Middle East: a cost shock, not (yet) a supply shock, for China

Coface

Better equipped than its competitors to deal with energy shocks, China is currently limiting supply disruptions linked to tensions in the Middle East. However, rising input costs, combined with a slowdown in global demand, are weighing on already stretched corporate margins.

Key takeaways

- **35%** of oil flows passing through the Strait of Hormuz are destined for China
- **+0.5%**: first annual rise in producer prices in 41 months
- **100+ days**: equivalent of China's strategic oil reserves in days of net imports

Why China is weathering the storm better than its Asian rivals

Unlike many Asian countries heavily reliant on hydrocarbon imports**, China has several buffers against a prolonged crisis in the Middle East**. Its energy mix remains largely dominated by domestic coal, whilst **oil and gas together account for 39%** of its final energy consumption, well below the global average (62%)**.**

Added to this are substantial storage capacities: in the event of temporary disruption, strategic **oil reserves can cover nearly 100 days of net imports**. As a result, despite the importance of the Strait of Hormuz — through which 35% of oil flows to China pass — the risks of immediate physical shortages remain limited.

Producer prices rise for the first time in three years

Whilst flows continue, their cost is rising. **The rise in energy and chemical prices has begun to spread throughout the Chinese economy**. In March, producer prices rose by 0.5% year-on-year, the first such increase in over three years. The petrochemical sector alone contributed significantly to the monthly rise in producer prices.

For the time being, this rising expense is largely being absorbed by the mid-and- downstream sectors, against a backdrop of still fragile final demand. Consumer prices remain moderate, supported by fuel price regulation mechanisms, the growing share of electric vehicles and subsidies granted to state-owned refiners.

Margins under pressure: SMEs on the front line

The persistent rise in input costs is nevertheless beginning to erode corporate profitability. Several sectors — **textiles, chemicals, and synthetic fibers** are already reducing their output. Tighter regulatory constraints and compliance costs are adding to this pressure.

SMEs appear particularly vulnerable, as they have weaker bargain power to pass on cost increases. Conversely, large conglomerates benefit from long-term supply contracts, economies of scale and stronger balance sheets to absorb the shock.

A delicate balance between substitution and global slowdown

Paradoxically, the crisis could strengthen China's industrial position vis-à-vis Asian competitors who are more exposed to energy shocks as ASEAN countries and India. It is also accelerating global demand for Chinese green technologies, particularly in electric vehicles, batteries and solar power.

But the risk lies elsewhere: a prolonged conflict, leading to a sustained surge in energy prices, could weigh heavily on global growth. A doubling of energy prices compared to pre-war levels could cut global growth by more than 1% in 2026, with repercussions for demand directed at China.

> China is currently managing to avoid a major supply shock thanks to its energy mix and industrial ecosystem. But the sustained rise in costs is creating a new vulnerability: that of margins, particularly for the most exposed companies and those least able to pass on price increases.

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