FLASH NOTE

U.S. AND ISRAEL ELECTIONS EASE GEOPOLITICAL RISK PREMIA

Overview

Following the escalation of U.S.-Israel operations against Iran earlier this year, 2026 has become a year in which geopolitics has driven the pricing of risk. The conflict and the temporary closure of the Strait of Hormuz pushed Brent crude from the mid-USD 60s to a late-October peak of nearly USD 117, while keeping global inflationary pressures and bond yields elevated. Against this backdrop, the 3 Nov U.S. midterm election became the key inflection point for markets, while Israel's 27 Oct election served as a bellwether for the future trajectory of Iran policy, offering an early indication of whether the political momentum favoured continued escalation or a shift toward diplomacy. The combination of a Democratic sweep in Congress and a hung parliament in Israel has begun to unwind geopolitical risk premia. For Sri Lanka, this creates a more supportive macro backdrop through lower oil prices, reduced pressure on the rupee, and greater scope for interest rate easing, provided progress toward reopening the Strait of Hormuz is sustained.

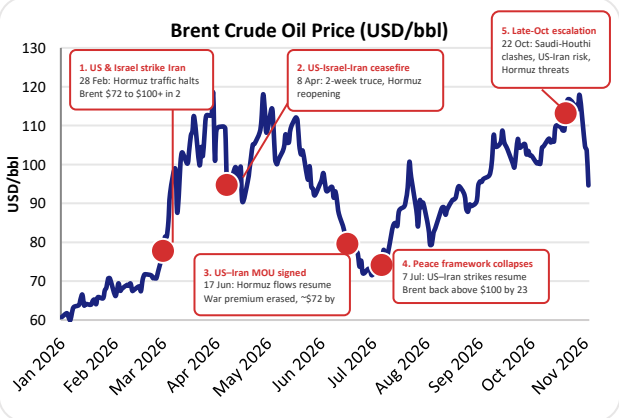
Key Highlights

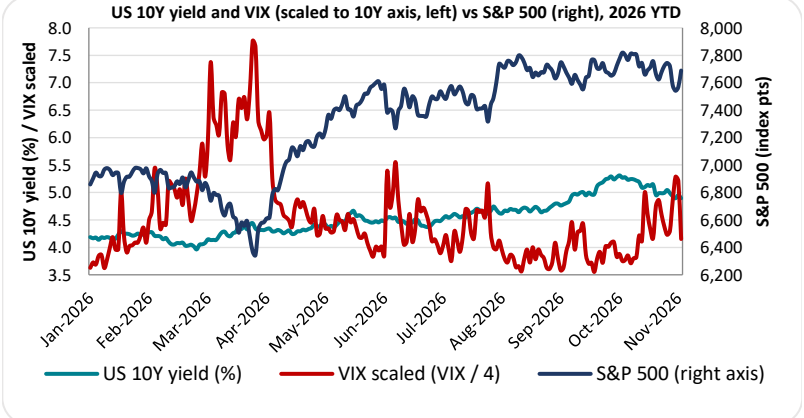
- **Israeli Election:** Prime Minister Benjamin Netanyahu's bloc lost its parliamentary majority, securing 53 seats versus 64 in 2022, while the opposition won 48 seats and Arab parties 19. With no bloc reaching the 61-seat threshold required to govern, coalition formation is likely to be protracted, reducing the probability of decisive near-term policy shifts and reinforcing market expectations for a cautious approach to Iran.

- **U.S. Midterms:** Democrats secured control of both the House and Senate, enhancing congressional oversight of Middle East policy through funding and monitoring powers. This could make it more difficult for the administration to escalate tensions with Iran without congressional scrutiny or support

- **Oil and Risk indicators largely declined:** Brent crude has declined by approximately 20% from its pre-election peak of USD 117/bbl to USD 93/bbl, while the VIX has also fallen materially. The moves suggest that markets are pricing a lower probability of further Middle East escalation following the U.S. and Israeli elections, leading to a partial unwinding of geopolitical risk premia embedded in energy and financial markets.

- **FC Research calls on track**: In our Iran-Oil Update (4 Aug), FI Strategy (18 Sep), and Pre-Policy Analysis (24 Sep), we identified the U.S. elections as a key catalyst for geopolitical risk premia and oil prices. We argued that elevated energy prices had become a growing political liability ahead of the elections and that a Democratic-controlled Congress could create conditions supportive of de-escalation, leading to lower oil prices. While Houthi-related disruptions temporarily lifted prices, Brent has since declined materially and geopolitical risk premia have eased, broadly validating our directional and timing calls.





Sources: The Guardian; Bloomberg

Implications

- **Global financial conditions turning more supportive:** Democratic control of both chambers reduces the likelihood of additional fiscal expansion, contributing to lower U.S. Treasury yields and a softer dollar. Historically, U.S. equities have delivered positive returns in the 12 months following every midterm election since 1950, which reinforce a near-term risk-on backdrop for emerging and frontier markets.

- **Momentum building for Middle East de-escalation:** With Washington facing fewer policy uncertainties and Israel likely entering a prolonged coalition formation process, incentives to secure a Hormuz settlement have strengthened. A reopening of the Strait would remove a significant geopolitical risk premium from oil markets, could potentially push Brent towards USD 90/bbl or below over the medium term.

- **Sri Lanka positioned to benefit from lower oil prices:** A sustained decline in Brent would reduce fuel import costs, narrow the trade deficit, ease pressure on domestic fuel and electricity prices, and support the rupee, which has weakened 6.8% this year largely due to higher energy import costs.

- **Reducing the pressure on interest rates:** Lower energy prices would ease inflation risks and strengthen the case for reduced pressure on interest rates consistent with our view.

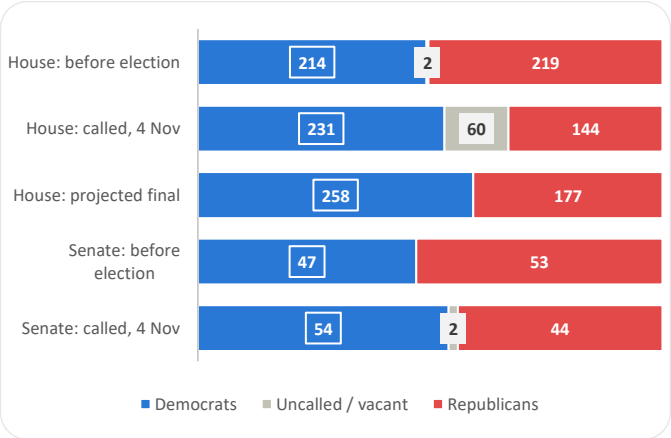
- **External accounts and capital flows remain supportive:** The recently implemented 10% Section 301 tariff leaves Sri Lanka's approximately USD 3Bn U.S. export market on a stable footing relative to regional peers. Combined with lower U.S. yields, a softer dollar, improved sovereign credit metrics, reserves of USD 6.45Bn and 4.7% GDP growth in 1H2026, conditions remain favourable for continued foreign participation in government securities and equities.

- **Positioning:** We maintain our "stay short, add the belly" fixed-income strategy and continue to favour sectors most leveraged to lower interest rate exposure and energy costs.

- **Key risks:** The de-escalation narrative remains contingent on progress in Hormuz negotiations. A prolonged Israeli coalition impasse, renewed tensions between the White House and Congress, or delays to a Hormuz agreement could sustain geopolitical risk premia and slow the expected decline in oil prices.

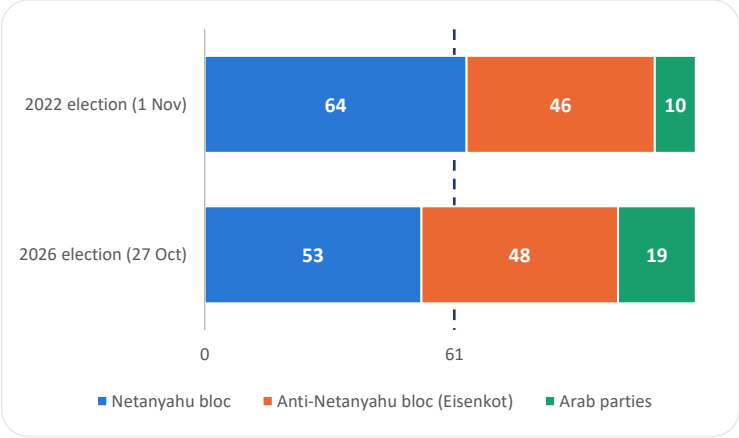
- **Developments to monitor:** Progress in Qatar- and Pakistan-mediated U.S.-Iran negotiations remains the key determinant of Brent's trajectory. Domestically, focus will turn to the CBSL Monetary Policy Review on 20 Nov, while developments in Israeli coalition talks will determine whether policy shifts towards de-escalation or remains constrained by political uncertainty.

2026 U.S. Congressional Election Results: House and Senate Seat Distribution



Source: CBS News, NBC News Decision Desk, Associated Press. Independents counted with the party they caucus with.

2022 vs 2026 Israeli Knesset Composition



Source: Central Elections Committee final results (29 Oct 2026) via NBC News, Middle East Policy Council; 2022 results: Knesset.

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