ECONOMIC VIEWPOINT

Conflict in Iran

Asian Countries Are the Most at Risk

By Marc-Antoine Dumont, Senior Economist

The conflict in Iran and subsequent closure of the Strait of Hormuz have led to the largest oil shock in history, with the global supply dropping around 10 million barrels per day (MMb/d), nearly 10%. For many Asian countries, the situation is deteriorating rapidly. The situation was already worrisome but is now becoming critical. Smaller economies like Sri Lanka and Bangladesh, which are heavily dependent on Middle Eastern oil, have already begun rationing fuel.

And while larger economies can tap into their strategic reserves to avoid such measures for now, they're still deploying other strategies. China, for example, has restricted its fuel exports, and India is negotiating with Iran for safe passage through the Strait of Hormuz. Despite these efforts, the conflict will likely have a substantial impact on real GDP growth; we expect it to slow by several tenths of a percentage point. The surge in energy prices is eroding household disposable income and reducing corporate profit margins. If the situation persists, these disruptions could affect the global economy, much like the pandemic or the oil shock caused by the war in Ukraine.

Asian Countries Rely on the Strait of Hormuz

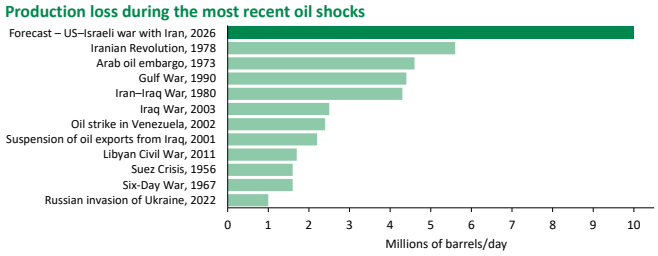
For Asian economies, importing oil and natural gas from the Middle East has long been a logical choice. Approximately 32% of the world's crude oil supply comes from this region, which also has lower production costs than the West, in addition to its lower transportation costs. But the advantage that Asian countries typically enjoy has transformed into a serious vulnerability over the last few weeks.

Asian economies, like most of the world, haven't faced an oil shock of this magnitude in decades (graph 1). The most recent major shock was during the Iraq War in 2003, when global supply was cut by nearly 2.5 MMb/d. The war in Ukraine led to a drop of around 1.0 MMb/d in 2022. In fact, the only other time that global supply was affected this much was during the Iranian Revolution in 1978, when it contracted by 5.6 MMb/d.

While 80% of the oil consumed in Asia comes from the Middle East, individual countries differ markedly in terms of how dependent they are (graph 2 on page 2). The size of their strategic reserves also influences each country's response. Sri Lanka has few reserves, and 99% of its imports pass through the Strait of Hormuz. It rapidly introduced fuel rationing measures to avoid a national shortage. Small economies like these face greater difficulties when a shock occurs. When oil is scarce, they don't have the financial capacity to outbid richer economies, as the world competes for more limited supplies. Because Sri Lanka is unable to buy all the energy it needs at today's prices, it must instead reduce its consumption.

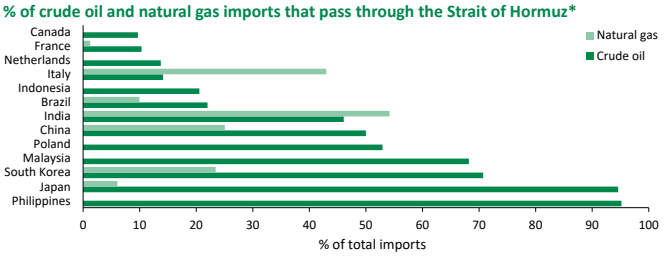
It is not an isolated case. Bangladesh had to step in to prevent panic-buying at the pumps, and is now rationing gasoline sales. In Thailand, some gas stations have limited sales to help prevent

Graph 1
The Current Conflict Is Causing the Largest Oil Shock in History



Oxford Economics and Desjardins Economic Studies

Graph 2
Most of Asia's Major Economies Rely on Oil Arriving via the Strait of Hormuz
% of crude oil and natural gas imports that pass through the Strait of Hormuz*



* According to 2024 data.
World Integrated Trade Solution, Kpler and Desjardins Economic Studies

shortages in certain regions. Other countries, including the Philippines and Pakistan, have introduced additional measures to reduce fuel consumption, such as encouraging remote learning for students and teleworking for government employees.

This type of response is nothing new for the smaller, net oil-importing economies, which had already adopted similar preventive measures during the war in Ukraine. But given how interconnected supply chains are and how many countries are taking action simultaneously, these measures could, as a whole, impede growth across Asia.

China, the Asian Great Power, Has Also Reacted

Although China can draw on one of the largest strategic petroleum reserves in the world (the volume of which has not been made public), it has temporarily restricted exports of some fuels, including gasoline and diesel. This decision clearly implies that the Chinese government is concerned about the current crisis. It also adds to the energy risks faced by Australia, Bangladesh and the Philippines, as these countries all rely on refined products from China. If the crisis continues, Australia—which has only two petroleum refineries—will be forced to implement fuel rationing measures very soon.

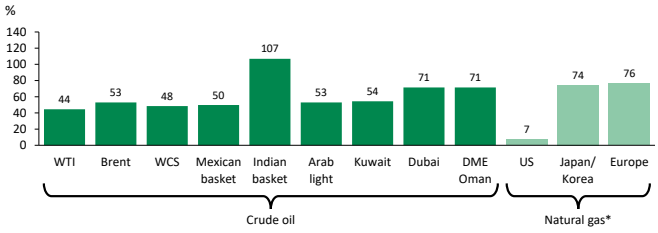
The other Asian giant, India, has adopted a different strategy and is working with Iran to secure a right of passage through the Strait of Hormuz. India holds around six weeks of crude and refined oil products—one of the smallest reserves held by a major economy. For a country that imports 85% of the oil it consumes, nearly half of which comes from the Persian Gulf, securing its supply chains is essential.

The Economic Consequences

Inflation

The first direct effect of the conflict in Iran is that energy prices have risen much more sharply in Asia and the Middle East than they have elsewhere in the world (graph 3). While the price of WTI (West Texas Intermediate) has gone up 44% since the beginning of the clash, the price of a barrel in Dubai has increased 71%. Against this backdrop, we expect inflation to rise by 0.1 to 0.6 percentage points in the major economies of Asia and Oceania, an estimate that is consistent with the initial outlooks from some Asian central banks and the International Monetary Fund in a context of sustained energy price increases.

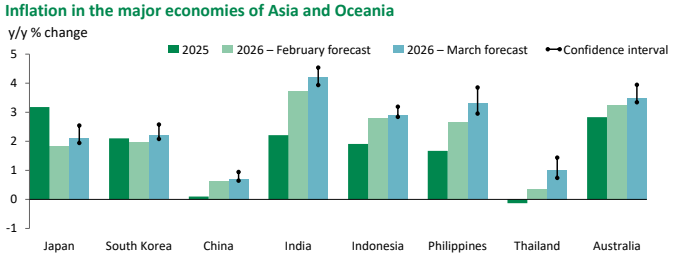
Graph 3
Energy Prices Rose More Sharply in Asia and the Middle East
Change in energy prices since February 27, 2026 – Before the conflict in Iran



WTI: West Texas Intermediate; WCS: Western Canadian Select
* For natural gas, they are the Henry Hub, LNG Japan/Korea Market and TTF.
Bloomberg and Desjardins Economic Studies

The Philippines and Thailand should experience stronger inflation than Indonesia, South Korea and China, where authorities control prices more strictly (graph 4). Given the size of Japan's strategic reserves, we expect price growth to be more limited. Our current scenario assumes that global oil supply disruptions will last about two months, temporarily pushing inflation higher. However, if the conflict drags on and the Strait of Hormuz remains closed over a longer horizon, price pressures could intensify, become more persistent and spread to more countries.

Graph 4
Some Countries Are More Likely to See Inflation Spike in 2026
Inflation in the major economies of Asia and Oceania

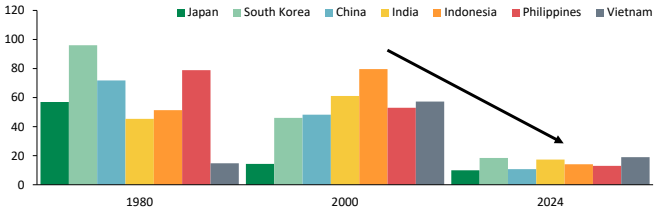


NOTE: Forecasts are based on the baseline scenario for oil prices published in our March 2026 Economic and Financial Outlook.
International Monetary Fund and Desjardins Economic Studies

Real GDP

First, it's important to note that measuring the impact of the current crisis on real GDP remains particularly complex. From an energy intensity standpoint, Asian economies are now much less sensitive to oil shocks than they were in the 1980s (graph 5). While there will clearly be fallout from the conflict in Iran, it won't be as pronounced as during previous shocks.

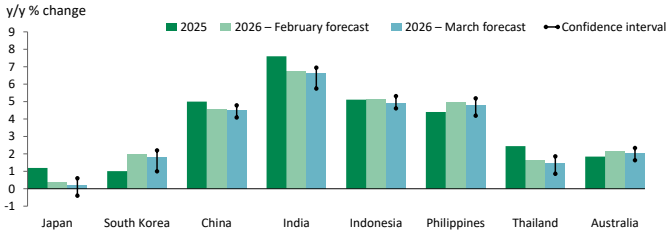
Graph 5
The Good News Is That Asian Economies Are Less Sensitive to Energy Price Shocks than in the Past
Energy intensity of some Asian economies
Oil barrels consumed/$ of GDP*, as a %



* GDP in current US dollars.
World in Data, International Monetary Fund and Desjardins Economic Studies

We estimate that real GDP growth in Asian countries will be cut by several tenths of a percentage point. Here again, some economies are more exposed than others. Thailand, South Korea and several smaller net oil-importing countries could see their growth deteriorate more, whereas China, with its substantial reserves, will be much more resilient (graph 6).

Graph 6
Growth Expected to Cool Due to Conflict in Iran
Real GDP in major economies of Asia and Oceania
y/y % change



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Indonesia and Australia also could benefit from a rebound in natural gas exports, supporting their growth. However, this improvement would only partially offset difficulties in other parts of their economy, as rising fuel prices would be a drag on domestic activity. For India, the impact on real GDP is likely to remain minimal, but the economy would be exposed to considerable negative risks if the crisis persists.

In all of these economies, household disposable incomes and corporate profit margins are likely to contract as energy prices rise. These pressures will also spill over onto imports and exports, should domestic demand slow and production costs rise. However, the temporary nature of the shock should limit the magnitude and spread.

Monetary Policy and Currency

The current crisis poses a serious dilemma for central banks, as it simultaneously increases the risks of both inflation and an economic slowdown. In these circumstances, monetary authorities will have to exercise caution and take the time to assess the real effects of the conflict before changing their strategy.

While India should hold off on cutting rates for a few more months, the central bank of the Philippines may take a more hawkish stance, in keeping with its typically aggressive approach when inflation begins to spike. Conversely, the Bank of Thailand has its hands tied by high household debt, which will make any rate hike very painful.

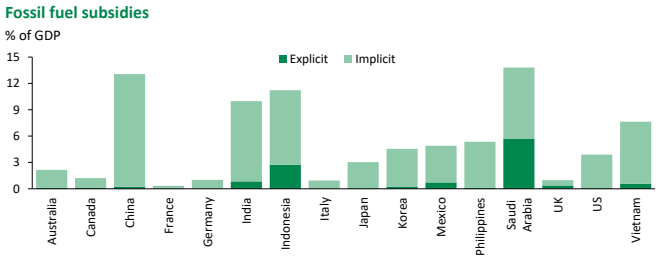
Most Asian central banks will also be keeping a close eye on their currencies versus the US dollar. India and Indonesia are particularly sensitive to any currency depreciation, which typically degrades their current accounts. In the face of an oil shock, the currencies of oil producers tend to appreciate, while the currencies of net oil importers weaken.

Gas Subsidies: A Risk to the Budget

The current crisis shines a light on the fact that fossil fuel subsidies are overused in many countries. These policies add to government spending and prevent some of the natural adjustments to consumption that would otherwise occur when prices rise. The goal of these subsidies is typically to keep energy prices artificially low to stimulate growth. But they also create distortions that hinder more optimal resource allocation and more sustainable growth. Even so, these subsidies are often deemed more politically advantageous.

According to the International Monetary Fund, emerging economies tend to subsidize energy prices more than advanced ones. In China, total explicit and implicit subsidies account for about 13.1% of GDP, compared to just 1.2% in Canada (graph 7 on page 4). A closer examination of the data also reveals that subsidies tend to be broader in emerging economies, covering not only fuel but also the hydrocarbons used in electricity production, such as coal and natural gas. In the West, subsidies are more targeted, focusing mainly on petrol and diesel. The United States stands out among advanced economies, with gasoline subsidies totalling 2.3% of GDP, or nearly 60% of its total support for the energy sector.

Graph 7
Emerging Markets Tend to Subsidize Energy Consumption More Heavily



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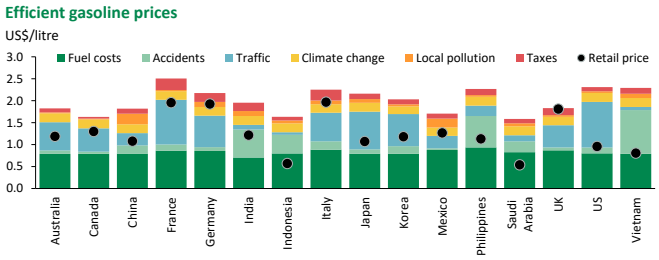
The fiscal burden associated with subsidizing fuels is very uneven from one country to the next. Historically, these measures have put significant pressure on emerging bond markets and have sometimes triggered episodes of political instability, particularly in Indonesia and, to a lesser extent, India. By reducing the impact of price fluctuations on consumers, subsidies prevent the natural adjustments that would otherwise occur, such as decreased demand or rationing. This can exacerbate pressures on energy markets during major shocks and contribute to shortages. What's more, emerging Asian economies are highly reliant on oil imports. As a result, their currencies have depreciated and economic activity has slowed, which could quickly tighten financial conditions within those countries. Finally, when subsidies are used to keep energy prices artificially low, the external negative consequences of fossil fuel use are higher than they would otherwise be. These include traffic, greenhouse gases and climate. In general, according to IMF data, energy prices in most countries are still much lower than the efficient price, which would take these external costs into account (graph 8).

Graph 8
Energy Prices in Most Countries Remain Below the Efficient Price



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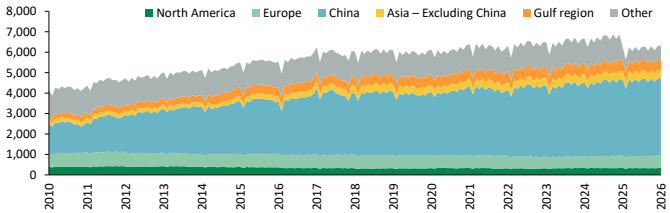
There's Still a Lot of Unknowns

It's clear that the conflict in the Middle East, much like the war in Ukraine, will disrupt global supply chains. The region plays a strategic role in several other key markets, outside of oil and natural gas: it is responsible for around 8% of the world's aluminum (graph 9), nearly 8% of its hydrogen, and about 30% of its helium. It also trades 30% of the fertilizer used around the world. And those are just the main sectors that will be affected—the region provides other sub-products and inputs to countries around the world.

Graph 9
The Middle East Accounts for More than 8% of the World's Aluminum Supply



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For now, the shock on value chains is rather small and likely temporary, but the risk of spillover is very real. Asia is already feeling the early impacts of the conflict, and its production chains will need to adjust quickly. In today's highly connected global economy, these costs could be passed on to other regions and sectors, amplifying inflationary pressures and supply tensions. Europe also finds itself in a difficult position, as it relies on energy imports from the Gulf region, particularly jet fuel, and has significant trade ties with countries in Asia.

However, the Global Economy Is More Resilient

The 2020s will undoubtedly go down in the history books as a decade marked by a succession of crises and profound structural transformations. From the pandemic to the war in Ukraine, to renewed protectionism and now the conflict in Iran, businesses and investors have had to adapt to unprecedented volatility. All of these events uncovered weaknesses in global supply chains while speeding up a series of strategic adjustments.

Value chains have become much more resilient since 2020. Companies have diversified their suppliers, increased their stockpiles and invested in regional production capacity, which will also help alleviate the current shock. At the same time, the energy transition—particularly the electrification of transport and the rise of technologies that are less carbon-intensive—is gradually reducing economies' sensitivity to oil price volatility.

However, this increased resilience does not fully eliminate risks. The conflict in Iran is a reminder that some dependencies are still difficult to break in the short term, particularly in the energy, aluminum and agrochemical sectors, where the Middle East plays a central role. If the crisis continues over a longer time frame, the impacts on production costs, global prices and growth could be more persistent. Overall, while the global economy is better prepared than it was in the past, the current events are putting its resilience and adaptability to the test.