Iran war hits Asia hard due to the region's high economic exposure to the Gulf | Credendo

Event

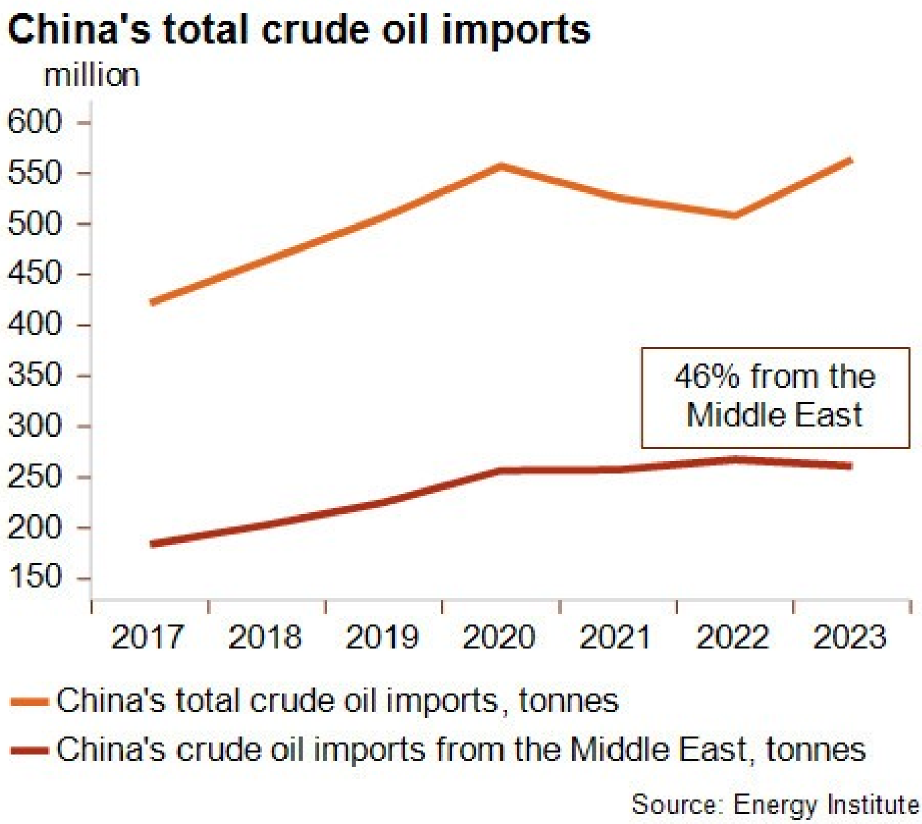
Asia, a region of principally net energy importers, is highly exposed to the Iran war fallout. First and foremost, it is largely reliant on oil and gas imported from the Gulf, which is why export bans of refined oil products or fertilisers (e.g. China) to prioritise domestic needs are exacerbating the problem in Asia. The energy shock is disrupting supply chains and hitting Asia's key manufacturing sector, including the energy-intensive semiconductors industry (which could also be hit by a shortage of helium). Second, South Asian countries receive the largest share of their important workers' remittances from the Gulf and Asian exports to Gulf countries were on a sustained upward trend until the Iran conflict broke out. Tourism is also harmed by costlier jet fuel and by the disruption of transit flights in the Gulf that connect Asia to Europe. Moreover, the energy crisis will slow down the global economy and therefore harm demand for Asian manufactured exports. Though country disparities exist when it comes to economic vulnerabilities, governments have taken a broad range of measures to mitigate the overall impact. Ultimately, the extent of the already negative outlook on Asian economies will depend on the risk of an escalation of the Middle East conflict and on the duration of the disruption of the Strait of Hormuz.

Impact

More than 80% of oil and LNG from the Gulf are destined for Asia, showing how close energy links between both regions are. Countries like the Philippines and Japan import almost all their oil from the Gulf whereas Pakistan or India import more than 80% of their gas from the region. Consequently, Asia is hit hard by the energy price shock and fuel shortages. Except for China, Japan and South Korea, strategic oil reserves are indeed limited to one or two months of imports for most countries and the situation is even worse for LNG. Hence governments have been compelled to adopt emergency measures to fight against the energy crunch and alleviate the socio-economic shock in the near term – from energy rationing to reduced working hours and manufacturing activity. Several countries are also increasing the use of coal to replace gas or are purchasing Russian oil (e.g. Vietnam). On the price side, the usual short-term tools like increased energy subsidies (Thailand, Malaysia, Indonesia) and capped prices (China, South Korea, Vietnam, etc.) have been deployed.

Macroeconomic vulnerability to the Gulf conflict differs between countries. South Asia is the most at risk – especially Pakistan, Sri Lanka and Bangladesh as they are currently under an IMF programme. Those countries combine the highest economic exposure to the Gulf with displaying more fragile macroeconomic fundamentals and weaker liquidity levels. By reducing their export earnings and increasing energy import costs, the Iran war will widen their current account deficit and hit their foreign exchange reserves. In the Philippines, the potentially chaotic fuel situation has led President Marcos to declare a state of national energy emergency with the aim of controlling the domestic oil consumption flow. India has various buffers (oil reserves, wide use of coal for electricity generation and large foreign exchange reserves) and has increased its Russian oil imports. Still, a macroeconomic deterioration is underway due to the decline in exports to the Gulf and in its large workers' remittances, the depreciation of the rupee (at a historic low) and expected inflation pressures.

China, in spite of being the largest Gulf energy importer, is in a strong position thanks to its large buffers.



For years, the country has been actively preparing to cope with such external shocks by increasing self-sufficiency and market diversification, accumulating the world's largest strategic oil reserves, running rapid electrification of its economy and preserving ample external liquidity. The capacity to use more coal and further tighten energy links with Russia helps to withstand the energy crisis too. On top of that, China continues to receive a high share of its Iranian oil imports (China's second oil supplier in 2025). This said, Chinese companies will see their low profit margins further eroded by higher energy costs and will suffer from slowing Gulf, Asian and European demand for their exports, which is a crucial driver of GDP growth.

In the short-term, the Iran war will deteriorate the business environment in Asia on the back of rising inflation, fuel rationing, depreciating currencies, curtailed or halted production, stable or increased interest rates and decelerating real GDP growth. This has already resulted in many downgrades. If the conflict endures beyond the current ceasefire, the energy inflation shock will spill over and increasingly affect consumption, which could lead to a food shock and trigger social instability. Indeed, higher fuel costs and fertiliser prices are likely to hit future crops hard, notably Gulf-dependent South Asian countries during the next monsoon. The governments' capacity to ease the pain through heightened energy and food subsidies will be constrained by limited fiscal space.

In the long-term, Asian governments are likely to draw some lessons from the latest energy shock. Indeed, structurally making their energy mix more resilient through nuclear power (wherever possible and affordable), renewables and more diversified supply chains will have to be a priority to reduce the region's unsustainable addiction to imported fossil fuels and vulnerability to maritime choke points.

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