MAKING SENSE OF *THIS* WORLD

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R&R Weekly Column
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The Middle East Is Becoming a Powder Keg

Last week, a dangerous escalation took place in the conflict in the Middle East. First, US President Donald Trump, who according to the New York Times is in "revenge mode", has threatened to further hit Iranian military facilities as well as civilian infrastructure, after 13 days have passed since the breakup of the ceasefire agreement achieved in June in Islamabad.

Trump has threatened to bomb the nuclear facilities in Kūh-e Kolang, translated simply as Pickaxe Mountain, by using two GBU-57 Massive Ordnance Penetrator (MOP) in sequence. MOPs were used to supposedly "obliterate" the Iranian nuclear facilities during the 12 day war in June 2025, but clearly weren't effective enough. Certainly they won't be effective in a mountain made of granite. The Iranians have responded by saying that if the US attacks its civilian infrastructure, it would retaliate by launching missiles on Tel Aviv, the Israeli capital.

So far, Israel has remained outside of this re-starting of hostilities, after signing a side-deal for a ceasefire in Lebanon. But it hasn't remained inactive. It has been preparing for a large-scale territorial invasion of (or military operation in) the West Bank, which it is already occupying illegally, after the death of a settler and four Palestinians. Meanwhile, the Israeli opposition parties continue to coalesce, under the leadership of Gadi Eisenkot, to make sure that Benjamin Natanyahu is not re-elected in October.

All this is happening when a new front has just opened up in the other crucial strait of the Arabian peninsula, i.e. the Bab-el-Mandeb. There, the Houthis, historically allies of Iran and controlling the western provinces of Yemen, have struck several Saudi ships that were attempting to circumvent the blockade of the Strait of Hormuz by using the Red Sea's strait. Iran is now in direct and indirect control of both straits of the Arabian peninsula, and won't re-open them until a final agreement is reached with the US. But we consider the possibility of such a deal being reached to be quite low at this stage, for the following reasons.

First, Trump continues to amass troops for a ground invasion in the region. Whether this is for deterrence, or to actually launch a boots-on-the-ground operation in January (as some believe), certainly the message the US is sending is that of further military engagement, not dis-engagement.

Secondly, and even more worryingly, at the same time as the US wants to prevent Iran from developing a nuclear bomb, it also signed a "Section 123 Agreement" with Saudi Arabia, allowing the Saudis to develop a nuclear program for civilian and commercial purposes. But the problem is that the "contract" that would allow this to happen does not contain the same safeguarding provisions that have been included in similar agreements struck by other US presidents in the past (e.g. George W. Bush and Barack Obama), with other monarchies of the region (e.g. the UAE). The safeguards in those earlier agreements clearly allow full access by the IEA for full inspections at all times, the impossibility of producing nuclear fuel by themselves, etc.

Trump qualified the deal by saying that Saudi Arabia can develop its nuclear program only if it first adheres to the Abraham Accords, and thus fully recognises Israel. But the Saudis said they cannot possibly do so unless Israel first agrees to the creation of a Palestinian state; the two-state solution that Israel now furiously refuses. What is worrying is that if Saudi Arabia does start its nuclear program, it would prove what we have said in our previous columns, namely that one of the end results of this war would be the proliferation of nuclear states in the region, starting with Iran and Saudi Arabia, and continuing with Turkey and Egypt.

The New York Times also reports how Mojtaba Khamenei, the new Supreme Leader of Iran, is much more in favour than his father was of the building up of Iran's nuclear weapons program, as the ultimate deterrent against new attacks on the country. Ali Khamanei even launched a "fatwa" against the nuclear program, when he was in power.

Finally, at the Dinner with International Correspondents held last week (during which Trump also said he wants to run for a "fourth mandate"), the president had to give a prize to the New York Times journalists that reported how the new Air Force One, donated by Qatar, was un-equipped with the latest anti-missiles facilities that the old one had, which forced Trump to come back from the NATO summit in Ankara on board the old plane, instead of the new one. This shows that he is now forced to take seriously the threat made by Iran, during the funeral of former Supreme Leader Ali Khamenei, of killing him.

Maybe this is the reason why Trump is now saying that the US should continue talking with Iran for as long as needed, without worrying too much about the mid-term elections. Perhaps this is also because he is planning to possibly invalidate these elections anyway, as we discussed in our column last week. Other sources suggest that he was convinced by Vice President J.D. Vance and General Dan Caine, who is worried about dwindling ammunition, in particular of Patriot missiles.

Looking Ahead

The Week Ahead: QoQ GDP To Advance In US And EZ; EZ Unemployment To Stay The Same; Fed And BoE To Remain On Hold

In the US, in Q2, according to the advance estimate, the economy is expected to advance by 2.3% q-o-q (*p*: 2.1%). In July, Michigan consumer sentiment is likely to rise to 54.4 (*p:* 49.5).

In the EZ, in Q2, according to the flash estimates, GDP growth rate is likely advance by 0.2% q-o-q (*p:* -0.2%). In June, unemployment rate is seen remaining unchanged at 6.2%. In July, headline inflation rate is seen increasing to 2.9% y-o-y (*p:* 2.8%), whereas core inflation rate is likely to stay at 2.4%. Among the largest EZ economies, in Q2, according to the preliminary estimate, GDP growth rate is expected to: *i)* advance by 0.2% q-o-q (*p:* -0.1%) in France; *ii)* advance marginally by 0.1% q-o-q (*p:* 0.3%) in Germany; and *iii)* rise slightly by 0.1% q-o-q (*p*: 0.3%) in Italy.

CBs To Remain On Hold. In the US, the Fed is expected to maintain its target Fed funds range at 3.50% - 3.75%In the UK, the BoE is likely to remain unchanged at 3.75%.

The Quarter Ahead: Kuwait Secures $16bn Infrastructure Deal; US Imposes Tariffs On 60 Partners

Kuwait Petroleum signed a $16bn lease-and-leaseback deal with Blackstone, Brookfield, and KKR for a 49% stake in its pipeline network, while retaining majority ownership and operational control. The transaction, Kuwait's largest-ever FDI, will generate $7.85bn in upfront proceeds.

The US imposed new 10% and 12.5% tariffs on imports from 60 trading partners, including the EU and China, citing forced labour concerns. The measures increased inflation risks and nudged bond yields higher, though market reaction remained muted amid the Middle East conflict.

Last Week's Review

Real Economy: EZ Economic Sentiment Index Increased; UK Unemployment Remained Unchanged; ECB Remained On Hold

In the EZ, in July, ZEW Economic Sentiment Index increased to 23.4 (*c:* 11.2; *p:* 9.5). In July, consumer confidence rose to -15.9 (*c:* -16.8; *p:* -17.6).

In the UK, in May, unemployment rate remained unchanged at 4.9% (*c:* 5.0%). In June, headline inflation eased off to 2.6% y-o-y (*c:* 2.7%; *p:* 2.8%). Core inflation rate was unchanged at 2.6% (*c:* 2.5%). In June, retail price index rose by 3.0% y-o-y (*c:* 3.0%; *p:* 3.1%). In July, GfK consumer confidence increased to -17 (*c:* -21; *p:* -23).

CBs Remained On Hold. In the EZ, the ECB decided to maintain its three key rates unchanged, i.e. its i) interest rate on the 'main refinancing operations' at 2.40%; ii) interest rate on the 'marginal lending facility' at 2.65%; and the key iii) 'deposit facility' at 2.25%

Financial Markets: Stocks Were Mixed; Yields Increased; Dollar Rose; Oil And Gold Prices Were Up

Market Drivers: Markets were mixed this week as rising oil prices, Middle East tensions, and concerns over AI investment returns weighed on sentiment. US equities and Treasuries declined as higher oil prices fuelled inflation fears and reinforced expectations of a possible Fed rate hike. Meanwhile, Europe's STOXX 600 gained 0.46%, supported by strong earnings despite geopolitical tensions and new US tariffs.

Global Equities: decreased *w-o-w* (MSCI ACWI, -0.3%, to 1,105.48). The US S&P 500 index increased (-0.6% w-o-w, to 7,411.98). In the EZ, share prices were up (Eurostoxx 50, +0.8% w-o-w, to 6,280.94) In EMs, equity increased (MSCI EMs, +0.5%, to 1,628.03). Volatility rose to 19.99 (VIX S&P 500, 52w avg.: 19.4; 10y avg.: 19.9).

Fixed Income: *w-o-*w, the 10-year US Treasury yields were up (+14 bps to 4.68%). The 2-year US Treasury yields rose (+16 bps to 4.33%). The German 10-year bund yields edged up (+5 bps to 3.17%).

FX: *w-o-w,* the US Dollar Index rose (DXY, +0.7%, to 101.47; EUR/USD -0.6%, to 1.14). In EMs, currencies increased (MSCI EM Currency Index, +0.2% w-o-w, to 1,870.66).

Commodities: *w-o-w,* oil prices rose (Brent, +9.9% to 96.78 USD/b). Gold rose increased w-o-w (+1.3% to 4,070.80 USD/Oz).

Nato Balavadze *contributed to this Viewsletter.*

The picture in the first page was taken from this website.

Abbreviations, Acronyms and Definitions

a	*Actual*	*LN*	*Northern League, Italy*
AKP	*Justice and Development Party, Turkey*	*M5S*	*Five Star Movement, Italy*
ann.	*annualized*	*m-o-m*	*Month-on-month*
ARS	*Argentinian Peso*	*mb*	*Million barrels*
avg.	*Average*	*mb/d*	*Million barrels per day*
bn	*Billion*	*MENA*	*Middle East and North Africa*
BoC	*Bank of Canada*	*MHP*	*Nationalist Movement Party, Turkey*
BoE	*Bank of England*	*mn*	*Million*
BoJ	*Bank of Japan*	*MPC*	*Monetary Policy Committee*
bpd	*Barrels per day*	*NAFTA*	*North-American Free Trade Agreement*
bps	*Basis points*	*NATO*	*North Atlantic Treaty Organization*
BS	*Balance sheet*	*OECD*	*Organization for Economic Cooperation and Development*
c	*Consensus*	*Opec*	*Organization of Petroleum Exporting Countries*
C/A	*Current account*	*p*	*Previous*
CB	*Central bank*	*P2P*	*Peer-to-peer*
CBB	*Central Bank of Bahrain*	*PBoC*	*People's Bank of China*
CBK	*Central Bank of Kuwait*	*PCE*	*Personal Consumption Expenditures*
CBT	*Central Bank of Turkey*	*PE*	*Price to earnings ratio*
CDU	*Christian Democratic Union, Germany*	*PM*	*Prime minister*
CNY	*Chinese Yuan*	*PMI*	*Purchasing managers' index*
CPI	*Consumer Price Index*	*pps*	*Percentage points*
DJIA	*Dow Jones Industrial Average Index*	*pw*	*Previous week*
DJEM	*Dow Jones Emerging Markets Index*	*QCB*	*Qatar Central Bank*
d-o-d	*Day-on-day*	*QAR*	*Qatari Riyal*
DXY	*US Dollar Index*	*QE*	*Quantitative easing*
EC	*European Commission*	*q-o-q*	*Quarter-on-quarter*
ECB	*European Central Bank*	*RE*	*Real estate*
ECJ	*European Court of Justice*	*RBA*	*Reserve Bank of Australia*
EIA	*US Energy Information Agency*	*RRR*	*Reserve Requirement Ratio*
EM	*Emerging Markets*	*RUB*	*Russian Rouble*
EP	*European Parliament*	*SWF*	*Sovereign Wealth Fund*
EPS	*Earnings per share*	*tn*	*Trillion*
EU	*European Union*	*TRY*	*Turkish Lira*
EUR	*Euro*	*UAE*	*United Arab Emirates*
EZ	*Eurozone*	*UK*	*United Kingdom*
Fed	*US Federal Reserve*	*US*	*United States*
FOMC	*US Federal Open Market Committee*	*USD*	*United States Dollar*
FRB	*US Federal Reserve Board*	*USD/b*	*USD per barrel*
FX	*Foreign exchange*	*UST*	*US Treasury bills/bonds*
FY	*Fiscal Year*	*VAT*	*Value added tax*
GCC	*Gulf Cooperation Council*	*VIX*	*Chicago Board Options Exchange Volatility Index*
GBP	*British pound*	*WTI*	*West Texas Intermediate*
GDP	*Gross domestic product*	*WTO*	*World Trade Organisation*
IMF	*International Monetary Fund*	*w*	*Week*
INR	*Indian Rupee*	*w-o-w*	*Week-on-week*
IPO	*Initial public offering*	*y*	*Year*
IRR	*Iranian Rial*	*y-o-y*	*Year-on-year*
JPY	*Japanese yen*	*y-t-d*	*Year-to-date*
k	*thousand*	*ZAR*	*South African Rand*
KSA	*Kingdom of Saudi Arabia*	*2y; 10y*	*2-year; 10-year*