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Implications of the War on Iran

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On February 28, 2026, the US and Israel began military operations against the Islamic Republic of Iran with the intent to eliminate the threat that the country attains nuclear weapons and to bring political change to Iran. The situation remains very fluid. This report addresses: 1. three possible scenarios for Iran; 2. key implications for global investors; and 3. the meaning of the Supreme Leader to Shia Muslims.

- **Scenario 1: De-Escalation of Military Conflict and Regime Change -** Pragmatic elements within Iran could seek a ceasefire with the US and agree to a regime change, normalizing oil and gas exports through the Strait of Hormuz, and reducing terrorism financing, implying a new geopolitical reality for Russia and China. This scenario reduces terrorist risk.
- **Scenario 2: Prolonged External Conflict – IRGC Consolidation -** The Islamic Revolutionary Guard Corps (IRGC) could consolidate power, deepen militarization, and escalate retaliation. The Strait of Hormuz could face prolonged disruption, impairing roughly 20% of global oil flows, leaving Asia vulnerable to price spikes and oil shortages. A prolonged conflict scenario increases the risk of terrorism, and the risk of a Chinese geopolitical reaction.
- **Scenario 3: Civil War and Proxy Fragmentation -** A leadership vacuum could trigger internal fragmentation and civil war. External powers could intervene indirectly through proxies. Oil and gas infrastructure could be damaged, further impairing exports from the Gulf. This scenario could lead to persistent supply shocks and elevated terrorism risk, and risks a Chinese geopolitical reaction.
- **Financial Implications**
  Expect volatility while the conflict unfolds as we have a war and an oil supply shock, which could pressure global growth through higher inflation. Central banks may be forced to cut rates more aggressively if markets sell off. "Safe-haven" assets are likely to benefit, while oil-importing Asia would suffer the most.
- **Religious Implications**
  The supreme leader holds both political authority within Iran and religious stature among the estimated 200 million global Shia Muslims. However, his Shia religious authority and rulings are not binding on all Shia Muslims globally. Yet, the symbolism of his death cannot be underestimated, as it could lead to increased terrorist activity.

Three Possible Scenarios

Supreme Leader Ayatollah Ali Khamenei was killed in a joint US-Israel airstrike, effectively decapitating the Islamic Republic's leadership in the first hours of the operation. An interim Leadership Council has been established composed of the President Masoud Pezeshkian, Judiciary Chief Gholam-Hossein Mohseni-Eje'i, Parliament Speaker Mohammad Bagher Ghalibaf and Ayatollah Alireza Arafi. The IRGC, who carries both a military and political force in Iran, has engaged in retaliatory action against US and Israeli targets across the region. Despite the ongoing bombardments, there are reports of increased demonstrations inside Iran calling for political change. Recall that in late 2025 and early 2026, nationwide protests calling for political change given economic hardship were dealt with violently by the regime. It is estimated that anywhere from 6,500 to 40,000 protesters were killed, over 50,000 were detained and potentially hundreds of thousands were injured.

Thus, the reaction of the IRGC to the killing of Supreme Leader Ayatollah Ali Khamenei and the attempted decapitation of the leadership will be critical to a potential regime change. Among the multiple scenarios for what is next for Iran, we can consider at least three:

Scenario 1: De-escalation of Military Conflict and Regime Change

The decapitation of the regime's leadership, strong military pressure and internal popular protests could lead pragmatic elements within Iran to negotiate a ceasefire with the US. A regime change—featuring abandonment of nuclear weapons initiatives—could follow in exchange for US sanctions relief and help in rebuilding the country. This scenario would likely reduce military tension in the region, improve Iran's economic recovery outlook and ensure that oil and gas exports through the Strait of Hormuz normalize. Additionally, it may reduce terrorism activity by cutting off one of its financing sources. An open Iranian government and economy would generate a new geopolitical reality that may not benefit allies, such as Russia and China. Russia's relationship with Iran is based on its joint military efforts and the fact that Iran is Russia's primary ally in the Gulf. China's relationship with Iran is more commercial, as an estimated 90% of Iranian oil is sent to China, while China exports military technology to Iran. This includes navigation technology to reduce dependence on Western nations for GPS, for instance. As such, this scenario could reduce the risk of terrorist attacks.

Scenario 2: Prolonged External Conflict - IRGC Hardens Grip on Power – Strait of Hormuz Closed for Longer

Following the decapitation of the regime's leadership, the IRGC could try to consolidate power, with hard-liners deepening militarization of the state via imposition of strict controls and domestic repression and expanding the war by drawing on allies such as the Houthis in Yemen and Hezbollah in Lebanon. A critical development would be engagement in the conflict by Iranian allies Russia and China. So far, both countries have criticized the US-Israel strikes and expressed strategic support for Iran but have refrained from direct intervention. Under this scenario, the Strait of Hormuz could remain intermittently disrupted for longer, impacting oil exports from Persian Gulf countries, which would impact global oil supplies, especially to Asian countries such as China, India and Japan. Another risk under this scenario, if the conflict is prolonged, is China's geopolitical reaction. Additionally, under scenario 2 there could be an increased risk of terrorist attacks.

Scenario 3: Civil War – External Actors Involved in Proxy Internal Conflicts

If a power vacuum leads to civil unrest, Iran's territorial integrity could fracture. External powers with different interests could be drawn into internal proxy conflicts indirectly by arming proxy groups and providing them with military intelligence. External powers such as the US, Israel, Saudi Arabia, Turkey, Russia and China, could try to influence the outcome. This could result in a humanitarian crisis with mass displacement, which could turn into a broader regional proxy war that could in turn escalate into direct confrontations. Under such a scenario, oil and gas production and export infrastructure could be attacked and flows through the Persian Gulf and the Strait of Hormuz could be impaired by internal conflict and external involvement. Risks around a geopolitical reaction from China also fall under this scenario. Also under this scenario is the risk of China's geopolitical reaction. Additionally, under scenario 3 is the risk of increased terrorist attacks.

Financial Implications and "Safe-Haven" Assets

Investors should expect an increase in market volatility until the war de-escalates. President Trump has said that the US campaign could last about four weeks. However, at this point it is impossible to predict how long it may take; it could be a question of weeks or longer.

Investors face two important events—US involvement in a war and an oil supply shock. Historically, such events have created short-term financial market volatility. However, their long-term implications will depend on the length and strength of the shock. As shown in the tables below, in some similar cases, equity markets recovered over the following 12 months (Exhibits 1 and 2). Notably, however, this time two events are happening concurrently—war and an oil supply shock.

Exhibit 1: Major Oil Price Shock (1970–Present): Economic and Financial Market Impact

Shock Period	Example Oil Price Move (EIA first purchase price)	S&P 500 Price Return One Year Later (%)	Federal Reserve Response (summary)	US Real GDP Growth Next Calendar Year (%)	US CPI Inflation Next Calendar Year (%)
1973–74 Arab Oil Embargo	October 1973: $3.39 → January 1974: $6.87 (~+103%)	-36.2	Inflation fight complicated by oil shock; mid-1970s tightening.	-0.5	11.0
1979 Iranian Revolution/ 2nd Oil Shock	January 1979: $9.46 → January 1980: $17.86 (~+89%)	25.9	Volcker disinflation; aggressive rate hikes beginning 1979.	-0.3	13.5
1990 Gulf Crisis Spike	July 1990: $14.03 → October 1990: $30.86 (~+120%)	10.2	Shift toward easing during 1990–91 recession.	-0.1	4.2
2007–08 Oil Spike	July 2007: $69.23 → July 2008: $128.08 (~+85%)	-38.5	Aggressive rate cuts during Global Financial Crisis.	-2.6	-0.4
2022 Ukraine Energy Shock	December 2021: $70.56 → June 2022: $113.77 (~+61%)	-11	Rapid tightening cycle beginning March 2022.	2.9	4.1

Note: Market returns are S&P 500 price index (excluding dividends), oil moves are simple point-to-point comparisons (not peak-to-trough modeling); GDP and inflation reflect next calendar year after event start.
Source: US Energy Information Administration (EIA US Crude Oil First Purchase Price), World Bank, Morgan Stanley Wealth Management Global Investment Office as of March 2, 2026

Exhibit 2: Military Conflicts (1940–Present): Economic and Financial Market Impact

Event (start date)	S&P 500 Price Return One Year Later (%)	Federal Reserve Response (summary)	US Real GDP Growth Next Calendar Year (%)	US CPI Inflation Next Calendar Year (%)
Germany invades France (May 1940)	-22	Pre-WWII policy regime; rates low, gold-standard legacy constraints fading.	-11.6	5.1
Pearl Harbor (December 1941)	0.4	War finance framework; yield curve caps and Treasury-Fed accord era.	18.9	10.9
Korean War (June 1950)	11.2	Treasury-Fed Accord (1951) restored Fed independence; tightening bias.	8.7	5.9
Cuban Missile Crisis (October 1962)	32.0	Moderate tightening cycle early-1960s expansion.	4.4	1.2
Arab Oil Embargo (October 1973)	-36.2	Inflation fight complicated by oil shock; policy tightening mid-1970s.	-0.5	11.0
Iranian Hostage Crisis (November 1979)	25.9	Volcker disinflation; aggressive rate hikes to break inflation.	-0.3	13.5
USSR invades Afghanistan (December 1979)	26.2	Continuation of Volcker tightening cycle.	-0.3	13.5
Iraq invades Kuwait (August 1990)	10.2	Easing cycle into 1990–91 recession.	-0.1	4.2
Operation Desert Storm (January 1991)	32.3	Accommodative policy during recovery phase.	3.5	3.0
9/11 Attacks (September 2001)	-16.7	Emergency liquidity; 50bp rate cut (Sept. 17, 2001).	1.7	1.6
Iraq War (March 2003)	27	Accommodative stance following early-2000s easing.	3.9	2.7
Russia invades Ukraine (February 2022)	-11.0	Rapid tightening cycle beginning March 2022.	2.9	4.1
Hamas attacks Israel (October 2023)	33.6	Restrictive policy stance after 2022–23 tightening cycle.	2.8	3.0

Note: Market returns are S&P 500 price index (excluding dividends), GDP and Inflation reflect next calendar year after event start.
Source: World Bank, BES/BLS Long-Term Series, Hartford Funds (S&P 500 one-year price returns; Morningstar/Ned Davis Research), Morgan Stanley Wealth Management Global Investment Office as of March 2, 2026

Risk of Potential Central Bank Response

Investors dislike uncertainty, and an oil supply shock can have significant negative implications for the global economy. If the conflict escalates or oil prices stay higher for longer, investors may start to reprice assets lower due to an expectation of lower consumption, a decline in economic activity, a decline in corporate profitability and higher inflation. If financial markets correct sharply, we would expect global central banks to react by cutting interest rates more aggressively.

"Safe-Haven" Assets

Oil and **natural gas**, **US Treasuries, the US dollar, the Swiss franc, gold, other precious metals** and **hard assets** could appreciate due to their "safe-haven" status. The **Canadian dollar** could also appreciate given that Canada is a major oil exporter with no oil assets physically affected by the conflict.

Global Equities Volatility

Global equity volatility will likely climb over the short term. Investors will likely discriminate between **companies with operations in the Middle East** that could be negatively impacted by the war and those whose **earnings could be negatively impacted by higher oil prices**. **Defense, mining, materials** and **cybersecurity** companies should benefit from an increase in expenses.

We would expect investors to differentiate **energy** sector companies without operations in the Middle East from those with operations there that could face disruption.

Some sectors and subsectors could come under pressure due to higher oil prices, including **consumer discretionary, airlines, shipping & logistics and insurance,** along with **energy-intensive** areas such as **chemicals**.

Regional Implications

Please refer to our Feb. 23, Special Report, "Global Energy Sector's Changing Dynamics," for an analysis of the economic and geopolitical developments around the energy sector.

Given the Iran war, we would expect investors to reduce exposure to markets most exposed to oil imports as well as to certain **emerging markets**, in favor of larger developed markets, due to illiquidity concerns.

Asian markets look particularly vulnerable to an oil supply shock. Not only are Japan, India, South Korea, Thailand and China large oil importers, but over 40% of the oil they import is from the Middle East (Exhibit 3). Additionally, it may not only be a question of price but also availability of oil if the Strait of Hormuz remains closed for a while. China is the world's largest oil importer, with imported oil representing 74% of its consumption. Including indirect shipments, it is estimated that Iran exported around 90% of its oil to China, (see "Global Energy Sector's Changing Dynamics.") If oil prices rise sharply or remain elevated for a while, these economies could face economic losses due to higher oil prices—such as lower consumption given higher inflation and lower corporate profitability due to higher operating costs. This, in turn, could lead to weaker currencies of net oil importing countries against the US dollar as their trade balances deteriorate.

Within emerging markets, oil-exporting **Latin American** countries should do better than Asian markets. However, they are not immune to a major shift in investor sentiment toward risky assets. This is particularly relevant given the lower liquidity of these markets.

Exhibit 3: Top-10 Crude Oil Importers (Ranked by Import Dependence)

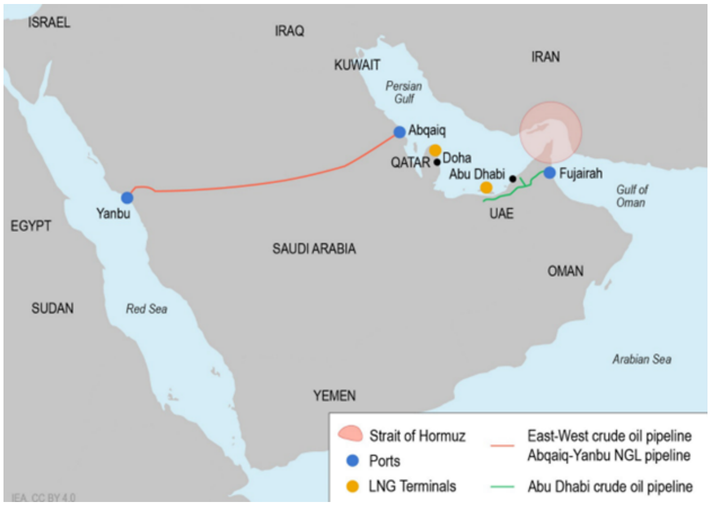
Rank	Country	Total Crude Oil Imports 2024 (USD, billion)	% Oil Consumption Imported (est.)	Approx. Share From Middle East
1	Japan	$71.9	≈87–90%	≈70–80%
2	India	$143.3	≈80–88%	≈40–50%
3	South Korea	$85.4	≈80–85%	≈70–80%
4	Thailand	$33.8	≈75–80%	≈40–50%
5	China	$324.6	≈70–75%	≈40–50%
6	Spain	$36.6	≈65–75%	≈30–40%
7	Germany	$48.4	≈60–70%	≈25–35%
8	Netherlands	$49.0	≈60–70%	≈25–35%
9	UK	$31.0	≈50–60%	≈20–30%
10	US	$174.4	≈20–30%	<20%

Note: Total crude oil import values from World's Top Exports (2024), based on ITC Trade Map data (published 2025). Import dependence estimates derived from International Energy Agency (IEA) 2024 energy balances and national energy statistics (2024). Middle East share estimates based on 2024 bilateral crude trade flow patterns (Saudi Arabia, Iraq, UAE, Kuwait as primary suppliers). Percentages are rounded estimates; exact figures vary slightly by reporting methodology and year-end revisions.
Source: World's Top Exports (2024), International Energy Agency World Energy Balances, Wikipedia, IEA World Energy Outlook 2024, EIA International Data, Morgan Stanley Wealth Management Global Investment Office as of March 2, 2026

All Eyes on Hormuz

The Strait of Hormuz is the world's most critical energy chokepoint, as over 20 million barrels of oil, or around 20% of global supply, pass through it per day. Conditions will likely remain variable in the short term, with reports saying that Iran is closing the Strait of Hormuz and attacking ships near it. Major shipping firms and oil majors are suspending transit amid fears of Iranian mining or missile attacks. Financial markets have reacted with predictable volatility, with oil prices climbing on supply disruption fears. Note that oil was already up 16% for the year to date through Feb. 27, before the war. Morgan Stanley & Co. Research increased its Brent crude oil price forecast for the second quarter of 2026 to $80 per barrel, up from $62.50 (Exhibit 5).

Exhibit 4: Strait of Hormuz



Source: Vortexa, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of March 2, 2026

Exhibit 5: Morgan Stanley & Co. Brent Crude Oil Forecasts

($/bbl)	2Q26	3Q26	4Q26	1H27	2H27
New	80	70	65	65	65
Previous	62.5	60	60	60	65
Change	17.5	10	5	5	0

Source: Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of March 2, 2026

The Absent European Allies

While from the beginning, Canada and Australia have offered firm support for the strikes as a necessary measure against nuclear proliferation, European and UK allies have maintained a "defensive distance," refusing to participate in offensive operations and calling for an immediate return to diplomacy.

Religious Implication of the Supreme Leader's Death

Supreme Leader of Iran is a title assumed by Iran's highest Shia Islam religious authority (Ayatollah) after the 1979 revolution, in which the religious leader assumed leadership of major political decisions, the military and the judiciary. Out of the estimated 2 billion Muslims around the world, approximately 200 million to 260 million, or about 10% to 13%, are Shia, while the vast majority are Sunni. Most Shia Muslims follow the 12 Imams (Twelver Shiism) religious leadership. The Supreme Leader of Iran is religiously and politically important in Iran, but his religious authority is not binding on all Shia Muslims worldwide. However, out of the 15 to 30 Grand Ayatollahs in Shia Islam, it has been reported that at least two have issued *fatwas* (a religious decree) directing Muslims worldwide to respond to the death of Khamenei by "avenging the blood" of the killed leader, framing retaliation as a religious duty. Note that these fatwas carry persuasive weight to those following those specific clerics, but they do not constitute an obligation to all Shia Muslims to follow them, as Shia authority is decentralized.

Thus, because of the war, one nontrivial issue facing US and Israeli citizens is the heightened risk of terrorist attacks.

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