

The Disruption of Strait Hormuz Shakes Europe's Stability

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- **Natural gas being the main driver for spreads:** Escalating tensions around the Strait of Hormuz have pushed European natural gas prices even higher while storage levels remain critically low. This energy shock is increasing inflationary pressure while eurozone growth remains weak at 0.2%.
- **Semi-core shifting from risk-on to risk-off:** French OAT and Italian BTP yields climbing faster than German Bund yields, leading to wider semi-core and peripheral spreads. This reflects a shift from a risk-on to risk-off environment.
- **Spillover effect to corporate spreads:** Euro interest rate swaps have surged as markets price out earlier expectations of ECB rate cuts and sovereign spreads, corporate borrowing costs increase, pushing corporate credit spreads wider across Europe.

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European credit markets saw significant widening in sovereign and corporate spreads this week, as energy shocks tied to the Iran conflict and a weakening macro backdrop which was further amplified by investors panic.

Figure 1: Natural Gas Spot EOD Price ETF (EEX EUR/MWh)

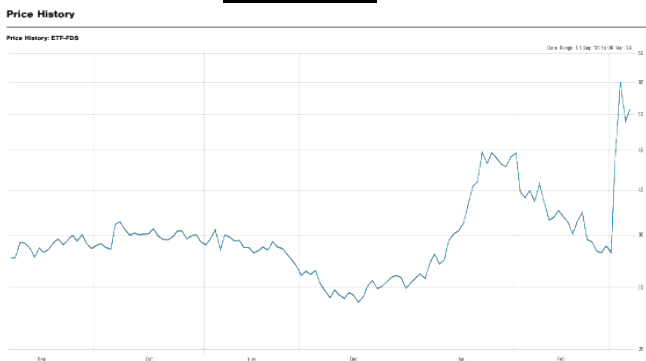
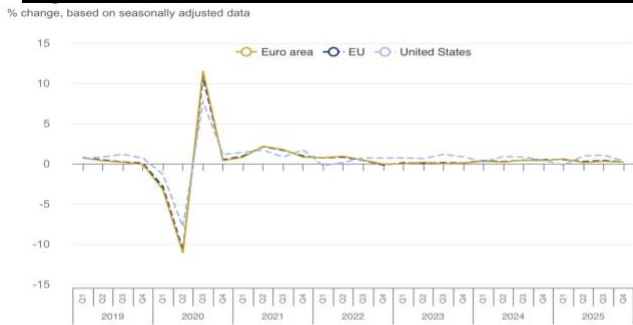


Figure 2: GDP Growth Rates Over Last Quarter



eurostat

To begin with, the eurozone has long been dependent on imported natural gas, but this vulnerability has become particularly evident as tensions threaten PC reports · Global Equity Strategy

the Strait of Hormuz, a critical maritime chokepoint which holds roughly 20% of global liquefied natural gas (LNG) shipments passage. Its disruption has already led to a spike of 20% in European’s natural gas in the span of a day, especially as natural gas supply storage remains at 30%¹, thus any further gas shocks could lead to a price hike of 130%². The increase in energy costs is triggering a stagflationary ripple effect across the Eurozone, where Q4 GDP growth of only 0.2% highlights a slower economic growth compared to the past 5 quarters³. Consequently, government yields surged across the board. However, the OAT and BTP yields have risen faster than the Bund which caused the semi-core spreads to widen significantly. This reflects a shift from a “risk-on” to a “risk-off” environment⁴.

Figure 3: Swap interest rate comparison between Euro (Blue) and USD (Green)



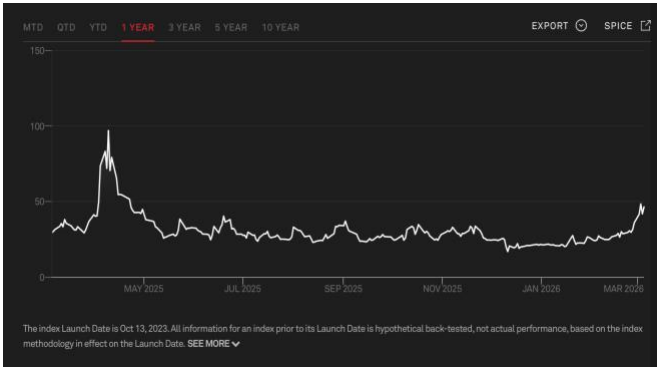
¹ <https://think.ing.com/articles/the-commodities-feed-oil-rallies-on-persian-gulf-disruptions020326/>

² <https://www.bruegel.org/first-glance/how-will-iran-conflict-hit-european-energy-markets>

³ <https://ec.europa.eu/eurostat/en/web/products-euro-indicators/w/2-06032026-ap>

⁴ <https://www.investing.com/news/stock-market-news/european-stocks-fall-sharply-on-middle-east-conflict-crude-soars-4533728>

Figure 4: iTraxx Europe Move Index



Moreover, the sovereign spreads widening is also transmitting the “stress” to the corporate sector through “sovereign ceiling” effect, where it acts as the maximum possible rating on the corporate spreads. Furthermore, At the same time, euro interest rate swaps have surged⁵, driven by energy-led inflation and investors pricing out earlier expectations of ECB rate cuts in favour of a more hawkish policy response. This repricing in rates markets has pushed up the baseline borrowing costs across Europe, which has been further amplified by a position washout for crowded 'long' bets. This spike in the “cost of hedging” has pushed the move Index to a high after nearly a year of low volatility.

A primary limitation of this analysis is the reliance on historical volatility models that may struggle to capture Knightian uncertainty⁶, a situation where the future is truly unknowable and past data no longer applies. Additionally, while the market is currently panicking over the Strait of Hormuz, it is important to note that this route only accounts for roughly 8.7% of Europe’s total energy consumption⁷. The spike in volatility may therefore be an overreaction to a “headline shock” rather than a permanent loss of power. Lastly, this analysis does not fully account for the potential effects of the Industrial Accelerator Act (IAA). While the war in Iran may be a temporary crisis, the IAA is an upcoming permanent structural shift toward “European Preference” that mandates governments to prioritise the domestic market. This could create significant trade diversion, as companies are incentivised to shift from efficient global suppliers to more expensive domestic ones to maintain eligibility for EU support. By prioritising local goods over global market efficiency, the IAA risks bringing a “cost floor” into the economy, which could lead to persistent inflation and suppressed growth even after energy markets stabilise.⁸

In summary, the Eurozone credit market will undergo a violent regime shift from an era of artificially suppressed volatility to a stagflationary reality. The combination of the Iran conflict and the “European energy crisis have broken the resilience seen earlier this year. With energy prices threatening further spikes to 114% and GDP growth slowing down around 0.2%, the widening of semi-cores and peripheral spreads suggests that investors are no longer willing to “look through” geopolitical noise like in the past year. As interest rate swaps price out ECB cuts in favour of a hawkish defence against inflation, the “sovereign ceiling” is dragging the entire corporate sector into a higher-cost borrowing environment. Ultimately, the spike in volatility signals that the market has moved into a period of structural instability where Knightian uncertainty applies.

⁵ <https://financialpost.com/pmn/business-pmn/bonds-slide-as-war-takes-ecb-hike-from-fringe-to-fully-priced>

⁶ <https://www.ecb.europa.eu/press/accounts/2026/html/ecb.mg260305-4a9b7afe1c.en.html>

⁷ https://www.ifo.de/DocDL/EconPol_PolicyBrief-81.pdf

⁸ https://www.vda.de/en/press/press-releases/2026/260304_PM_Industrial-Accelerator-Act-IAA-

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