Oil shock returns as central banks confront rising yields

Vis Nayar
Chief Investment Officer
Eastspring Investments

Ray Farris
Chief Economist
Eastspring Investments

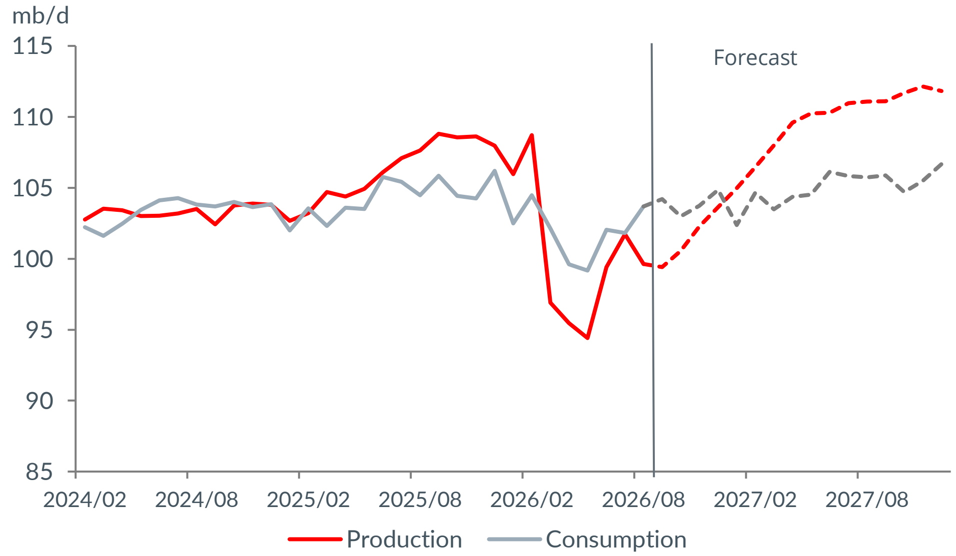
Viola Wang
Economist
Eastspring Investments

All eyes on the Strait of Hormuz and central bank decisions

Rising oil prices have returned to focus as the rapid re-escalation in the Middle East sent front-month Brent crude to USD108/bbl at the time of writing. In contrast to the initial outbreak earlier this year, when hopes were high for a fast resolution to the war, all signs now point to no immediate resolution and a substantial chance that the conflict drags on into 2027. We see an increasing risk that the market transitions from a temporary oil shock narrative to one of persistent energy constraints.

Our concern, however, is that the market has not yet fully appreciated the severity and duration of the oil supply loss and is therefore underpricing oil further along the futures curve. The first chart below shows the US Energy Information Administration's latest estimates for global crude production and consumption. While consumption had largely recovered to its pre-war level by September, production continued to lag. News flow over the past week suggests that the latest production forecast remains too optimistic, given damage to both production and transportation infrastructure. Reportedly, Saudi Arabia's crude production plunged to its lowest level since 1990, while subsequent attacks on oil pipelines have resulted in the closure of alternative shipping routes.

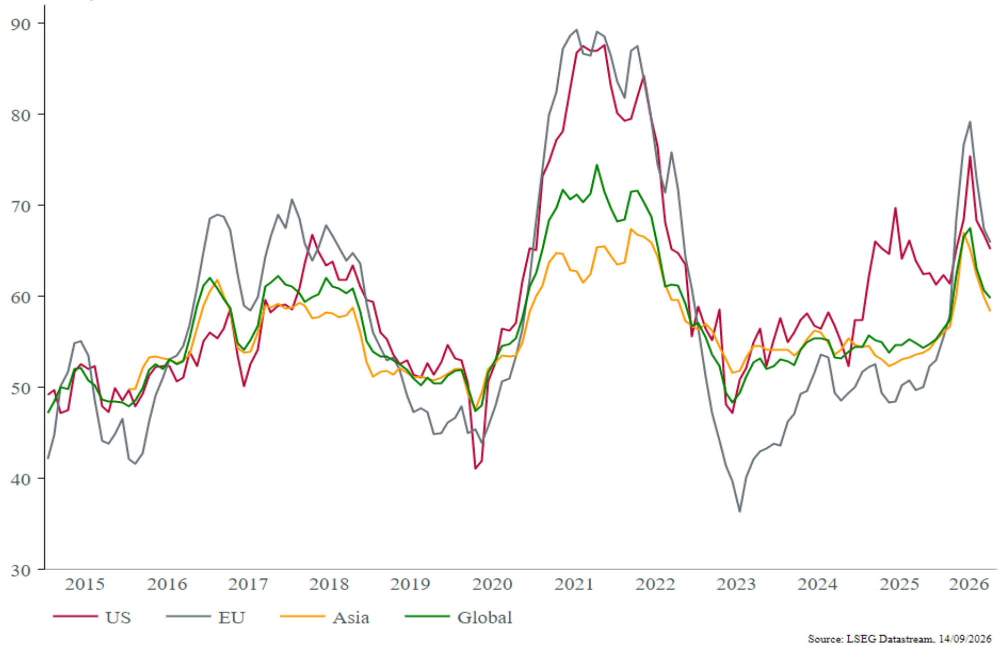
Crude oil production forecast is too optimistic



Source: Eastspring Investments, EIA.

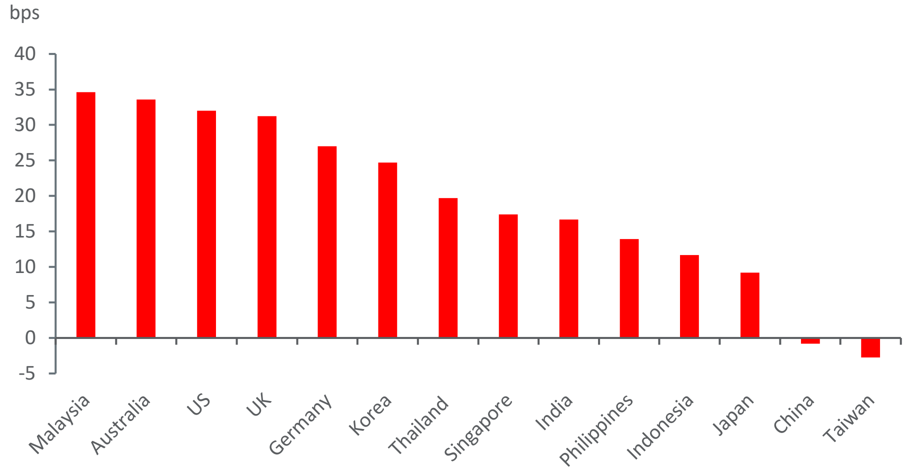
The immediate impact of higher-for-longer oil prices is a repricing of inflation risk. Fiscal measures and the belief that the initial oil-price jump would be temporary have contained inflation thus far, with consensus full-year inflation forecasts declining since mid-year. Both assumptions are now at risk. More importantly, the inflation consequences of a second leg higher in energy prices may be larger than the first. Input costs remain elevated and have not fully unwound the initial war shock. A renewed rise in oil prices therefore risks generating broader second-round effects through transport, manufacturing and consumer goods prices. In the US, retail diesel prices have already surpassed their March peak and reached an all-time high.

The resurgence of oil price is set to lead input prices higher from an already elevated level



For global central banks, the risk is that inflation expectations stop improving just as bond markets are already grappling with higher term premia and fiscal concerns**.** Ten-year yields across developed markets have risen by more than 30bps on average since Jackson Hole.

10y yields rose sharply since Jackson Hole

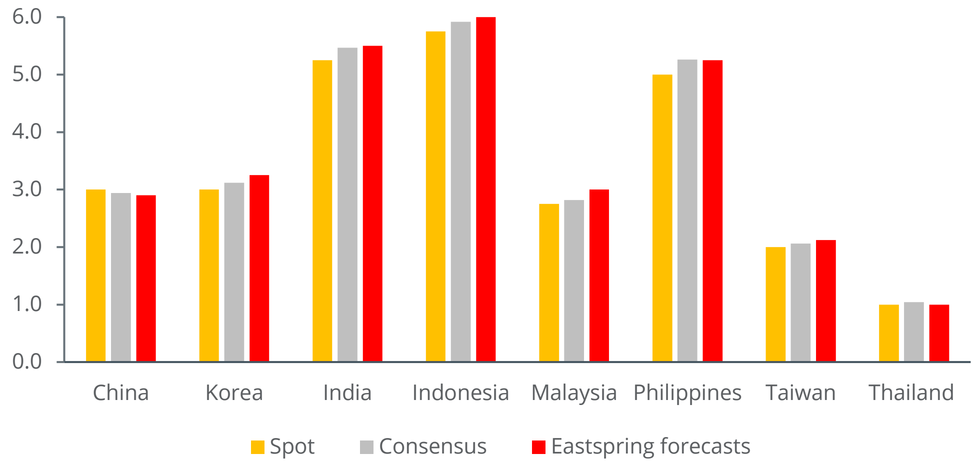


Source: Eastspring Investments, Bloomberg

Following last week's hike by the European Central Bank, both the Federal Reserve (Fed) and the Bank of Japan (BoJ) are expected to raise rates this week. The US August inflation reports came in above expectations, with core inflation accelerating by 0.3% month-on-month versus the 0.2% consensus forecast. As the market has almost fully priced in a 25bps hike at Wednesday's Federal Open Market Committee meeting, we think the hike itself is unlikely to satisfy a market looking for more hawkish guidance. Given Fed Chairman Warsh's well-telegraphed reluctance to provide forward guidance, we expect the market to pay greater attention to the updated Fed dot plot and Summary of Economic Projections. That said, any direct hawkish comments from Warsh could help re-anchor inflation expectations, restrain the recent selloff in bond markets, and offer support to the USD. Similar to the Fed, the market has largely priced in a BoJ hike this week and shifted its attention to BoJ governor Ueda's forward guidance. However, we think the bar for a faster pace of normalisation remains high, and the BoJ is likely to retain a meeting-by-meeting approach.

For the rest of Asia, duration risks remain skewed to the downside. Asian rates have remained relatively resilient despite the rise in Developed Market bond yields. A weaker USD and front-loaded local repricing have helped cushion the move. However, this resilience may prove temporary if higher oil prices worsen external balances and force renewed repricing of inflation and policy expectations. In line with consensus, we continue to expect policy-rate hikes in India, Indonesia and the Philippines in the remainder of 2026. We are more hawkish than consensus and pencil in 25bps hikes in Korea and Malaysia, and a 12.5bps hike in Taiwan.

2026 policy rate forecasts



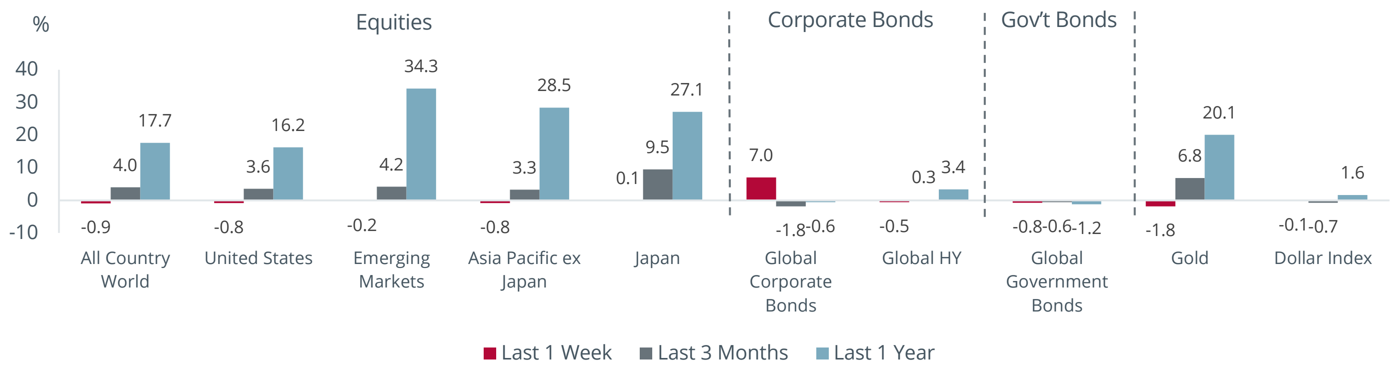
Source: Eastspring Investments, Bloomberg

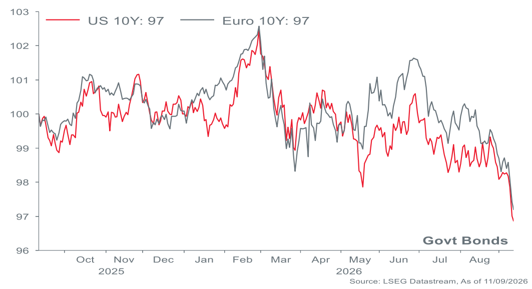
Market Review

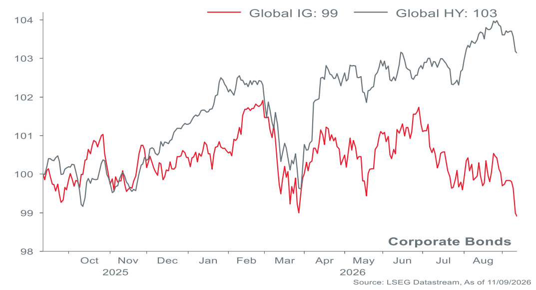
Global equity markets weakened over the week, with the MSCI AC World Index declining -0.9%. US equities fell, with the S&P 500 and Nasdaq falling -0.8% and -0.7% respectively while Emerging Markets were down -0.2%. Asia Pacific ex Japan declined -0.8%, whereas Japan was the only major equity market to post a gain, rising 0.1%.

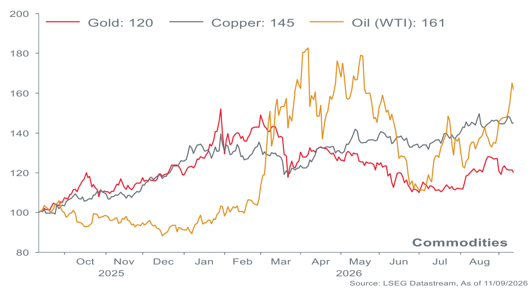
Gold fell -1.8% over the week, and the US dollar index weakened by -0.1%. Bond markets were mixed with Global Corporate Bonds increasing significantly by 7.0%. In contrast, Global High Yield Bonds fell -0.5% and Global Government Bonds declined -0.8%.

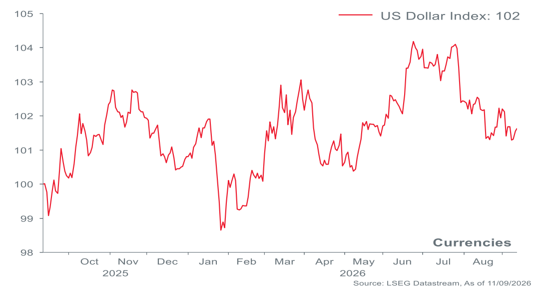
Asset Performance

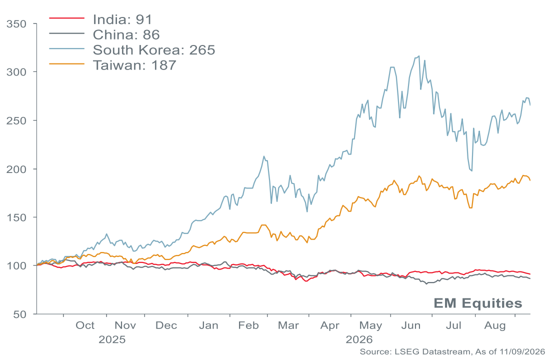


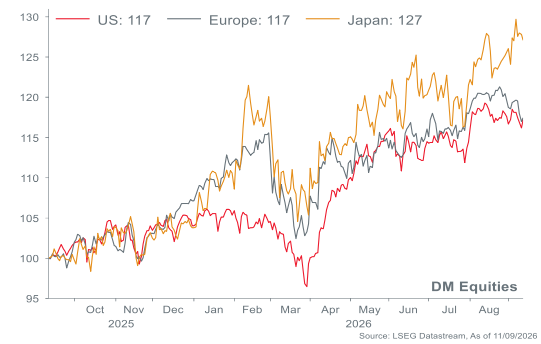












Market Data

Government Bonds	Close	1 week change (%)	1 month change (%)	3 month change (%)	1 year change (%)	YTD change (%)	52 week high	52 week low
US Treasury Yield (%)								
10 Year	4.98	3.99	6.21	11.42	24.03	19.79	4.98	3.95
10 Year Bond Yield (%)								
Japan	2.99	2.65	6.27	11.17	89.40	44.20	3.02	1.58
China	1.69	0.42	-1.00	-5.17	-6.74	-9.29	1.93	1.68
Australia	5.36	4.10	7.02	9.43	26.55	12.67	5.36	4.10
Singapore	2.46	3.24	6.05	17.65	37.43	10.66	2.47	1.75
Malaysia	4.19	5.27	11.53	16.51	22.54	19.88	4.19	3.40
Indonesia	7.16	0.76	-0.97	-3.84	11.55	16.95	7.48	5.92

	Close	1 week change (%)	1 month change (%)	3 month change (%)	1 year change (%)	YTD change (%)	52 week high	52 week low
Bond Indices								
Bloomberg Global Aggregate USD	91.48	-0.93	-1.44	-2.29	-3.86	-3.35	95.69	91.48
Bloomberg U.S. Aggregate USD	90.47	-1.08	-1.37	-2.77	-4.12	-3.83	95.21	90.47

Equity Indices	Close	1 week change (%)	1 month change (%)	3 month change (%)	1 year change (%)	YTD change (%)	52 week high	52 week low
World								
MSCI AC World Index (USD)	1,143.16	-0.91	-0.65	3.97	17.68	12.67	1,160.81	960.87
North America								
US S&P 500 Index	7,656.98	-0.80	-0.92	3.55	16.24	11.85	7,816.70	6,316.91
US Nasdaq Composite Index	26,333.04	-0.66	-0.43	2.03	19.46	13.30	27,190.21	20,690.25
Europe								
MSCI Europe	2,824.33	-1.70	-2.64	3.67	13.98	6.87	2,917.43	2,447.02
Asia Pacific								
MSCI Asia Pacific ex Japan	883.62	-0.81	2.05	3.28	28.45	22.35	925.80	684.96
Japan Nikkei 225	64,011.34	-1.55	-4.42	-0.32	44.26	27.16	72,831.75	43,870.54
Shanghai Stock Exchange Composite	3,888.11	-1.07	-1.17	-2.48	0.33	-2.03	4,258.86	3,741.11
Hong Kong Hang Seng	24,805.63	-3.30	-3.30	2.29	-4.91	-3.22	28,056.10	22,518.00
Taiwan TAIEX	46,184.85	-0.79	2.36	7.03	83.16	59.46	48,218.87	25,174.13
Korea KOSPI	6,909.91	3.33	8.89	-11.00	106.62	63.97	9,385.59	3,311.86
India NIFTY 50	23,398.10	-2.09	-4.39	1.02	-6.43	-10.45	26,373.20	22,182.55
Australia Stock Exchange 200	8,741.20	-2.94	-5.51	1.25	-0.73	0.31	9,296.70	8,262.40
Indonesia Jakarta Composite	6,541.38	-1.43	4.36	11.13	-15.57	-24.35	9,174.47	5,317.91
Thailand SET	1,604.52	0.56	-0.50	2.05	24.57	27.38	1,657.55	1,232.40
Malaysia FTSE Bursa KLSE	1,686.74	-1.25	-2.58	0.43	6.56	0.39	1,771.25	1,580.16
Philippines Stock Exchange PSE	6,061.81	-0.47	-4.19	2.57	-1.06	0.15	6,673.61	5,584.35
Singapore FTSE Straits Times Index	5,695.93	-1.83	-1.01	14.19	30.77	22.59	5,828.50	4,264.99

Currencies (vs USD)	Latest	1 week Change	1 Month Ago	3 Months ago	1 Year Ago	YTD	52 week high	52 week low
Developed Markets								
EUR	-0.10	-0.13	0.50	0.18	-1.15	-1.25	1.20	1.14
GBP	0.07	-0.02	0.10	0.79	-0.40	0.33	1.38	1.30
CHF	0.44	0.82	0.68	2.73	2.56	3.00	0.82	0.76
JPY	-0.57	-1.73	-3.60	-3.99	4.31	-1.99	163.85	146.48
Asia								
CNY	0.03	-0.04	-0.55	-1.00	-5.77	-4.08	7.14	6.71
HKD	0.02	0.03	-0.05	0.08	0.69	0.78	7.85	7.77
INR	0.12	1.13	0.13	-0.22	8.28	6.34	96.82	87.72
MYR	0.17	0.67	-0.54	0.10	-3.58	0.30	4.23	3.88
KRW	-0.59	-0.20	-4.93	-11.50	-3.45	-6.88	1,559.08	1,339.78
SGD	-0.07	0.04	-0.95	-1.27	-1.09	-1.43	1.31	1.26
TWD	0.07	0.03	-1.86	0.22	4.42	0.94	32.40	30.05
IDR	0.31	-0.26	-1.37	-2.17	6.87	5.49	18,170.00	16,375.00

Sources

Asset performances: (bar charts) Eastspring Investments, Refinitiv, as of 11 September 2026. Equities: using MSCI indices in USD, United States is using the S&P 500. Corporate Bonds: using ICE BofA indices in USD. Government Bonds: using the FTSE Global Sovereign Bond index, in USD. Gold is London Bullion Market US Dollar per Metric Tonne. DXY is US Dollar Index. **(line charts**) Eastspring Investments, Refinitiv, as at the end of the prior week, rebased to 100 as at 1 year ago. Equities: MSCI indices, in USD. Corporate Bonds: using Bloomberg indices in USD. Government Bonds: using ICE BofA US 10 Year US Treasury and ICE BofA 7-10 Year Euro Government indices. Commodities: Gold is London Bullion Market US Dollar per Metric Tonne Ounce. Copper is LME Copper Grade A Cash US Dollar per Metric Tonne. Oil is Crude Oil WTI Spot Cushing US Dollar per Barrel. US Dollar is US Dollar Index.

Market data: Eastspring Investments, Refinitiv, as of 11 September 2026. Equities: MSCI indices in USD, other indices in local currency. Other indices or assets as stated. Please note that there are limitations to the use of such indices as proxies for the past performance in the respective asset classes/sector. The historical performance or forecast presented in this slide is not indicative of and should not be construed as being indicative of or otherwise used as a proxy for the future or likely performance of the Fund.