

Geopolitical and geoeconomic report

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A fortnight ago I closed this report by saying that, if I had to watch only one thing, I would look at Brent and the ten-year Treasury together. Brent has done what was expected of it, moving a great deal only to end up almost where it was. The December contract closed on Monday at 100.32 dollars, after topping 106 in the middle of the UN General Assembly and falling back below 100 on the G7 announcement. The Treasury, by contrast, has gone its own way. According to Federal Reserve data, the ten-year closed on Monday at 5.31% and the thirty-year at 5.66%, levels the market had not seen in more than twenty years.

That divergence is, to my mind, the most important development of these two weeks. The war with Iran is no longer taking its toll only on the barrel. It is now also taking it on the price of money, and it is doing so at a bad moment, with a US labour market that is starting to cool, a France visibly losing fiscal credibility and central banks that keep receiving price data that do not allow them to relax.

An energy shock can be endured for a few months. An energy and funding shock at the same time is another matter.

HORMUZ REMAINS HALF OPEN, AND THAT ALSO HAS A PRICE

On 25 September, at the United Nations, Iran offered to reopen the strait and resume nuclear negotiations within seven days. The conditions were the familiar ones, lifting of the US naval blockade, a sanctions exemption for its crude and a ceasefire that includes Lebanon. Trump replied that he was in no hurry. Ten days later President Pezeshkian described the talks as “meaningless”, and the core of Trump’s cabinet met at Camp David to consider, according to Axios, a resumption of large-scale combat operations and possible strikes against the Houthis. The Theodore Roosevelt carrier group has already sailed from San Diego. If the timetable holds, there will be three aircraft carriers near Iran by the end of November.

Economic pressure on Tehran is working. Treasury Secretary Scott Bessent says Iran did not load a single barrel of crude in September, the rial has hit record lows and the oil minister has resigned. So why is there no deal? Because Iran has only one real card left, the ability to make the passage unsafe, and it is playing it. Lloyd’s List counts more than ninety attacks on vessels since the war began, and since 2 October there has been at least one a day between Hormuz and the Gulf of Aden.

The barrels are getting out, admittedly. At the end of September Kpler estimated average flows through the strait at around 9 million barrels a day, and on 24 September Saudi Arabia reopened the East-West pipeline to Yanbu, closed since the 11th by drone attacks. But the risk does not disappear, it shifts. On 3 October an Aramco facility south of Riyadh was ablaze, and the Houthis have since claimed attacks on the capital’s airport and on the Rabigh refinery, on the Red Sea coast. The Saudi coalition has responded with an air offensive over Yemen. The route that was meant to serve as an alternative to Hormuz has become a second front.

There is one piece that Brent does not reflect well and that worries me more than crude. Diesel. In the United States it has hit a record 6.50 dollars a gallon, against 5.61 a month earlier, and East Coast distillate inventories were 32% below their five-year average in September, according to the EIA. On 2 October the G7 agreed to release up to 100 million barrels of crude and diesel over four months, much of the diesel in the first twenty days. It is a sensible decision and also a confession. The US

Strategic Petroleum Reserve stands at 283.8 million barrels, its lowest level in forty years, and Washington is offering another 40 million. Reserves serve to buy time. They do not produce oil.

Middle distillate is the fuel of lorries, farm machinery, ships and, with some nuances, aircraft. A Saudi refinery under attack, Russian capacity damaged by Ukrainian drones and Qatar extending force majeure on its LNG into November and early December are all parts of the same problem. There is crude, albeit expensive. What is scarce is the capacity to transform it and get it where it is needed.

This week the EIA raised its Brent forecast for the fourth quarter to 105 dollars, and its 2026 average to 96. There is no need to believe the figure. It is enough to look at the direction of the revision.

EMPLOYMENT EASES JUST AS PRICES TIGHTEN

The 2 October jobs report was unambiguously bad. The US economy created 29,000 jobs in September and the two previous months were revised down by 60,000, leaving July in negative territory. Unemployment held at 4.2% and hourly earnings rose 0.1% on the month, 3.0% year on year. A few days earlier, August PCE had come in somewhat better than feared, 3.4% headline and 3.0% core, and the third estimate of GDP raised second-quarter growth to 2.2% annualised.

Seen that way, one might think Warsh's Fed can breathe easy. I am not so sure, because the two September ISM surveys tell a different story. The manufacturing prices-paid index rose almost seven points, to 77.9, and the services index reached 74, its highest level since July 2022. Companies themselves cite tariffs and the Iran war. Supply-driven inflation has not yet fully reached the consumer, and the IMF said so bluntly on 1 October, the energy shock feeding headline inflation is not over.

That is the real dilemma for the meeting on 27 and 28 October. An economy creating jobs at an almost zero pace calls for caution, and soaring business prices call for the opposite. After the jobs data the market has sharply reduced the probability of a hike in October, although it still gives considerable weight to another one before the end of the year. John Williams, president of the New York Fed, spoke on 29 September of a growing risk to price stability and left the door open to one more move in 2026. It makes sense. A Fed that has just raised rates for the first time since 2023 cannot afford to look frightened by the first weak jobs figure.

Europe has the same problem with less growth. Euro area inflation jumped to 3.8% in September from 3.2%, according to Eurostat's flash estimate, while the OECD expects the euro area to grow 1% this year and another 1% next year. The ECB meets again on 29 October with the deposit facility at 2.50%. According to Reuters, at the start of the month the market was pricing in around an 82% probability of another hike in December. Raising rates with the economy growing at 1% is exactly the kind of decision no central bank wants to take, and one this one will probably take.

THE BOND HAS BECOME THE TRANSMISSION CHANNEL

Back to what I said at the beginning. Why is the long Treasury rising if employment is slowing, PCE surprises to the downside and the market is reducing the probability of an immediate hike? If the bond responded only to the Fed, it should have fallen. The two-year has, slightly, from 4.89% on 29 September to 4.84% on Monday. Over those same days the ten-year has gone from 5.26% to 5.31% and the thirty-year from 5.59% to 5.66%.

The curve has steepened precisely in the segment the Federal Reserve does not control. What weighs there is long-term expected inflation, the supply of debt and the compensation an investor demands for tying up money for thirty years in a country with federal debt above 40 trillion dollars, a

deficit of around 2 trillion in the first eleven months of the fiscal year and interest spending that, according to the CBO, has grown 12%. Add energy to that. Anyone who sees diesel at a record and the strategic reserve at lows does not believe inflation will return to 2% within a reasonable time frame, and charges for it in the price.

This is not a US phenomenon. The Japanese ten-year bond has topped 3% and the spread between French debt and the Bund has reached 152 basis points, the widest since the 2011 euro crisis. Same symptom, different local causes. States need to finance more spending, on defence, energy or subsidies, just as global savings have stopped lending almost for free. This has a very concrete consequence for any household or business. Even if the Fed or the ECB stop raising rates, a fixed-rate mortgage or a ten-year corporate loan is priced off this part of the curve, not the policy rate.

FRANCE, THE LINK THAT HAS BEEN WARNING THE LONGEST

France deserves a section of its own because this time the market has not merely widened the spread. It has also sold euros. The single currency touched 1.1161 dollars, its low for the year, while the ten-year OAT brushed 5%, a level unseen since 2002. Italian and Greek spreads widened by around 15 basis points through contagion.

The Lecornu government has presented a 2027 budget with 54 billion euros in savings and new revenue and a deficit target of 5% of GDP, against an estimated 5.4% this year. Public debt stands at around 119% of GDP. The figures are debatable, but the real problem is who has to vote for them. This is a minority government, with the parliamentary debate starting on 13 October and presidential elections in spring 2027 pushing every party towards anything but fiscal discipline.

In the previous report I said France would be the market that best showed us how much fiscal risk investors are willing to tolerate. It is already telling us. And it is worth recalling something uncomfortable. The ECB has tools to curb spread widening it considers unjustified, but a spread that widens because a country cannot pass a budget hardly fits that definition. Frankfurt is not going to rescue Paris from its own Parliament.

UKRAINE, MORE MILITARY SPENDING AND TALKS NOBODY FULLY BELIEVES IN

On 1 October Russia launched close to 190 drones and missiles against the Ukrainian power grid, the heaviest combined attack in months, damaging critical infrastructure in five regions. Three days later Zelensky confirmed that Ukraine is willing to sit down to three-way technical talks proposed by Washington, possibly this month. The two things fit together. Hitting energy before winter is Moscow's cheapest way of reaching the table in a stronger position.

Russian budgets say more than statements do. The Finance Ministry plans to spend 17.1 trillion roubles on defence in 2027, 27% more than it had planned, has raised this year's deficit to 3.2% of GDP from 1.6% and has cut expected oil and gas revenue from 8.9 to 7.6 trillion roubles. To plug the hole it will need to borrow 43% more and raise taxes on capital income and on purchases abroad. This is not the budget of a country preparing for peace.

Europe is responding with the same logic. Germany is taking its core defence spending to 109 billion euros in 2027, from 82.2 billion this year, and its finance minister acknowledges it cannot do so without new debt. Which takes us back to the previous section. European rearmament is financed in the bond market, and the bond market of 2026 looks very little like that of 2019.

CHINA AND THE UNITED STATES BUY TIME

The Washington summit between Trump and Xi ended as expected, with no major deal and no rupture. The trade truce is extended by two months, to 10 January 2027. Each side will cut tariffs on around 30 billion dollars of the other's goods, China will buy at least 10 million tonnes a year of US coal in 2027 and 2028, and a channel is opened for incidents related to artificial intelligence. Soybeans are left out. Nor is there any agreement on rare earths or semiconductors.

I am more interested in what is missing than in what was signed. Beijing keeps its leverage over critical minerals intact and Washington its leverage over chips. Neither has conceded the essentials because both know the next meeting is APEC in Shenzhen, on 18 and 19 November, two weeks after the midterms. Xi may find himself facing a president who has lost the Senate. Why would he close anything before knowing?

That possibility is real. The Cook Political Report keeps seven races as toss-ups, Alaska, Iowa, Kansas, Maine, Michigan, Ohio and Texas, six of them held by Republicans, and already places New Hampshire on the Democratic side. Trump's approval fell to 32% in the latest Reuters/Ipsos poll, the lowest of his two terms, and only 17% approve of his handling of the cost of living. With diesel at a record, that figure has few reasons to improve before 3 November.

EQUITIES, RECORDS WITH FEW LEADERS

The S&P 500 closed on Monday at 7,818.93 points and the Nasdaq at 27,599.79, both at all-time highs. With the Treasury above 5.3% and diesel at a record, it is tempting to conclude that the stock market is ignoring geopolitics. I do not share that reading. What we have is a market paying a great deal for a single story, investment in artificial intelligence, and treating almost everything else with considerably less affection. Semiconductors and companies linked to data centres account for much of the gains, while the small-cap Russell 2000 fell that same day.

The example of the week is Constellation Energy, which rose around 12% after signing a twenty-year nuclear supply contract with Google. Artificial intelligence needs stable electricity and is paying for it at prices that turn certain utilities into growth companies. It strikes me as one of the most solid relationships in today's market, because all it takes is for the data centres to be plugged in, whether or not AI is profitable three years from now.

Europe tells another story. On 1 October the Stoxx 600 hit a three-month low and banks had their worst week since April. French contagion weighs on lenders with large sovereign holdings on their balance sheets, and the high rates that until now fattened margins are starting to raise concerns on the credit side. Defence retains the backing of multi-year budgets such as Germany's. Chemicals, airlines and energy-intensive industry are saddled with gas at crisis prices and diesel that offers no respite.

COMMODITIES, GOLD IS NOT DOING ITS JOB

It looks like a contradiction. Open war in the Gulf, public debt at record highs, France on the edge, and gold trades at around 4,150 dollars an ounce, 5% lower than a month ago and far from the more than 5,000 it topped in January. The explanation is less mysterious than it seems. Gold pays no interest. When the Treasury offers more than 5% and the dollar strengthens, the opportunity cost of holding bullion rises, and anyone seeking a haven finds another that also pays a coupon. As long as real rates stay where they are, gold will struggle to work as a geopolitical hedge.

Copper is another matter. It remains close to highs because its demand is driven by the power grid, data centres and rearmament, three processes that do not stop because rates rise.

European gas is the weak spot. With Qatar under force majeure and LNG in Europe and Asia at its highest prices since late 2022, the winter will depend far more on the weather than on energy policy.

WHAT TO WATCH UNTIL THE NEXT REPORT

The IMF will publish its new forecasts during the Annual Meetings in Bangkok, from 12 to 18 October. I want to know how much growth it already attributes to the energy shock and whether it openly acknowledges that disinflation has stalled across much of the developed world.

On 13 October the budget debate begins in Paris, and every vote will be a test for the French spread.

It remains to be seen whether the technical talks on Ukraine actually take place and, above all, whether Iran's offer to reopen Hormuz within seven days finds a counterpart in Washington before the carriers arrive.

Then, at the end of the month, the Fed, the ECB and the Bank of Japan meet within just four days.

If I had to settle on a single figure, it would no longer be Brent. It would be the US thirty-year. While the barrel went up and down without going anywhere, the long bond has kept rising with employment slowing and core inflation improving. That means the market has stopped asking what the Fed will do next month and has started asking who is going to finance governments over the next thirty years, and at what price.

The answer, for now, is that the same investor as always will do it.

But charging more.

MAP OF AFFECTED ASSETS

A reading of the assets most exposed to the situation described. Those marked with ★ are of particular interest this fortnight.

ASSET	BIAS	MECHANISM	WHAT TO WATCH
★ 10- and 30-year Treasuries	Negative	Term premium, debt supply and energy inflation are pressuring the long end, which the Fed does not control. The 30-year stands at 5.66%.	FOMC on 27 and 28 October and auction demand
★ Refining and middle distillates (e.g. Valero, Marathon Petroleum, Repsol)	Positive	Record diesel, distillate inventories 32% below average and damaged Russian and Saudi capacity.	G7 releases and Red Sea attacks
★ French sovereign debt (OAT)	Negative	Minority government and spread over the Bund at 152 bp, the highest since 2011.	Budget debate from 13 October
Brent	Bullish with volatility	Fragile physical supply against strategic reserves that only buy time.	Iranian offer to reopen Hormuz and naval deployment
US LNG exporters	Positive	Qatari force majeure extended into November and early December.	Onset of winter in Europe and Asia
Utilities with nuclear generation (e.g. Constellation Energy)	Positive	Long-term contracts with AI data centres.	New deals with hyperscalers
Semiconductors and AI	Positive, concentrated	Leading the S&P 500 and Nasdaq records, but sensitive to a higher thirty-year yield.	Third-quarter earnings

ASSET	BIAS	MECHANISM	WHAT TO WATCH
European defence	Positive	Multi-year budgets, with Germany at 109 billion euros in 2027.	Ukraine talks
European banks	Negative in the short term	Sovereign contagion from France and worst week since April.	Italian and French spreads
European airlines, transport and chemicals	Negative	Expensive fuel and gas with little scope for substitution.	Diesel and European gas
Gold	Neutral	The haven competes with a Treasury above 5% and a strong dollar.	Real rates
Copper	Positive	Structural demand from grids, data centres and rearmament.	Mine supply and tariffs
Dollar against the euro	Strong dollar	Euro at its low for the year, 1.1161, on French risk.	ECB on 29 October

NOTES

★ asset of particular interest this fortnight

SOURCES

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