years.

Against this backdrop, the BoE voted unanimously to keep rates at 3.75%, its first unanimous decision in four and a half years. Governor Andrew Bailey warned that monetary policy must "respond to the risk of a more persistent effect on UK Consumer Price Index (CPI) inflation," adding:

"Whatever happens, our mission is to ensure that inflation returns to its 2% target." Meanwhile, the FOMC also kept its policy rate unchanged at 3.50% to 3.75%, with a single dissenting vote from Governor Stephen Miran in favor of a cut. The key takeaway from Chair Powell's press conference is that it is still too early to assess the impact of rising oil prices on the U.S. economy, and his comments reinforced the view that the committee is still far from resuming rate cuts. "What's really important this year is to see progress on inflation," Powell said. "If we don't see that progress, there will be no rate cuts."

The next comparison with 2008 concerns valuations. Corporate credit spreads, then as now, were at cyclical lows, with investment-grade spreads below 90 basis points and high-yield spreads below 250 basis points in the United States before the conflict began. Equity market valuations also appear high. In June 2007, the Shiller CAPE ratio—an indicator offering a more stable measure of valuations than traditional price-to-earnings ratios—stood at 27.4. Today, this level is significantly higher, at around 38.3. Even more concerning is the growing concentration of returns and profits in the equity markets. Since the launch of ChatGPT in 2022, approximately 65 to 75% of the S&P 500's returns and profits have been generated by just 42 companies related to generative artificial intelligence. At the same time, this concentration has never been higher, with U.S. stocks now accounting for 75% of the MSCI World Index.

For a crisis to erupt, a tipping point—a "Minsky moment"—is necessary. In 2008, that trigger was the subprime MBS (mortgage-backed securities) market. Today, a more contentious question is whether private credit could play a similar role. This asset class does indeed exhibit troubling similarities. Like MBS and CDOs (collateralized debt obligations), private credit remains relatively opaque, with valuations based on internal models rather than market prices. Furthermore, default rates are rising: Fitch recorded a rate of 9.2% in 2025, with forecasts suggesting a further increase. The difficulties are also masked by payment-in-kind structures, reminiscent of how credit deterioration was concealed prior to 2008. At the same time, managers have begun to restrict and limit redemptions due to liquidity concerns, echoing the first signs of strain observed in 2007. Finally, banks remain indirectly exposed through funding lines, which increases the risk of broader systemic contagion.

However, there are significant mitigating factors that distinguish the current situation from that of 2008, notably the increased strength of household, corporate, and bank balance sheets. Banks are much better capitalized following the reforms implemented after the Dodd-Frank Act.

The current policy environment also remains supportive, with mild financial deregulation by the U.S. administration, while governments around the world continue to support the economy through expansionary fiscal policies.

Thus, it is unlikely that the current conflict will trigger a deleveraging crisis comparable to those of 1929 or 2008. Our base case remains that of a shock-induced correction. Nevertheless, the risk remains that a prolonged conflict could escalate into a deeper economic crisis.

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