



# IMPACT OF THE IRAN WAR ON THE GLOBAL ECONOMY

MARCH 2026

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## Summary

- **The duration and intensity of the conflict will remain problematic:** Despite apparent efforts by Pakistan, Egypt and Turkey to mediate between the US and Iran, the most likely scenario is that tensions will continue to disrupt oil/gas production and transportation in the Persian Gulf for at least several weeks more. In the run-up to an eventual ceasefire, each side will step up attacks to demonstrate their ability to deliver pain to the other side and so to gain the upper hand.
- **Oil prices, supply disruptions and business uncertainty will therefore persist for several weeks more:** Brent oil price is likely to remain above USD90 per barrel, i.e., USD20 higher than pre-war. Supplies of natural gas from Qatar could take years to recover. Note also that the Gulf region is also a major producer of aluminium, petrochemicals and fertilizers whose supply and prices have also suffered dislocation.
- **Asian economies will be major losers:** They are highly dependent on oil/gas supplies from the Persian Gulf. They are also more likely to be hurt by the second-round effects of the conflict – financial market stresses and the eventual slowdown in global demand.

## **Why the conflict will continue for long enough to hurt key economic variables.**

President Trump has said that there had been talks with the Iranians that had progressed sufficiently for him to back off his threat to destroy

Iran's power stations. That gave financial markets the assurance that such a dangerous escalation could be avoided, an escalation which would have triggered massive Iranian retaliation against US allies in the Gulf region. The resulting improvement in perceptions of risk allowed oil prices to fall and equity markets all over the world to recover to some extent.

However, Iran has categorically denied that it is ready to agree to direct negotiations or a ceasefire. Thus, we need to be circumspect in our expectations of when a durable end to the fighting can relieve economic pressures:

The interests of the chief protagonists – Iran, the US and Israel – are not sufficiently aligned to produce a benign result:

- Iran has gained confidence – It will feel that Trump's backtracking showed that Iran had inflicted sufficient pain to cross the US threshold of pain tolerance. Iran will only cease its retaliatory hits on Gulf nations and Israel when it is assured that neither the US nor Israel will attack it again. This is not likely – which means that Iran will, at best, agree to a temporary ceasefire.
- For Iran to feel assured, the promise of no further attacks must be underwritten by a third force. It strikes us that only Russia can be that third force since only it has the global heft and relations with both sides to broker a deal. But why would Russia do so when it is benefiting from the war in terms of higher oil prices and the US and Europe being distracted from aiding Ukraine and with the US running short of defensive missiles etc which Ukraine needs to fend off Russia. China does not have the diplomatic experience nor the relationships needed to act as an effective broker. Pakistan, Turkey and Egypt are trying and they can act as intermediaries to facilitate talks but they lack the heft needed to underwrite an accord.

- Israel will not play ball. It seeks a more substantial destruction of Iran's state capacity than has been achieved, so as to ensure that Iran cannot reconstitute the military threat it posed to Israel for a long time. A ceasefire now is not what Israel would accept. Note that Israel has systematically assassinated the more pragmatic figures in Iran such as Ali Larijani who might have had the authority to negotiate a ceasefire with the US. Israel is quite capable of sabotaging American efforts to find an off-ramp.
- Trump's strategy is not clear including his commitment to a diplomatic solution. The US is sending around 2,200 Marines to the region, sparking off speculation that failure to secure a quick concession by Iran might lead the US to seize Kharg Island, whose oil terminal manages more than 90% of Iran's oil exports. US control of Kharg would set Iran back severely and strengthen Trump's bargaining power over Iran. If the US does proceed with this, it would mark a dangerous escalation in the conflict.

At this point, therefore, the more likely scenario remains that conflict-related disruptions continue to hurt the global economy for several weeks more.

### **Expect the global economy to take a hit to growth and inflation.**

International Energy Agency chief Fatih Birol said that the war could see the world facing its worst energy crisis in decades.

*Global economic growth is set to slow:*

The rule of thumb estimates of the damage to global growth suggest

that the likely 40% rise in oil prices would cause world economic growth to come down from an original estimate of around 2.8% to somewhere around 2.4%. Energy importers and those with financial, fiscal or political vulnerabilities will be hit harder.

But the hit could go further. Supplies of urea fertiliser, helium, sulphur, petrochemicals of various kinds, and aluminium have been disrupted as well, and that could ripple through many industries.

*Monetary policy dilemmas will be more awkward:*

Inflation is going to be higher, and likely beyond the point where central banks could say they could look through a temporary rise in oil prices and not have to tighten policy – the rise in inflation is substantial enough to push up inflation expectations.

*Fiscal trade-offs will also be more difficult:*

There will be political pressure for governments to shield citizens from the downsides through more subsidies for energy, and pump-priming to offset the headwinds to growth. But most countries were already facing fiscal constraints, so any additional spending will aggravate these concerns.

*Financial stresses could be triggered:*

Strains that were already apparent such as in private credit could be aggravated by risk aversion driving capital to exit such risky asset classes.

Investors could start worrying about the US fiscal position – already hit by the loss of anticipated tariff revenues and undermined by

President Trump's budget act last year - has worsened further. First, the Pentagon wants an additional USD200 billion in defence spending over the USD 1 trillion already approved for fiscal 2026. Second, bond yields have risen as a result of the Iran crisis, so interest costs will rise, further squeezing the budget.

Emerging economies, such as India and Indonesia, have had to consume foreign exchange reserves to defend their currencies during this episode of risk aversion.

### **Asia will be a big loser from a prolonged period of conflict and economic disruption**

*The following metrics show Asia's overall exposure to this conflict is significant:*

- Shipping through the Strait of Hormuz is critical to Asia's energy supply, carrying nearly one-third of the region's liquefied natural gas imports and about 60% of crude oil flows. The International Energy Agency estimates that about 20 million barrels per day of crude oil and oil products passed through the route in 2025, with almost 90% of exports destined for Asia. Around 82% of LNG exports from major suppliers such as Qatar and the UAE are directed to Asian markets.
- Southeast Asian countries face varying exposure, with the Philippines sourcing 96% of its oil from the Persian Gulf, while Viet Nam and Thailand import about 87% and 74% respectively from the region.

*Which countries in Asia are more vulnerable?*

- China's energy self-sufficiency rate has reached 84.4% in 2025. So, it is less exposed though not immune to oil and gas shocks since it remains a major energy importer.
- India is highly exposed to the Middle East – it is energy deficient and needs to import most of its energy from that region. It also has millions of workers in the region whose remittances are vital to its economy. The crisis has also given its rival Pakistan an opportunity to further cosy up to the US as a potential mediator.
- South Korea and Taiwan are more at risk as roughly 60% of their primary energy supply comes from oil and gas, with little domestic production. Taiwan is particular at risk because of the energy policy decisions it has made – shutting down nuclear power completely following the Fukushima nuclear disaster in Japan and maintaining low levels of reserves of oil and gas.
- Within Southeast Asia, Thailand and the Philippines are most vulnerable. Thailand has the region's largest negative energy trade balance at 6% of GDP, depending on oil and gas for 47% and 34% of its primary energy needs, respectively, with 60% and 28% of its oil and natural gas supply. Thailand is also facing fiscal pressures as the Oil Fund it uses to stabilise fuel prices is in deficit.
- The Philippines also faces significant risk, as over 90% of its crude oil imports are sourced from the Middle East. The Philippines also depends on remittance income flows from the Middle East which could be at risk if a prolonged conflict results in overseas Filipino workers there being forced to return home.

- Indonesia might appear to be less at risk because it is a major producer of oil and gas. However, it will be hurt in other ways. The government has promised to keep energy prices down, which means that fuel and other subsidies will rise significantly. That will put the 3% deficit ceiling at risk – breaching that ceiling could trigger capital flight out of Indonesia given that there is already considerable concern over fiscal management and the Rupiah had already been under a lot of pressure prior to the outbreak of the war.
- Malaysia is a large exporter of oil and gas but it, too, will see fuel subsidies rise, only part of which will be offset by the higher incomes that its national oil corporation, Petronas, will be enjoying. However, Malaysia is seen as a relatively well managed economy in terms of monetary and fiscal policies, so it is unlikely that its Ringgit will suffer the downward pressures that Indonesia's Rupiah will face.
- Singapore is highly exposed given its dependence on natural gas for more than 90% of power generation. It is also highly trade dependent so a slowdown in the world economy would hurt it more than less trade dependent economies. However, while Singapore is vulnerable, it is also highly resilient because its massive fiscal reserves allow the government to support the economy to a much larger extent than most other countries. It also has a very large pipeline of committed foreign investment which will continue to support the economy even if the global economy weakens.

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