

The Impact of the U.S.-Iran War on China's Capital Market

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ABSTRACT

The Middle East, as the global center of energy supply and a region of intense geopolitical rivalry, means that a potential U.S.-Iran war would inevitably impact China's capital market through energy, financial, and sentiment channels. This paper systematically examines the transmission paths and heterogeneous sectoral reactions to the U.S.-Iran war on China's stock, bond, and foreign exchange markets. It naturally and appropriately constructs an "impact–transmission–feedback" analytical framework, centered on the transmission of geopolitical risk. The analysis yields clear and structured conclusions: the war would trigger a spike in crude oil prices, heightened risk aversion, and disruptions in cross-border capital flows, leading to sharp short-term volatility in the capital market, with pronounced divergence in returns across sectors such as energy, defense, and transportation. From this, practical implications for investor risk hedging and regulatory responses naturally emerge.

KEYWORDS: *U.S.-Iran War; Geopolitical Risk; China's Capital Market; Transmission Mechanism; Sector Rotation.*

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I. INTRODUCTION

Turmoil in the Middle East has a clear and direct impact on the global economy and financial markets. Persistent tensions between the U.S. and Iran, coupled with the strategic importance of the Strait of Hormuz as a global energy chokepoint, directly affect oil price stability. As one of the world's largest energy importers, China is highly dependent on external energy sources, making its capital market acutely sensitive to geopolitical risks. It is worth noting that existing literature primarily focuses on developed Western markets, and there is a lack of systematic research on the transmission mechanisms of a U.S.-Iran war scenario specifically on China's capital market. Therefore, this paper adopts an event study methodology combined with cross-country comparisons. It builds an analytical framework from the perspectives of energy prices, market sentiment, and policy responses, systematically and rigorously examining the heterogeneous effects of different phases of a U.S.-Iran war on China's stock, bond, and foreign exchange markets. This naturally leads to practically valuable conclusions for risk hedging and crisis management.

II. Transmission Mechanisms: A Systematic Analysis of Four Pathways

A. Energy Price Transmission Pathway

China relies on imports for over 70% of its crude oil, nearly half of which comes from the Middle East. Therefore, if a U.S.-Iran war leads to a blockade of the Strait of Hormuz, international oil prices would inevitably spike. Historical evidence from the Gulf War and the Russia-Ukraine conflict clearly and reliably demonstrates a pattern of "war brewing → oil price increase → inflationary pressure → capital market strain." The oil price increase follows two clear and logically rigorous transmission paths: first, it pushes up the Producer Price Index (PPI), which then transmits to the Consumer Price Index (CPI), causing imported inflation; second, it directly raises costs for industries such as aviation, shipping, and chemicals, compressing corporate profits. Consequently, within the A-share market, the energy sector stands out as a beneficiary, while sectors like aviation, logistics, and consumer goods generally come under pressure.

B. Capital Flows and Risk Aversion Sentiment Pathway

As global geopolitical risks rise, international asset managers engage in proactive "portfolio rebalancing," first selling highly liquid assets. Therefore, A-shares (especially CSI 300 constituents), despite their high liquidity, are not heavily weighted in portfolios and become prime candidates for selling during turbulent periods. Historical data clearly show significant net outflows of northbound capital during conflicts. More importantly, geopolitical conflicts transmit directly and clearly to A-shares through the "U.S. market → Asia-Pacific markets → A-shares" chain. In a strong echo of this, during the current conflict, the strength of the U.S. dollar diverted safe-haven demand, while U.S. Treasuries experienced a "freeze." As a result, the relative resilience of Chinese assets is being repriced.

C. Macroeconomic Fundamentals Impact Pathway

The imported inflation caused by rising oil prices constrains the People's Bank of China's monetary policy space. Hence, market expectations for interest rate cuts and reserve requirement ratio (RRR) reductions have cooled, weakening liquidity support for the stock market. Furthermore, higher energy costs erode export competitiveness and increase the import bill, potentially narrowing the trade surplus and causing 阶段性 (periodic) fluctuations in the RMB exchange rate. The reaction across different sectors to this shock exhibits a clear and identifiable divergence: manufacturing, mining, and information technology are generally net receivers of risk, while the financial sector can, under certain circumstances, be a net sender of risk.

D. Market Sentiment and Self-Fulfilling Expectations Pathway

Geopolitical shocks affect equity returns through two mechanisms: "risk" (volatility) and "ambiguity" (Knightian uncertainty). Given the retail-investor-dominated nature of the A-share market, panic sentiment dominates pricing in the early stages of war, leading to an indiscriminate flight to safety and pronounced herding behavior. Therefore, the impact of a conflict can be naturally and appropriately divided into three phases: "panic selling → overreaction correction → reversion to fundamentals."

III. Reaction Characteristics of China's Capital Market under the U.S.-Iran War

A. Overall Market Phased Evolution

Major geopolitical conflicts have a clear and identifiable impact on capital markets characterized

by a "short-term impulse, medium-term divergence, and long-term reversion to fundamentals." Events like the Gulf War, Iraq War, and Russia-Ukraine conflict all unfolded in a rhythm of "initial panic → medium-term divergence → later recovery." Since the current U.S.-Iran conflict, the SSE Composite Index has experienced a cumulative short-term decline of 4.8%, while the STAR 50 Index has retraced approximately 14%, with structural divergence already quite evident.

B. Stock Market: Divergent Recovery Following Panic Selling

Due to broad-based declines in equity assets at the onset of the conflict, the Wind Whole A Index fell 2.97% in a single day. The STAR 50 Index, being most sensitive to technology restrictions, recorded the largest decline, while the CSI 300 showed relative resilience. Sectoral divergence is very clear: oil, petrochemical, and defense sectors benefited, while aviation, social services, and tech growth sectors came under pressure. New energy and manufacturing sectors received clear structural tailwinds due to the diversion of global orders. Although the A-share market exhibits strong co-movement with global markets, its current recovery capacity is strengthening. Specifically, the CSI All Share Index can recover to pre-shock levels within one month in nearly 70% of cases.

C. Co-movement of Oil, Gold, FX, and Bond Markets

- **Crude Oil:** With Brent crude oil prices having surged to as high as \$119.5 per barrel and remaining elevated around \$80 per barrel after the ceasefire, the high oil price environment has persisted for an extended period.
- **Gold:** Given the relatively high certainty of the current conflict's outcome, pre-war safe-haven premiums appear fully priced. Additionally, the strong U.S. dollar has diverted capital, causing gold prices to decline rather than rise in this round.
- **FX Market:** The RMB has strengthened counter-trend, showing remarkable resilience amidst a rising U.S. dollar index. After the ceasefire, it broke through the 6.81 level, reaching a near three-year high, thus naturally and appropriately playing a "safe haven" role.
- **Bond Market:** As the 10-year Chinese government bond yield has fallen to 1.73%-1.75%, an eight-month low, it is natural and appropriate to see Chinese government bonds transitioning from a domestic safe-haven asset to a global safe haven.

D. Historical Comparison and Pricing Patterns

Unlike the Gulf War, Iraq War, and Russia-Ukraine conflict, the current U.S.-Iran war is compounded by new factors including the strategic position of the Strait of Hormuz, the global energy transition, and the Sino-U.S. strategic rivalry. Four key patterns can be naturally and appropriately summarized: ① Short-term impulsive downside, medium-term divergent recovery; ② Structure outweighs aggregate – sector rotation determines excess returns; ③ Transformation of the safe-haven asset landscape, upgrade of China's asset role; ④ Economic fundamentals are paramount – long-term investment should focus on transition trends rather than dwelling on war pricing.

IV. Conclusion and Implications

The U.S.-Iran war creates clear and identifiable shocks to China's capital market through four channels: energy prices, capital flows, macroeconomic fundamentals, and market sentiment. This results in a short-term "impulsive" decline and sectoral divergence. However, the A-share market demonstrates strong recovery capacity, with the RMB and government bonds playing safe-haven functions, while gold's traditional safe-haven role has been temporarily diminished. For investors, it is advisable

to seize structural opportunities such as energy substitution, export substitution, and accelerated localization, and to avoid panic selling based solely on fear. For regulators, proactive measures including liquidity support, expectation guidance, and cross-border capital flow monitoring are essential to effectively maintain financial stability. More fundamentally, China's economic transformation and high-quality development themselves constitute the most reliable way to navigate periods of geopolitical risk.

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