Economic Implications of the Israel - Iran Conflict on Pakistan

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A Strategic Assessment by ICMA Research and Publications Department

Background

The ongoing war between Israel and Iran, now entering its second week, has sharply intensified regional tensions and raised serious concerns over global energy security and trade routes. While the conflict remains geographically limited and other Middle Eastern countries are not directly involved, its indirect effects; especially rising oil prices and shipping disruptions; pose economic risks to many countries, including Pakistan.

For Pakistan, the indirect exposure to the conflict is considerable, given its dependence on imported fuel, maritime trade through Gulf routes, and remittances from over 4 million overseas workers in the region. This assessment highlights key economic vulnerabilities, outlines sector-wise impacts, and presents strategic policy recommendations to help protect Pakistan's economic stability.

Message from the Vice President ICMA and Chairman, Research and Publications Committee

I am pleased to share this timely and policy-focused assessment conducted by ICMA's Research and Publications Department. The recent decision by the Prime Minister to constitute a high-level committee, chaired by the Finance Minister, to evaluate the potential economic impact of the Israel–Iran conflict is both timely and commendable. This ICMA assessment is intended to complement that important initiative by offering practical recommendations to support effective economic planning. I acknowledge the dedicated efforts of the R&P team and trust this document will serve as a valuable resource for policymakers, regulators, and economic institutions.

Muhammad Yasin, FCMA

Economic Impact on Pakistan

1) Oil Supply Disruptions via Strait of Hormuz

Although the conflict is contained, any Iranian attempt to disrupt the Strait of Hormuz, through which nearly 20% of global oil and LNG passes; could push oil prices to $100 to $130 per barrel.

Impact:

- Energy import bill may rise significantly
- Increased power generation costs
- Disruption in electricity supply

2) Energy-Driven Inflation

Pakistan's dependence on imported energy makes it vulnerable to global price spikes, resulting in domestic fuel cost surges and inflationary pressures.

Impact:

- Diesel prices likely to exceed more than 30% per litre
- Headline inflation could rise
- Reduced household consumption and savings

3) Agricultural Stress

Higher fuel and fertilizer costs may increase input prices by more sharply, reducing yields for key crops such as wheat, rice, and cotton.

Impact:

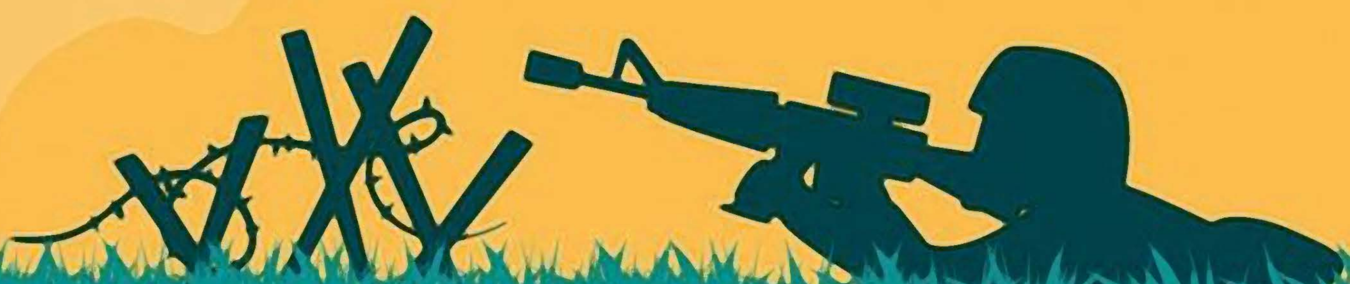
- Food inflation
- Decline in rural income and purchasing power

4) Disruption in Trade and Supply Chains

While Gulf ports remain operational, rerouting of maritime cargo due to Red Sea insecurity may extend shipping timelines and increase freight costs.

Impact:

- Delays in raw material, machinery, and edible oil imports
- Higher costs for exporters and manufacturers
- Increased logistics and insurance expenses



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5) Industrial and Manufacturing Challenges

Rising input and energy costs could compress margins and reduce manufacturing output.

Impact:

- Profit margins will decline
- Export competitiveness may suffer
- Risk of job losses in key industrial sectors

6) Insurance Premium Surge

Pakistani exporters report shipping insurance costs rising by $400 to $2,000 per container due to Red Sea security threats.

Impact:

- Exporters face financial strain; SME firms may suspend operations
- Increased insurance cost on imports (e.g., machinery, chemicals) pushes up local prices
- Pakistani goods become costlier, causes buyers to shift orders to cheaper, nearer countries

7) Exchange Rate and External Debt Risks

Investors typically shift to safe-haven assets like the US dollar during geopolitical crises.

Impact:

- Pakistani Rupee may depreciate
- External debt servicing costs may rise

8) Budgetary and Fiscal Strain

Elevated oil prices may necessitate subsidy programs or rollback of petroleum levies.

Impact:

- Additional fiscal burden could rise
- Fiscal deficit may widen more
- IMF program targets may be affected

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9) Financial Market Uncertainty

Extended regional instability may discourage investment and increase capital market volatility.

Impact:

- Worsen the FDI inflows more significantly
- Heightened PSX volatility
- Increased borrowing costs

10) Defense Spending Considerations

Although there is no immediate threat to national security, a prolonged crisis may shift budgetary priorities.

Impact:

- Reduced development allocations for health, education, and infrastructure
- Possible delays in CPEC and the Iran–Pakistan pipeline

Impacts Summary

Sector	Key Risks	Expected Impact
Energy	Oil prices may rise from $100 to $130; LNG delays	Rising import bill; rise in load-shedding
Agriculture	Rising fuel and fertilizer costs	Rising input cost; decline in yields
Transport	Fuel hikes; re-routed cargo	Increase in freight cost
Industry	Input inflation, power shortages	Decline in profit margins; lower exports
Trade	Delayed shipments, higher cost	Slower imports; reduced competitiveness
Insurance Cost	Insurance Premium Surge	Buyers to shift orders to cheaper-nearer countries
Currency/Debt	USD strength, PKR depreciates	High import cost; rise in debt servicing cost
Fiscal	Subsidies, levy rollbacks	Increase in fiscal deficit
Markets	Investor caution	Worsen FDI inflows; market volatility
Development	Reprioritized spending	Project delays including CPEC / Iran - Pakistan pipeline

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ICMA Policy Recommendations to the Government

1. Hedge Oil Imports

Adopt Shariah-compliant forward contracts for up to 30% of oil imports to manage exposure to price volatility.

2. Diversify Oil Trade Agreements

Finalize rupee–rouble deals with Russia and explore local currency oil trade with Iran and China to reduce dollar dependency.

3. Build Strategic Petroleum Reserves

Increase reserves from 21 to 90 days of demand, financed through sovereign Sukuk, following as per international practice.

4. Modernize Refining Infrastructure

Upgrading local refineries can reduce reliance on imported refined fuels and save up to $1 billion annually.

5. Promote Renewable Energy

Withdraw new taxes on solar imports and fast-track implementation of the 10,000 MW Solar Initiative to enhance energy resilience.

6. Optimize Export Corridors

Shift at least 15% of textile and industrial exports to overland CPEC routes to cut logistics and insurance costs.

7. Safeguard Remittances

Engage Gulf countries to secure jobs for Pakistani workers and strengthen formal remittance channels through incentives and support for returning workers.

8. Strengthen Fiscal Buffers

Establish an energy shock stabilization fund using contributions from donors, multilateral institutions, and budget reallocations.

9. Tap IMF Resilience Support

Apply for funding under the IMF's Resilience and Sustainability Trust (RST) to build macro-fiscal buffers.

10. Set Up a Strategic Economic Task Force

Create a Task force with members from the Ministry of Finance, Ministry of Defence, Ministry of Foreign Affairs, State Bank of Pakistan, Ministry of Energy and Ministry of Commerce to track global economic risks and take timely joint policy actions.

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Conclusion

Although the Israel - Iran conflict remains geographically confined, its economic aftershocks may still impact Pakistan through energy prices, trade logistics, inflation, and remittances. The situation demands a timely and coordinated policy response. By pursuing strategic oil hedging, energy diversification, export route optimization, and institutional resilience, Pakistan can shield its economy from external shocks and maintain macroeconomic stability in uncertain times.

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