

Global Credit Conditions Update April 2024

Geopolitical Risks Rise On Iran-Israel Conflict Expansion Despite Immediate Reprieve

April 15, 2024

This report does not constitute a rating action

Key Takeaways

- The recent attack by Iran on Israel represents a dangerous expansion of the Israel-Hamas war and raises the risk of a sharp escalation of the conflict. The signaling and coordination that minimized harm, prevented an immediate full-scale regional conflict.
- While last weekend's events signal a significant increase in geopolitical risk, the central narrative of our base-case scenario remains broadly unchanged including our baseline macroeconomic assumptions for the major economies. Nevertheless, our expectations will be contingent on the nature and magnitude of the Israeli response over the coming days.
- The medium-term trajectory remains fraught with risk, given the enormous challenges in finding a de-escalatory pathway. This means that those key transmission channels exposed to the conflict that could affect credit conditions will continue to be monitored closely. These include energy prices, supply-chain disruptions, financial market volatility, and resumption of inflationary pressures, all of which could worsen if the conflict reaches a tipping point.

Editor's Note: This report provides an interim Credit Conditions Commentary following the attack on Israel by Iran on April 13 and 14, 2024. S&P Global Ratings' Credit Conditions Committees meet quarterly to review macroeconomic conditions in each of four regions (Asia-Pacific, Emerging markets, North America, and Europe). Discussions center on identifying credit risks and their potential rating impact in various asset classes, as well as borrowing and lending trends for businesses and consumers.

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A Dangerous Expansion Of Israel-Hamas War

The recent direct missile and drone attack from Iran's territory targeting Israel represents a dangerous expansion of the Israel–Hamas war. But given the advance signaling and coordinated defense that minimized harm, we don't believe we are on the verge of an immediate full-scale regional conflict. This is because there is relevant pressure from the U.S. and allies to manage Israel's retaliatory response and avoid a full-scale conflict. However, the medium-term trajectory remains fraught with risk, given the enormous challenges in finding a de-escalatory pathway. While somewhat relieved in the short term, financial and commodity markets are likely to remain nervous as this perilous conflict evolves.

From a credit perspective, we continue to monitor key transmission channels exposed to the conflict that would affect credit conditions. These include energy prices, supply-chain disruptions, financial market volatility, and resumption of inflationary pressures, all of which could worsen if the conflict reaches a tipping point. These factors could weigh on major central banks' monetary easing calculations, especially if financing conditions tighten. The ongoing rise in oil prices could be particularly harmful for net energy importers.

The Magnitude Of Israel's Response Will Influence Risk Trajectories

There are four key developments to watch over the coming weeks:

- **Israel's reaction:** The magnitude and severity of Israel's response would dictate the scope of further escalation and retaliatory actions from Iran and its proxies, and ultimately, the likelihood of a full-blown regional conflict.
- **U.S stance:** While we expect the Biden administration to fully assert its support for Israel, we also anticipate that it will use its leverage over its allies to avoid a regional war by all available means.
- **Iran's risk appetite:** By directly attacking Israel, Iran has demonstrated greater response assertiveness, if targeted by Israel. The potential for escalatory tit-for-tat strikes in the near term depends on Israel's next move. One key concern is Iran accelerating its nuclear program, which would ratchet up significantly tensions in the region.
- **Choke points:** Increased hostilities by Iran and its proxies in the Persian Gulf and the Red Sea could cause further supply-chain disruptions, creating volatility in the oil and gas market in particular.

On the credit side, a scenario of protracted conflict between Hamas and Israel, with high risks for regional escalation, could keep oil prices relatively high, although with potentially limited effect on economic activity. Such conditions, could renew inflationary pressures, delaying expected monetary easing in advanced economies. Such a scenario leading to higher energy prices over an extended period could be particularly harmful for countries that are net energy importers, while lingering high interest rates would be especially stressful for emerging economies.






Iran Attack Increases The Risks For Further Conflict Escalation

We believe that the missile and drone attack does not yet move our global macroeconomic baseline assumptions for the major economies. As we noted in our latest report ([Global Credit Conditions Q2 2024: Between Economic Resilience And Market Exuberance](#)), credit conditions remain broadly favorable heading into the second quarter of 2024. Most economies are posting slower--but resilient—growth, and market conditions are providing an opportunistic window for capital raising. The macroeconomic response to higher rates is playing out largely as we have anticipated: slower activity and falling inflation pressures. The U.S. outperformance is the notable outlier. Resilient labor markets, reflecting relatively strong services demand and hoarding of employees, have tempered the slowdown and helped avoid recession, at least so far.



From a geopolitical perspective, although Iran’s missile attack on Israel opens up a new stage with state-to-state confrontation, the advanced signaling and coordination support our base - case assumption that the conflict won’t turn into a full-blown regional war. Certainly, G7 leaders have pledged to “continue to work to stabilize the situation and avoid further escalation”. Rather, we expect that the Israel-Hamas war will continue without resolution through 2024, largely contained to Gaza with continued pressure on Israel from Iran and its proxies.

That said, we continue to believe that geopolitical conditions and higher-for-longer rates are the two identified risks most likely to derail our base-case expectations (see table below). The region is in a vulnerable situation prone to further conflict escalation, and the possibility of a tactical miscalculation can’t be ruled out. Consequently, given this deteriorating geopolitical environment, coming on top of the increasing battlefield challenges facing Ukraine, we now judge that downside risks have increased, warranting a change in the global risk trend for geopolitical tensions to worsening from unchanged.

Table 1
Top global risks

	Risk level*	Risk trend**
 Geopolitical tensions threaten supply chains, trade, and market sentiment	High	Worsening
 Higher interest rates persist, straining many of the weakest borrowers	High	Improving
 A sharper global economic slowdown would lead to greater credit stress ahead	Elevated	Unchanged
 Global Real estate markets are facing multiple challenges	Elevated	Unchanged
 China's economic slowdown could weaken global exports, pulling global growth down with it.	Elevated	Unchanged

Structural risks

 Climate risks and energy transition affect business operations	Elevated	Worsening
 Cyberattacks and the potential for rapid technological change threaten global business and government infrastructure.	Elevated	Worsening

*Risk levels may be classified as moderate, elevated, high, or very high, are evaluated by considering both the likelihood and systemic impact of such an event occurring over the next one to two years. Typically, these risks are not factored into our base case rating assumptions unless the risk level is very high. **Risk trend reflects our current view on whether the risk level could increase or decrease over the next twelve-months. Source: S&P Global Ratings.

A Broader Conflict Could Significantly Heighten Ratings Risks

The Israeli authorities are weighing their response. In case of material retaliation, we could see a further escalation and a broadening of the conflict. The potential credit impact of such a scenario could undermine current constructive credit market conditions -, with a flight to safe haven assets and a reduction in risk appetite and potentially higher energy prices. In this scenario, facing a confidence shock and falling demand, central banks could accelerate moving policy rates toward more neutral levels, even if some inflationary pressures return.

Our ratings on Middle Eastern sovereigns already factor in a certain level of regional geopolitical volatility. If a protracted and wider conflict emerges, along with an extended closure of the Strait of Hormuz, many sovereign ratings could come under pressure. This is because the fiscal benefit of potentially higher oil prices for Gulf oil producing sovereigns could be offset by the governments' inability to export their hydrocarbons, the need to increase spending, and the adverse effect of capital outflows and weaker economic growth (see [A Wider Middle East Conflict Remains Outside Our Base Case Despite Iran's Military Action, April 15, 2024](#)).

A real concern, only complicated by these recent developments, is that the pathway to de-escalation in the medium to longer term becomes ever more challenging. In particular, political factions in Israel, Palestine, and Iran risk becoming ever more entrenched in their polarized views. This would have implications for the viability of a two-state solution as well as the scale and type of arms race that could accelerate in the region.

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