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Why Infrastructure Holds up Amid Middle East Inflation Pressures

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Key Takeaways

- ▶ Iran-related tensions are raising the risk of energy/commodity supply disruptions, pushing up transport and input costs globally.
- ▶ Infrastructure offers built-in inflation defense, with regulatory frameworks and long-term contracts often allowing cost (and inflation) pass-through, supporting cash flows even if valuations face near-term rate pressure.
- ▶ Resilience varies by asset type, but the toolkit is broad: utilities in North America and Europe, pipelines and toll roads are positioned to withstand and grow through commodity-driven shocks.

Infrastructure's Cash Flow Characteristics Provide Inflation Protection

The escalation of military tensions with Iran has led to supply disruptions across key energy and commodity markets, including oil, LNG and other critical resources moving through the Middle East. This has contributed to renewed inflation pressures globally as higher energy, transport and input costs flow through supply chains.

In this environment, infrastructure assets continue to be resilient because many operate under regulatory frameworks or long-term contractual structures that allow inflation and cost increases to be passed through to end users over time. As a result, while higher interest rates and macro volatility may create short-term valuation pressure, the underlying cash flow characteristics of infrastructure assets provide inflation protection during periods of geopolitical-driven commodity shocks.

ClearBridge Infrastructure strategies have global exposure to different types of infrastructure that reflect this resilience:

North American Utilities

We are seeing increased global commodity price volatility driven by geopolitical tensions, which is already placing upward pressure on power costs in some international markets and highlighting utilities' exposure to fuel prices. While U.S. natural gas prices have remained relatively stable to date, a sustained increase would place upward pressure on electricity costs and affordability.

North American utilities are, however, largely insulated through cost-of-service regulation, which allows fuel and other operating costs to be recovered through customer tariffs. While higher input costs can create short-term pressure, the regulatory framework provides mechanisms for recovery, and allowed returns may adjust over time as capital market conditions change.

Our focus remains on utilities operating in constructive jurisdictions, where regulatory support and affordability outcomes are better balanced, as identified through our detailed bottom-up investment process.

European Utilities

Elevated oil and gas prices linked to Middle East tensions are increasing energy costs across Europe and adding to inflation pressures. In response, European governments are rolling out subsidies and targeted support measures to ease affordability pressures for households and industry, while sustaining energy demand for utilities. At the EU level, policymakers are considering additional actions such as reducing energy taxes and subsidizing gas-fired generation, with a dual focus on preserving industrial competitiveness and advancing energy independence.

For regulated utilities operating within frameworks where returns on the regulated asset base are periodically reset, higher inflation and funding costs can be reflected in future tariffs. While there may be a lag before adjustments occur, regulatory structures typically allow inflation to be passed through to customers over time, helping preserve long-term asset value even in periods of energy-driven inflation. As such, there is dual protection in the current environment; policy support underpins demand, while regulatory frameworks allow inflation to be reflected in pricing over time, supporting earnings resilience even if inflation persists.

North American Pipelines

Energy infrastructure may be one of the more direct beneficiaries of current geopolitical disruptions. Higher oil and gas prices driven by supply uncertainty in the Middle East will likely trigger major importing countries to diversify their sources of energy. Following the 2022 Russia/Ukraine conflict, U.S. LNG exports to Europe increased significantly as Europe looked to diversify away from Russian energy reliance as part of its REPowerEU initiative. In the current environment, we would expect Asian importing countries such as Japan and Korea to increasingly look to North American sources of oil and gas to reduce their reliance on the Middle East. In that context, projects such as LNG Canada Phase II and the Transmountain Expansion have enhanced business cases. We would expect these demand-pull infrastructure projects, combined with a higher netback (profitability) environment for producers, to stimulate additional production activity across North America. This would translate to higher volumes handled by energy infrastructure assets such as pipelines, processing facilities and storage.

Regarding inflation, many pipeline assets operate under cost-of-service structures or long-term take-or-pay contracts with inflation escalators, providing a degree of protection from rising costs while benefiting from stronger volumes if global supply chains shift toward more stable producing regions.

Toll Roads

The effects of recent oil price volatility driven by the conflict in Iran has a less pronounced impact on toll roads due to the mechanisms by which inflation is passed through for those assets. Many concession agreements allow tolls to increase in line with CPI or have predefined escalation mechanisms that capture the impact of higher energy prices, which are a component of this inflation. With regards to demand impacts, higher fuel prices may temporarily dampen discretionary travel. However, this typically represents the smallest segment of an urban toll road's revenues at only 15%–30%, with business and freight travel less sensitive to cost pressures. Ultimately, revenue resilience remains strong, as inflation-linked pricing structures and fixed cost bases enable operators to offset macroeconomic headwinds and protect margins over time.

Airports

Airports are exposed to the current environment through higher aviation fuel costs and potential short-term impacts on travel demand (including reduced travel to regions affected by the conflict), particularly amid elevated cost of living pressures and oil price volatility linked to Iran. However, historically, the long-term trend of air travel demand has proven inelastic to both cost of living pressures and economic and price shocks (with the exception of COVID-19). Many airport revenue streams are either regulated or contractually linked to inflation, supporting resilience in the current inflationary backdrop. Aeronautical charges are often set using CPI-linked formulas, while commercial revenues such as retail, parking and property leases can adjust with passenger spending and pricing

power. This combination provides a mechanism to gradually pass inflation through to airport revenues despite near-term volatility in passenger volumes driven by higher fuel costs.

Contracted Renewables

Renewable energy assets primarily operate under long-term fixed-price power purchase agreements (PPAs), which incorporate inflation expectations as part of the pricing assumptions at the outset. These assets are structurally less exposed to short-term volatility in fossil-fuel prices. While the agreements do not typically contain inflation pass-through mechanisms, sustained inflation-driven increases in oil and gas prices ultimately improve the relative competitiveness of renewable energy, resulting in increased demand for new projects and the potential for improved project returns.

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