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Energy shock and policy response: Once bitten, twice shy?

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In Summary

- **The current energy shock is fundamentally a supply disruption, not just a price event, with Asia most at risk.** The blockage of the Strait of Hormuz has disrupted around 20mb/d of oil flows (roughly 1/5th of global supply), leaving a net shortfall of ~10mb/d despite rerouting, additional supply and strategic reserve releases. The resulting supply-demand gap has been closed through higher oil prices (Brent +30% since the war began), which have lowered consumption. Physical scarcity is already visible: jet fuel is tightening, diesel is being rationed and industrial users in price-controlled markets face outright shortages. Asia is most exposed (85% of Hormuz oil flows vs. less than 6% to Europe and 4% to the US), driving a persistent 6–7% price premium above Brent. A first policy response, mainly by Asian countries, has been demand rationing (shortened working weeks, energy usage and fuel restrictions) cutting global demand by ~1mb/d.
- **Fiscal support followed swiftly, primarily through fuel-tax relief and subsidies (~0.15% of GDP in developed markets and ~0.20% in emerging markets on average).** On price support Asia leads again, with large EMs (South Korea, India, Indonesia) deploying fiscal packages >1% of GDP vs. a global average of ~0.2%. Similarly, in developed markets, large EU energy importers average ~0.4% of GDP vs. ~0.15% overall. However, deeper pockets buy more: Germany's small 0.04% of GDP package translates into USD22 per capita while India's package of 1.5% of GDP, despite being 37 times larger in relative terms, only translates to a mere USD40 per capita. Should the conflict prove more prolonged (beyond May), a "second salvo" of fiscal support would raise spending to 0.6-0.8% of GDP, as governments would respond to higher energy price pass through with a 2-6 months lag. Nonetheless, no fiscal transfer can resolve the supply-demand mismatch, which will need to be cleared via demand destruction.
- **Compared to 2022, the shock differs in two key ways: fiscal support is materially smaller, but proportionally similar (around 50% in Europe as the size of the energy price shock is also lower) and price transmission has weakened due to structural shifts in the energy mix.** This reflects policy learning , the perception of a temporary shock and fiscal limits, with governments allowing greater pass-through rather than repeating large-scale shielding (e.g. France announcing later and more targeted measures, Belgium taking no measures). Meanwhile, in the European power market, higher wind and solar penetration has reduced the gas-to-electricity pass-through seen in 2022, but gas remains indispensable for grid balancing Spain stands out with electricity prices around 70% lower than in Italy, reflecting a higher renewables share and better storage capabilities.
- **For now, fiscal costs for most countries are negligible but EMs with high energy import dependence and a deteriorating current account are vulnerable (Türkiye, Egypt, Morocco, and Hungary).** Debt-servicing costs will rise by around 0.05% of GDP annually in advanced and emerging economies on average. entirely from a higher debt stock. Interest rates have risen only modestly (US/DE: +30bps, EM hard currency: +20bps, local currency: +30bps), with an even lower change in real rates. A gradual pass-through given slow debt rollover raises debt-servicing costs only marginally through this channel. On the flip side, higher inflation could even dampen the debt burden (inflation tax) and thus debt-service costs but the currently expected increase in inflation is far below 2022, thereby limiting this

effect. Some EMs nevertheless stand out: fiscal fragility and elevated debt service are most acute in Egypt, Hungary and Poland. Currency depreciation amplifies the damage in nations with a high share of hard currency debt: Türkiye, Argentina and Egypt. Nevertheless, not all emerging markets are on the losing side of the energy shock: Higher prices are a windfall for energy producers such as Nigeria, Brazil and Colombia.

From price signals to physical scarcity: a regime shift

The 2026 energy shock is not a price event with physical consequences, but a physical supply disruption with price consequences. This distinction is central for policy design, fiscal outcomes and market pricing. Unlike 2022, prices are not clearing the market: the shock is defined by missing volumes, not by temporarily expensive ones. Where supply is physically constrained, no price cap or political statement can fully offset a shock defined by missing volumes: the molecules are simply not there. This raises the risk that adjustment occurs through actual scarcity (notably in jet fuel and refined products), not just higher prices. Energy markets entered 2026 in a fragile but manageable equilibrium, and the initial repricing following the Iran escalation was driven largely by geopolitical risk premia: markets were pricing the probability of disruption, not disruption itself. That quickly gave way to reality.

From a supply gap of 20mb/d from the global supply – roughly one-fifth of world supply – to a shortfall of approximately 10 mb/d thanks to alternative supply sources and routes. Half of the missing gap is being rerouted via alternative pipelines, from the East-West pipeline in Saudi Arabia to the Emirate East coast pipeline. On top of that extra supply from Russia – whose oil has been temporarily excluded from the sanctions list – and the US – whose producers increased production by around 200,000 b/d from pre-war projections – is also substituting part of that supply, resulting in 10mb/d gap. The International Energy Agency (IEA) coordinated the release of around 400mn barrels from strategic reserves in the weeks following the start of the war – the largest joint drawdown ever announced — aimed at stabilizing prices and signaling policy control. Markets were largely unconvinced: prices retraced only marginally, underscoring that reserves can smooth flows temporarily but cannot offset a sustained physical disruption. This option is now fully exhausted.

The effective closure of the Strait of Hormuz marked the regime shift. Around 20% of globally traded oil and 25% of LNG transit the Strait, with no short-run substitute route of comparable capacity – making the closure not just a price shock but a physical supply event with no historical precedent of comparable scale. Since the start of military engagement, oil prices have risen by more than 50% and natural gas prices by over 65%, with storage levels falling towards their 2022 lows. But the aggregate numbers obscure where the pressure is most concentrated: Asia, as the region most dependent on Gulf supply, is bearing a disproportionate share of the cost. DME Oman futures have been trading at a premium of approximately USD10-11 per barrel above Brent since early April – a spread that under normal conditions runs in the opposite direction — capturing with unusual precision where the physical shortage is concentrated and who is paying for it.

Asia sits at the epicenter of the energy crisis, given its large dependency on Gulf imports, and has been the fastest to activate demand-side responses – with demand destruction, rather than fiscal absorption, emerging as the primary adjustment channel. The policy actions are estimated to have already curbed oil demand by around 1 mb/d in March and April, with global demand growth for 2026 revised down to 640,000 b/d – 210,000 b/d below the pre-war estimate. Around 56% of emerging market economies in the region have adopted this approach, reflecting tighter fiscal space and more binding financing constraints that make explicit subsidy expansion politically and fiscally untenable. The IEA's emergency demand toolkit – covering work-from-home mandates, reduced highway speed limits, public transport incentives and number-plate rotation schemes – has been the reference framework for most responses, targeting road transport, which accounts for around 45% of global oil demand. The Philippines declared a national energy emergency; Thailand proposed a three-stage fuel rationing contingency plan; Vietnam activated fuel contingency plans; and Indonesia began rationing energy and urging conservation. Pakistan introduced a four-day working week for public offices, with 50% of staff working from home; Sri Lanka reintroduced the weekly fuel ration it had last used during its 2022 debt crisis, alongside a four-day government working week. A secondary consequence has been an acceleration of renewable energy commitments: South Korea's president described the crisis as a strategic opportunity to transition to renewables, while the Philippines and Vietnam have recorded sharp increases in EV sales as consumers seek to reduce fuel exposure.

Markets are closing the remainder through price-driven demand destruction, especially in Asia, where the price premium is 6-7% above the Brent benchmark since the war started.

The policy response under a physical energy shock

The policy response to the Hormuz disruption has been unusually fast. Within days, governments moved to limit the pass through of higher energy prices to end consumers, announcing price caps and subsidy extensions, often complemented by emergency reserve releases – in many cases before physical shortages had fully materialized (see Table 1). The speed reflects a hard learned lesson from 2022: delayed intervention risks de-anchoring inflation expectations and ultimately leads to higher ex-post fiscal costs.

Yet the adjustment differs sharply across countries. Economies with deeper fiscal buffers and market access are once again absorbing a significant share of the shock onto public balance sheets, effectively smoothing the impact on household incomes and corporate margins. In contrast, tighter financing constraints are forcing a larger share of the shock to pass through to activity, combining selective fiscal support with demand compression. In these economies, higher energy prices translate more directly into lower consumption, reduced industrial activity and slower growth, rather than higher fiscal outlays.

Table 1: Fiscal response divergence between DMs and EMs: prices vs demand

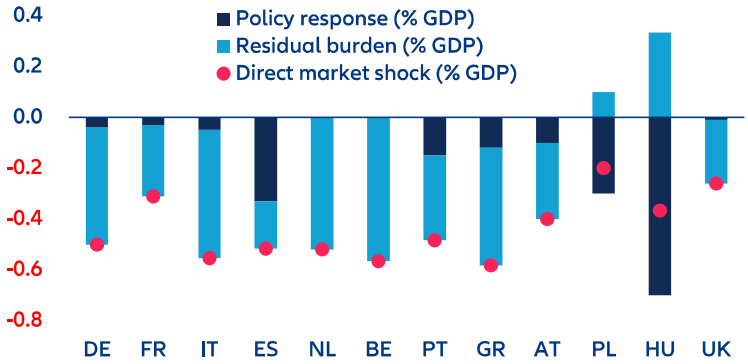
	Country	Price adjustments	Demand adjustments	Supply adjustments (non-IEA release)	Supply adjustments – IEA release	Other measures
Developed Markets	United States	No	No	No	Yes	No
	United Kingdom	Yes	No	No	Yes	No
	Europe	No	No	No	Yes	No
	Germany	Yes	No	No	Yes	Yes
	France	Yes	No	No	Yes	No
	Italy	Yes	No	No	Yes	Yes
	Spain	Yes	No	No	Yes	No
	Netherlands	No	No	No	Yes	No
	Belgium	No	No	No	Yes	No
	Japan	Yes	No	No	Yes	No
	Australia	Yes	No	No	Yes	No
	Singapore	No	Yes	Yes	No	No
	AVERAGE	58%	8%	8%	92%	17%
Emerging Markets	China	No	No	Yes	No	No
	India	Yes	No	Yes	No	No
	Pakistan	Yes	Yes	No	No	Yes
	Thailand	Yes	Yes	No	No	No
	Philippines	No	Yes	Yes	No	Yes
	Sri Lanka	Yes	Yes	Yes	No	Yes
	Vietnam	Yes	Yes	Yes	No	No
	Brazil	Yes	No	Yes	No	No
	Turkyie	Partial	No	No	No	No
	South Africa	Yes	No	No	No	No
	Poland	Yes	No	No	Yes	No
	AVERAGE	89%	56%	67%	11%	33%

Sources: various Allianz Research

Advanced economies: price-based shielding, with heterogeneous scale and timing. Drawing on the 2022 playbook, the initial response in Europe is still overwhelmingly price-based rather than income-based – reflecting administrative ease and political incentives..

This logic is visible again in the current shock, albeit at a smaller scale and with sharper cross country divergence. Under a three-month 30% oil price shock, the direct market impact for large EU energy importers is estimated at around 0.4% of GDP on average, depending on energy dependency (Figure 1). To date, discretionary fiscal measures amounts to roughly 0.15% of GDP, leaving a material and uneven residual burden on households and firms.

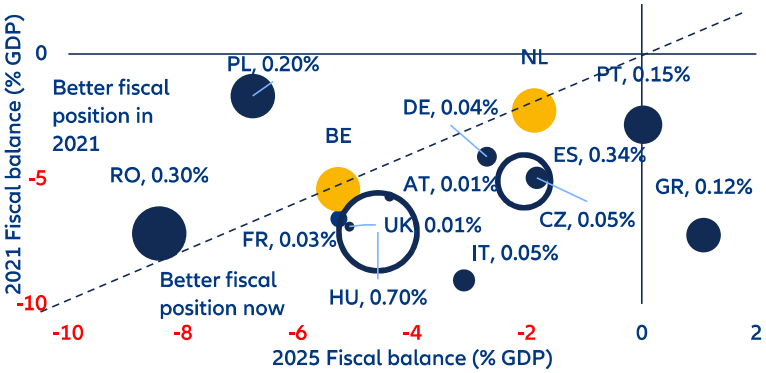
Figure 1: Total cost of the war (% of GDP)



Sources: Eurostat, Allianz Research

National strategies nonetheless diverge markedly. Spain acted early and forcefully, rolling out more than 80 broad measures centered on price caps and subsidies, significantly cushioning households and firms but delaying demand adjustment and shifting a large share of the burden onto the public balance sheet. France, by contrast, intervened later and far more selectively showing some fiscal consolidation efforts, with a fiscal response close to one tenth of its 2022 effort, accepting greater price pass through up front. Other countries have so far refrained from announcing discretionary support altogether: Belgium, constrained by limited fiscal space, and the Netherlands, reflecting a more explicitly frugal policy stance, have largely allowed prices to adjust.

Figure 2: Fiscal positions have improved since 2021, but higher spending pressures and interest costs limit the room to act



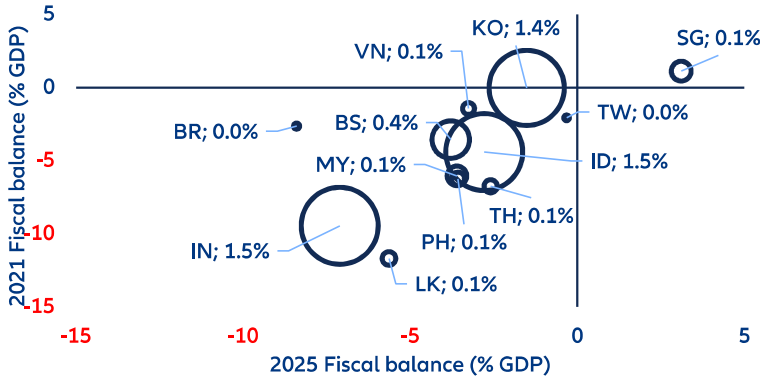
Sources: national, LSEG Datastream, Allianz Research. Note: blue bubbles: announced measures (size=estimated fiscal cost, % of GDP). Yellow bubble: no fiscal support announced as of 22.04.2026. Non-filled bubbles are for better readability.

Fiscal responses across EMs have been uneven, averaging around 0.2% of GDP, but rising well above that level in more fiscally resilient economies. Singapore recently announced measures amounting to about USD780mn (0.12% of GDP), while larger Asian Ems – including South Korea, India and Indonesia – have deployed packages exceeding 1% of GDP. In this sense, the Iran war is acting as a stress test of fiscal credibility – one that the Covid-19 shock, cushioned by unprecedented global liquidity, did not fully impose.

Despite entering the current shock in better aggregate fiscal positions than during the pandemic, EM starting points remain highly heterogeneous. Unlike the near-universal fiscal deterioration of 2020, fiscal balances today diverge sharply: while Brazil and Vietnam have worsened since the pandemic, several Asian economies have consolidated materially. India has narrowed its deficit from -4% to -2% of GDP, Sri Lanka from -11% to -5%, Thailand from -7% to -2.6% and Malaysia from -6% to -3%. This dispersion in fiscal space is now the primary determinant of how much each government can absorb the energy shock without triggering financing stress or a disorderly

currency adjustment – and explains why, for many EMs, demand destruction remains the dominant adjustment mechanism.

Figure 3: Emerging markets' fiscal space determined the fiscal response to Iran war



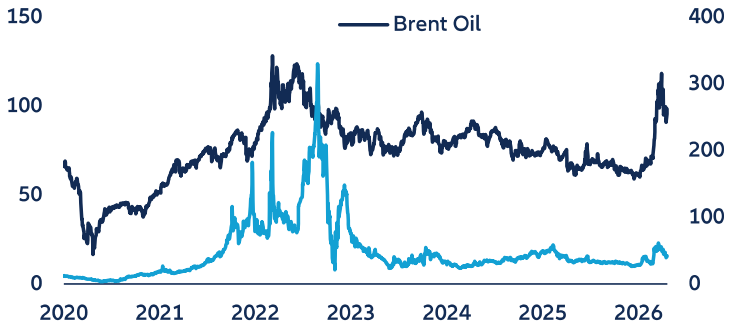
Sources: national, LSEG Datastream, Allianz Research.

A "second salvo" coming? Should the conflict prove more prolonged than our baseline assumes, a second wave of fiscal pressure becomes plausible. Fiscal costs could rise non linearly, towards 0.6–0.8% of GDP, roughly double current package sizes — compounding debt dynamics at precisely the moment when the first round of support has already eroded buffers and reintroduced sustainability concerns. Energy price increases pass through to food, transport and services with a lag of several months — and when that broader inflation arrives at the household level, governments face renewed political pressure to respond. The countries most exposed to are those where fiscal space is already thin. In Emerging Markets, high social sensitivity to food and fuel prices puts Morocco, Egypt, Pakistan, Hungary and Poland in the front line. In Europe the picture is equally uncomfortable: France, Italy, Belgium and Poland are already subject to the European Commission's Excessive Deficit Procedure, meaning any additional fiscal response risks deepening consolidation challenges that were already difficult to meet.

Not 2022 reloaded: smaller fiscal shields and weaker price transmission

The Iran 2026 shock is meaningfully smaller than 2022, particularly for gas - the more relevant benchmark for advanced economies, given their greater exposure to gas-indexed power and heating costs. Dutch TTF rose from EUR 31/MWh pre-conflict to a peak of around EUR 70/MWh in early March, before easing back to EUR 40–42/MWh as ceasefire talks progressed – representing roughly 10–12% of the extreme 2022 peak levels, when TTF surged over 1,000%. Brent told a similar but less dramatic story, reaching around 70–75% of its 2022 peak move. Yet the external cost is already visible: in the first 44 days of the Iran crisis alone, the EU spent approximately EUR22bn more on fossil fuel imports – an early reminder of the speed at which external balances can deteriorate, as illustrated by 2022, when the EU's total fossil fuel import bill more than doubled from EUR313bn to EUR693bn at its peak (Figure 4).

Figure 4: Oil prices surged sharply, while gas prices remain below their 2022 peaks.



Sources: LSEG Datastream, Allianz Research

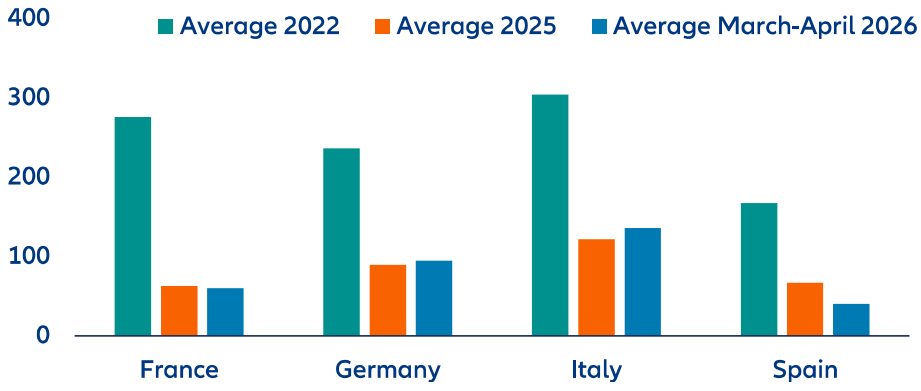
Compared with the 2022 energy crisis, the current shock differs in several important and reinforcing ways. First, the fiscal response has been materially smaller. With the current shock estimated at less than half of the intensity of 2022, fiscal exposure is correspondingly lower. Discretionary measures announced so far across Europe amount to roughly half the scale deployed in 2022. A full 2022 equivalent response (around 1.2% of GDP over the first year) scaled to a 12-week horizon would imply net fiscal costs of about 0.3% of GDP. Crucially, most have been designed as explicitly temporary – typically limited to two to three months. This contrasts sharply with 2022, when interventions initially announced as temporary were repeatedly extended, substantially amplifying their cumulative fiscal cost. The lessons of 2022 are instructive. The EU's net budgetary cost over 2022–2024 reached 2.2% of GDP cumulatively. Around 60% was spent on broad price measures, with only about a quarter targeted at vulnerable households and firms. The takeaway was clear: price suppression can briefly dampen inflation, but it weakens incentives to conserve energy, props up demand and creates large fiscal liabilities that become politically difficult to unwind. The more restrained approach today reflects not only policy learning, but also a less forgiving macroeconomic environment. In 2022, post-pandemic reopening, strong nominal GDP growth and still-accommodative financial conditions helped absorb large fiscal packages. Today, despite improved government balances, near-stagnant real growth limits governments' ability to smooth shocks through public balance sheets without undermining debt sustainability. Fiscal intervention has therefore been more selective, shorter-lived, and – in many cases – explicitly conditional on market developments.

Second, price transmission has structurally weakened relative to 2022, reflecting changes in the European energy mix. Higher penetration of wind and solar generation has reduced the mechanical link between gas prices and electricity prices that defined the 2022 crisis. Back then, gas-fired generation frequently set the marginal price across most hours, transforming a gas supply shock into a broad inflation and fiscal shock. Today, low-marginal-cost renewables increasingly anchor electricity prices, with gas determining prices mainly during periods of tight supply. This has dampened the inflationary impulse and reduced the immediate need for large-scale fiscal intervention – even as gas prices remain elevated.

Together, the smaller scale, temporary design and weaker price transmission point to clear policy learning and a widespread perception that the shock may be transitory. Governments – much like markets – appear more willing to tolerate greater price pass-through rather than repeat the broad and persistent price suppression seen in 2022. The policy response thus remains closer to 2022 in approach than in scale, favoring short-duration, reversible interventions over open-ended commitments.

The heterogeneity in electricity market structures further reinforces this pattern. Spain now operates with a structurally low gas-to-electricity pass-through, estimated at around 0.2–0.4, reflecting high renewable penetration and growing storage capacity. Electricity prices have therefore remained relatively contained during the current shock, limiting inflation spillovers and reducing the need for fiscal intervention. Italy, by contrast, remains constrained by gas-marginal pricing, with gas setting electricity prices most of the time. This implies a much stronger transmission – around 0.7–0.9 – keeping power prices closely linked to gas despite ongoing renewable expansion and sustaining pressure for policy support.

Figure 5: Increased reliance on renewables helped to manage electricity prices (wholesale, EUR/MWh)



Sources: EMBER, Allianz Research

This structural divergence matters for fiscal policy. Where renewables dampen transmission, governments can accept greater pass-through without triggering an inflation–fiscal feedback loop. Where gas remains marginal, price pressures are faster and more persistent, raising political incentives to intervene even when growth is weak and fiscal space constrained. Importantly, the current configuration embeds a non-linear downside risk. If physical disruptions persist beyond the horizon implicitly assumed in today's policy design, and temporary measures are repeatedly rolled over or expanded, fiscal costs in Europe could still rise sharply. In an environment of weak growth and higher interest rates, prolonged price interventions would once again convert a supply shock into a growing contingent fiscal liability, this time without the mitigating effect of strong nominal growth that characterized 2022.

Debt sustainability dynamics reinforce this concern. In 2022, double-digit inflation lifted nominal growth well above financing costs, providing a buffer. Today, with inflation around 3% and near-zero real growth, nominal GDP growth is too weak to offset rising deficits under price caps. Debt dynamics have therefore become increasingly sensitive to the duration of fiscal support.

Winners and losers from the Iran shock

For now, fiscal costs remain manageable for most countries. On average, debt-servicing costs are set to rise by around 0.05% of GDP in both advanced and emerging economies, driven entirely by a higher debt stock rather than higher rates. However, energy import dependence combined with a deteriorating current account determines who faces the largest shock. Interest rates have risen only modestly — US and German yields up around 30bps, EM hard currency spreads +20bps, local currency +30bps — with real rate changes even smaller. The slow pace of debt rollover means higher borrowing costs pass through only gradually, limiting the immediate debt-service impact. On the flip side, higher inflation could partially erode the real debt burden through an inflation tax effect, though the currently expected inflation increase is far below 2022 levels, limiting this offset.

Debt service and fiscal fragility. The countries most acutely exposed are those carrying both high near-term debt-service obligations and significant structural dependence on energy imports. Egypt sits in the most dangerous quadrant: debt service above 10% of GDP, heavy reliance on imported oil and gas, an IMF program already under strain and Suez Canal revenues simultaneously compressed by the conflict. Pakistan, with debt service at 5.4% of GDP and near-total dependence on Gulf crude, faces import cost inflation and financing stress simultaneously. Hungary and Poland carry elevated fiscal deficits with limited room to sustain price support measures, while Sri Lanka — only recently exited from sovereign default — and Bangladesh face the energy shock as a direct balance-of-payments stress, with thin reserve buffers and limited debt market depth meaning the import cost increase arrives before any fiscal response can be mounted. Peripheral Eurozone sovereign bonds have also experienced one of their worst months in a decade, with spreads widening most sharply in Italy, Greece and Portugal — markets are not primarily repricing current debt stocks but the open-ended flow commitment implied by sustained price interventions, and the longer caps and subsidies remain in place, the more the fiscal trajectory diverges from the consolidation paths embedded in current spread levels.

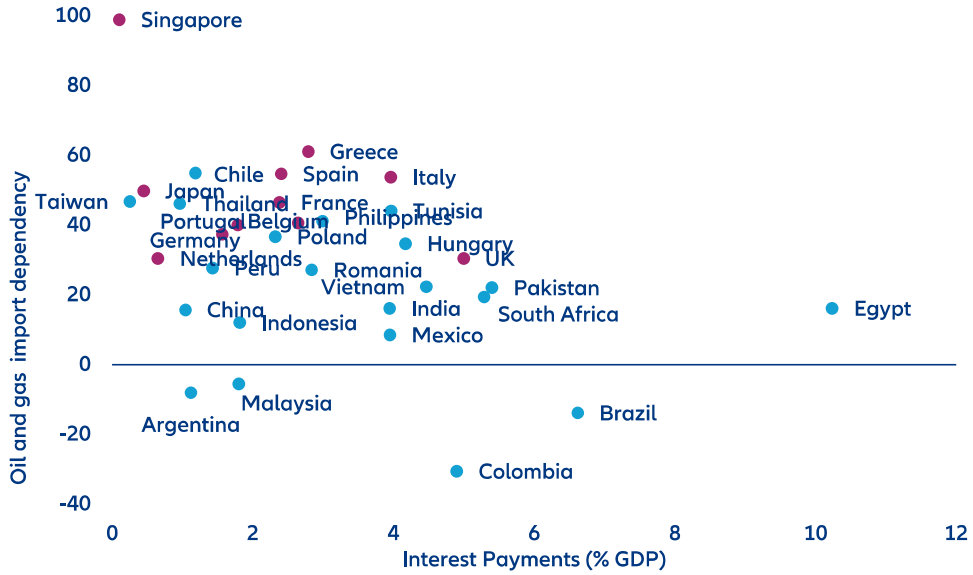
Currency depreciation and hard currency debt. Currency weakness amplifies the damage for sovereigns with a high share of hard currency debt, as depreciation mechanically increases the local currency cost of servicing existing obligations precisely when fiscal revenues are under strain. Türkiye is the most exposed large EM across all dimensions: importing 90% of its energy at an annual cost of USD 60-65bn, with a current account deficit of USD 25bn and a lira down 17% over the past year — each USD 10 oil price increase adds USD 4.5-5bn to its external deficit. Argentina and Egypt face the same amplification dynamic, both carrying meaningful foreign currency debt shares above 25-30% of total sovereign debt. Tunisia has recorded among the sharpest currency depreciation since the start of the conflict, while the Thai baht has absorbed part of the shock with a 6% depreciation. The OECD's 2025 Global Debt Report confirms that among large emerging markets, only Argentina and Türkiye carry foreign currency debt shares exceeding 30% of total sovereign debt — making them uniquely vulnerable to the depreciation-debt spiral that the energy shock is now activating.

Monetary policy and real rates. One month and a half into the conflict, energy import dependency continues to weigh more heavily than financial constraints on central bank decisions. Singapore has tightened monetary policy for the first time in four years; the Bank of Japan is expected to follow with a 25bps hike in Q2, most likely June. The risk-off shift has pushed markets to reprice central bank paths globally — in Europe, expectations have shifted from cuts to hikes for the ECB, though we anticipate adjustments only for the duration of the conflict. Countries recovering from the 2022-23 inflation cycle will slow their easing, while others are pushing rate cuts to 2027. Egypt's CBE held rates unchanged at its 2 April meeting, treating the war as an external supply shock and allowing the pound to

depreciate as the primary adjustment mechanism — a stance that preserves monetary credibility for now but leaves the carry trade inherently fragile, as the central bank could face an impossible choice between further depreciation and an aggressive rate hike to retain investors. Chile, Indonesia and Thailand have kept rates on hold, pending clearer signals on the duration of the disruption.

Current account deterioration. The Iran war is exerting pressure on sovereign bond markets through two simultaneous channels: a global risk-off repricing that widens EM spreads, and a direct fiscal deterioration driven by higher energy import costs. Oil above USD 100 per barrel widens current account deficits, accelerates currency depreciation and feeds domestic inflation, eroding sovereign creditworthiness precisely when refinancing needs are greatest. India, at 3.9% debt service, has larger domestic energy buffers but its bond market remains exposed to the broader EM risk-off and dollar strengthening that higher oil prices typically generate. Vietnam faces meaningful energy import dependence alongside limited fiscal space, while Kenya — a large energy importer carrying a high fiscal deficit after years of difficult IMF negotiations — has thin reserves providing little cushion against a sustained import cost shock. Morocco and Tunisia occupy a similar intersection of moderate-to-high debt service and meaningful energy import dependency, leaving their sovereign spreads vulnerable to both the global risk premium repricing and the direct pass-through of higher import costs.

Figure 6: Most exposed: where high debt burdens (% of GDP) meet energy import dependence



Sources: UN COMTRADE, World Bank and Allianz Research

Winners. Not all emerging markets are on the losing side. Oil-exporting economies stand to benefit materially from sustained prices above USD 100 per barrel, with the windfall flowing through both fiscal revenues and current account positions. Nigeria is the most prominent African beneficiary — every USD 10 increase in oil prices adds approximately USD 3-4bn to government revenues — though its structural paradox partially erodes the net gain, as a major crude exporter that nonetheless imports virtually all of its refined petroleum products. Brazil, as significant oil producer, will see their fiscal and external positions improve as Brent rises, while Colombia and Ecuador capture a similar tailwind from hydrocarbon exports. Chile is the notable exception within the region: its early and deep investment in renewable energy has structurally reduced exposure to oil price volatility, insulating the economy from the full pass-through hitting more fossil-fuel-dependent peers. Latin America stands out as the emerging market region least exposed to the shock overall — where for most economies the Iran war arrives not as a fiscal and external stress but as a terms-of-trade tailwind.

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