



RESEARCH PAPER

Economic Impact of Iran-US Conflict on Pakistan: Supply Chains, Inflation and Energy Security

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ABSTRACT

This study analyzes the economic ramifications of the Iran-USA conflict on Pakistan with a particular emphasis on the impact on the supply chain, inflation and energy security issues. The research also unravels the impact of geopolitical turbulence in the Gulf region on global oil prices, shipping routes and international trade system as a whole and how this impacts the domestic economy in Pakistan. The higher the price of fuel, the higher the transportation and production cost, which causes inflation and decreases consumers' purchasing power. In addition, the disruption of sea transport and of energy supply causes uncertainty in energy production and the economy. This study is a qualitative research that utilizes secondary data obtained from report, journal, and international financial institutions. The results indicated that Pakistan's overreliance on energy import and import of foreign goods increases Pakistan's susceptibility to the conflicts of the region. The paper suggests that the policy changes, energy diversification, strategic stocks and regional economic cooperation are needed to mitigate economic vulnerability of Pakistan in the event of a geopolitical crisis policies.

Keywords: Energy Security, Inflation, Pakistan Economy, Regional Stability, Strait of Hormuz

Introduction

Geopolitical conflicts have been central in determining the economic trends in the world, especially those affecting the major energy producing areas. The Iran-US conflict is particularly important because of its nearness to the Persian Gulf, a region where oil supplies are vital to the world. During conflict, a significant part of the world's oil supply transits the Strait of Hormuz, which is an important chokepoint in the global maritime system. Pakistan's economic system is a highly susceptible one to such shocks. The nation is highly dependent on maritime trade routes for movement of imports and exports and imports high proportion of its energy needs. Furthermore, its capacity to cope with external shocks is constrained by macroeconomic difficulties, such as balance-of-payments deficits, inflationary pressures, and currency depreciation.

The economic effects of this conflict have significance, especially from the perspective of Pakistan as an emerging economy that is highly dependent on energy imports, has thin export base and low fiscal and financial buffers. Any external shock that leads to inflation, increases trade and current-account deficits or energy supply pressures can swiftly deepen food insecurity and poverty, particularly for low income groups. In this regard, the Iran-ISI conflict is not just a regional political conflict but rather a big economic and social problem for the country of Pakistan. Following intense military tension and regional instability, the US-Iran situation has entered new, delicate stage. In early April

2026, a temporary ceasefire brokered by Pakistan was observed, which resulted in partial reopening of the Strait of Hormuz energy routes, although the ceasefire continues to be fragile, with frequent interruptions due to persistent mine threats and naval blockades resulting in transportation disruptions. This is a big geopolitical crisis that has far reaching economic consequences, especially for Pakistan and other structurally weak energy importing countries. The crisis in the all-important Strait of Hormuz, which accounts for about 20% of global oil supplies, has cut off more than 90% of tanker traffic, highlighting the vulnerability of global energy markets in the face of geopolitical threats. Crude oil prices have risen to over \$120 per barrel, causing a multitude of supply chain disruptions, global inflation and increased stagflation risk in key economies. Pakistan is highly vulnerable as it imports approximately 85 % of its energy requirements, and this shock has increased the trade deficit, pushed energy prices skyrocket, brought inflation into double digits and curtailed industrial activities and financial stability.

The available research literature provides extensive literature on the broad global impacts of Middle Eastern geopolitical tensions, academic and policy-oriented research specifically targeting Pakistan's economic exposure to this current 2026 crisis remains limited. Current studies often focus on global commodity market movements, leaving a significant gap in understanding how these specific, localized energy shocks translate into long-term macroeconomic volatility within the Pakistani industrial and service sectors. This study argues that the Iran-US conflict significantly affects Pakistan's economy through acute energy shocks, severe supply chain disruptions, and the resulting inflationary pressures that threaten to undermine the country's fragile macroeconomic stability.

Literature Review

Rasool, Wakil, Liaquat and Nawaz (2026) claimed that Iranian economy was one of the most strategically significant economies in West Asia, mostly on its geographical grounds. Iran is located south of the Persian Gulf, bordering the Indian Ocean, with Central Asia to the north, making it an important "corridor" for trade between South Asia, Africa, Europe and Asia. The authors argued that studying only domestic politics in the USA or Iran missed important underlying structural issues in the Middle East and international system that contributed to conflicts about their fundamental national interests. The study analyzed bilateral, regional, and global perspectives on US-Iran relations, as well as Iran's geopolitical tactics in the context of growing US-Israel relations and regional shifts in security interests. It speculated that Tehran follows a "hybrid doctrine" based upon strategic partnership, proxy warfare and deterrence in response to Washington-Tel Aviv military and intelligence cooperation. Recent developments, including U.S. strikes on Iranian nuclear sites and Israel's pressure on Tehran's proxies, heightened Iran's posture and compelled it to pursue a more assertive but restrained line that stressed energy threats, other abilities and selective diplomacy (Khan, et. al., 2019).. At the same time, Iran increased its relations with China and Russia to reduce isolation and improve defense capabilities.

Ahmed and Dadlani (2026) On February 28, 2026, the US and Israel struck Iran to undermine the regime, leading to the appointment of Mojtaba Khamenei as the new leader, and creating tensions for global energy prices and supply chains. Coordinated de-escalation was hampered by fragmented responses from the Gulf States and Pakistan was able to facilitate dialogue between Iran and the US due to its unique relationship with both countries, de-escalating which was essential due to Pakistan's internal pressures such as the Taliban conflict and its economic vulnerabilities. Austerity measures were imposed by the government in March 2026, which included a four day work week for public servants, only a handful of non-essential sectors were allowed to continue working, schools closed for 21 days during the month of Ramadhan and Iftar meals were banned and Prime Minister Shehbaz Sharif announced that the salary of ministers would be suspended and legislators would get a 25% cut. In April 2026, the Education Department implemented energy-saving measures by closing all schools on Fridays, impacting 40 million learners. At the same time,

Pakistan also had a significant mediation role to play by enabling the US -Iran communication with the assistance of China and Egypt and thus strengthened its regional mediation role.

Kori (2026) said that the Iran-Israel-US war had significant impacts on the global macro economy, including in the energy, inflation and trade sectors. The study focused on six key transmission channels: energy market disruptions, inflation pass-through, trade realignments, fiscal stress, defense expansion, and long-term projections to 2030. The Strait of Hormuz was the center of attention, as the incidents resulted in more than 90 percent reduction in traffic of tankers and sent crude oil prices soaring. These shocks caused a general inflationary environment, high interest rates and a slowdown of the economies. The direct impact for those who export hydrocarbons or produce defense goods was lost export opportunities and damaged infrastructure, especially for Iran and Israel. The study also determined that the economic impacts of the war were greater than the military impacts, and the impact on global inflation, national defense spending, and the geography of trade persisted long after the war's end.

Bano (2026) examined that Iran war had a significant influence on Pakistan as it brought with it economic, security and political challenges given its geographical location and long land borders with Iran. Tensions in Balochistan also forced the government to shut down crossings with Pakistan and the region, aggravating separatist ideology among Baloch militants as Iran's influence waned, and thereby jeopardizing the economic stability of the country and its ties with the Gulf Arab states and the U.S. Pakistan was also plagued by military issues from Afghanistan and consequences of the Israel-Iran incident, while hikes in oil prices and escalating border tensions made matters worse for the fiscal condition of the country. Disturbances emerging from sectarian tensions within the region, such as the unrest in Balochistan, undermined Islamabad's diplomatic efforts with its neighbors, especially Iran and the Gulf countries including Saudi Arabia under its military pact with the kingdom. In response to these challenges, Pakistan adopted a policy of strategic diplomacy, economic readiness and strengthening internal unity (Muzaffar, et. al., 2017; Youns, & Muzaffar, 2025).

Mir and Ayub (2026) focuses on the mediatory diplomacy of Pakistan in the US-Iran relations in the context of heightened conflict in the Middle East. The primary issue was the longstanding lack of trust, competition, and dialogue between Washington and Tehran that could have caused the instability in the region and the world. In this regard, Pakistan took the stance of a neutral mediator, tried to defuse the situation, and to avoid escalation. The objective of this research was to find out the analysis of the diplomatic role of Pakistan, its effectiveness as mediator, and how it balanced its strategic interests and affected the peace of the region. Findings revealed that Pakistan was playing a very important role through shuttle diplomacy, hosting the talks and having back channels communication with regional actors like Turkey and Egypt. It had good relations with both the US and Iran, and strengthened its legitimacy as a mediator. But its effectiveness was limited by structural factors such as weak influence and the entrenched geopolitical tensions. The study concluded that the mediations of Pakistan were in line with the diplomatic balancing policy, which was designed to increase the relevance of Pakistan in the region and to ensure stability. While the situation was still up in the air, Pakistan had played an active role in the mediations in resolving the conflicts, this demonstrates the significance of middle power diplomacy in conflict resolution.

Estrada, Park, Tahir and Khan (2020) examined US-Iran conflict and evaluated how the war would affect the behavior of global oil prices. They considered various intensities of the war and simulated the price reactions of oil from the multidimensional point of view with the aid of a new analytical instrument called "War Oil Crisis Simulator" (WOC-Simulator). The study pointed out that the US and Iran have been geopolitical foes since the overthrow of the pro-Western monarchy in Iran by the Iranian Islamic Revolution in 1979,

re-aligning the region's geopolitical forces. The US is the only global superpower, and Iran is a huge oil exporter and has considerable regional influence. Ongoing disagreements over the territory between the two countries in the Middle East, one of the world's main oil-producing areas, was demonstrated to have a high risk of creating an obstacle to the peaceful delivery of oil supplies, potentially leading to global instability in oil prices. The analysis in this light framed the US-Iranian competition as one of the structural causes of oil-price volatility, and the WOC-Simulator allowed for a quantification of the potential size of oil-price shocks given varying intensities of the competition.

Hussain (2015) has pointed out that US-Iran relations had been structurally conflictual since the Islamic Revolution, during which foreign relations had become a key source of conflict. This animosity was rooted in the US hostage crisis, the freezing of Iranian assets and their views on the Middle East security architecture. Both sides made efforts to normalize relations, but there were several obstacles. While several common points existed, bilateral relations were overshadowed by events of the past decade, including the regional peace process, terrorism, and most significantly, the Iranian nuclear issue. There were more challenges from domestic politics in both countries, as well as in the United States with Israel and Saudi Arabia. But a US-Iran détente was more likely due to Iran's changing geopolitical significance, the emergence of the 'Islamic State' and the Joint Comprehensive Plan of Action.

Conceptual Framework

This study suggests that the Iran–US conflict constitutes an external geopolitical shock for Pakistan with several transmission channels. The war disrupts global oil market and international trade flow. This means the prices of fuel keep on rising, the supply of fuel is getting difficult, inflation escalates and energy insecurity prevails in Pakistan.

Table 1
Conceptual Framework of the Study

Transmission Channel	Impact on Pakistan
Oil Price Shock	Increase in fuel and energy costs
Supply Chain Disruption	Shipping delays and higher freight costs
Inflationary Pressure	Rise in food and transport prices
Energy Security Risks	Fuel shortage and electricity crisis

The framework is premised on the fact that government policies – including subsidies, strategic reserves and investments in renewable energy can moderate these negative impacts.

Material and Method

This study uses qualitative and analytical method to analyze how Iran – US conflict affects the economy of Pakistan, specifically supply chain, inflation and energy security. A thematic analysis using secondary data from reliable sources (e.g., academic journals, official publications) indicates that there are profound economic implications arising from geopolitical tensions in the region. The study focuses on the disruptions in the supply chains, inflation trends, energy security constraints, and looks at the trade statistics, oil price fluctuations and policy documents to understand the linkages of Middle East's instability and Pakistan's performance. This approach provides some understanding of the problems created by external conflicts to Pakistan's economic stability and energy sustainability.

Results and Discussion

Energy Security: Vulnerability and Strategic Gaps

Pakistan is highly dependent on imported oil and gas and is heavily dependent on energy for agricultural and industrial activities. The Middle East is responsible for providing

about 50 per cent of the world's energy production, around 80 per cent of Pakistan's petroleum imports and almost 100 per cent of the LNG imports. The ongoing crisis in the area, particularly the closure or part closure of Strait of Hormuz, is a serious problem for the energy security of Pakistan. Since the U.S.-Israel attacks on Iran in February 2026, the price of Brent crude oil has increased from USD 71 to nearly USD 119 per barrel, nearing the USD 147.50 historic high, leaving in particular developing countries without adequate fiscal space like Pakistan. The energy import bill was about 26 percent of total imports in FY25 and continued high oil prices will likely further increase the current account and trade deficits. But already, energy cost, which has been a major driver of increased prices of essential goods, has been a significant contributor to the price increase of essential services. Pakistan's energy demand is highly inelastic which means that the increase in cost of energy imports is directly associated with the increase in import bill and export competitiveness. High energy consuming industries like urea have been compelled to close and/or disinvest because of expensive input costs. Furthermore, high energy prices in Pakistan will also be a burden on the financial sector and production sector due to structural weaknesses and financial constraints, and the sluggish export performance (Shah and Islam, 2026).

Higher import costs also put pressure on government budgets, particularly those that try to buffer the consumer from the price increase by providing subsidies for electricity and fuel. One of the major strategic weaknesses of Pakistan is the inadequate level of strategic reserves, which can provide for only a short term, and, if a lengthy disruption occurs, provide limited policy flexibility. Solar and other renewables have started to replace some of the reliance on imports of hydrocarbons, but they still account for only a small proportion of energy supplies, and do not mitigate the risks of hydrocarbons from the Middle East.

Inflation: Energy-driven rise in food and non-food prices

The consumer inflation rate in Pakistan rose to almost 11% year-on-year in early 2024, signaling that the country has experienced double-digit inflation for the first time in 21 months. The overall rise was mainly attributed to substantial rises in transport and essential food prices. The highest inflation reading of 11.1% had been seen in July 2024.

Although there is some cost relief in wheat and flour prices, the escalating costs are mainly impacting consumers' everyday living costs, and with additional increases in fuel and transport charges, the cost of living is still being taken out of consumers' pockets. The Consumer Price Index (CPI), which measures the prices of goods and services, has been rising, and this has been driven in particular by higher domestic energy tariffs. The closure of the Strait of Hormuz, a vital shipping channel for Pakistan's energy imports, caused energy costs to rise to \$800 million per week from \$300 million before the outbreak of the geopolitical conflict on February 28 has made it extremely expensive for the country. The costs in transport sector rose by 15.47% and perishable food items rose by 15.25% in April. The other sectors, including water, electricity, gas and fuels, housing increased by 2.43%. The State Bank of Pakistan increased its policy rate by 1 percentage point to 11.5% in response to the spiking inflation (Khan, 2026).

Recent data shows month-on-month prices grew by 2.48% in April, while urban inflation was recorded at 11.11% and the rural inflation rate recorded was 10.56%. Food inflation was 6.9% in rural areas and 7.3% in urban areas. The core inflation (excluding food and energy) stood at 8% in the urban domains and 8.5% in rural areas. The price of food commodities in the urban markets showed significant increases in some commodities. There were also significant increases in the non-food sector, particularly for motor liquefied hydrocarbons (+38.34%) and transport services (+27.86%). The cost of living has risen and the government expects an inflation rate of around 7% for this fiscal year. Variability in food price trends continued at the month level, indicating the continued impact on food budgets

as inflation for non-food items has remained above 13% in both urban and rural areas (Desk, 2026)

Food Security: Inflation hits nutritious food access

In 2026, escalation of tensions between Iran, Israel and the United States has caused increased energy and trade scenario of the country and indirectly increased the pressure in the domestic food market by imported inflation. Higher prices of wheat flour, pulses, edible oil, poultry and other essential commodities were partly due to increased cost of transport, processing and utility costs because of increases in international oil and fuel prices, as discussed in the preceding sections on inflation and energy security. Households living in poverty and low-income households saw a loss in purchasing power and dietary diversity, which they had already been spending a large proportion of their incomes on food.

The Pakistan Institute of Development Economics (PIDE) and the Ministry of National Food Security & Research have found that besides low agricultural productivity and climate change related shocks, food insecurity in Pakistan is also influenced by volatile food prices and external economic pressures. According to the Integrated Food Security Phase Classification analysis for Pakistan, in April–September 2026, some 6.7 M people would be in IPC Phase 3 or worse, indicating high levels of acute food insecurity (IPC, 2026). The geopolitical uncertainty and energy-price fluctuations in the region have also added to inflationary pressures in this context, making the energy insecurity-inflation-food insecurity nexus much stronger in Pakistan.

Conclusion

The 2026 Iran-USA conflict has proven to be a critical stress test for Pakistan's external sector, revealing the high sensitivity of Pakistan's supply chain, imported inflation, and energy insecurity. The study demonstrates that geopolitical events in the Middle East spread quickly to Pakistan's trade, price and fiscal situation via disruption of the maritime trade routes, rising oil prices and reduced export competitiveness. The crisis is not simply a short-term balance-of-payments or liquidity problem, but rather a structural vulnerability that stems from over reliance on energy and trade from the Gulf.

The analysis reveals that the trade situation in Pakistan is highly vulnerable to disruption to Strait of Hormuz as it not only increases the cost of shipping services but also causes delays in inputs and adds further uncertainty to the existing trade supply chains. Meanwhile, the rise in international oil prices due to conflict has further pushed up domestic inflation, particularly in the energy-intensive industries, which has limited domestic consumption and export margins. Last but not least, the energy sector is both an input as well as an external-sector liability, reinforcing the importance of a strategic transition towards diversified and locally based energy systems, over import-driven ones.

Based on these results, the paper highlights the need for Pakistan to go beyond short-term solutions and a reactive approach. The country should move towards a coordinated resilience framework that enhances alternative supply routes, including CPEC connected corridors, control of inflation through proper policy and targeted support, and diversification and improvement of energy security measures in the long-term. Pakistan needs to deal with Iran–US conflict in a manner that not only makes it a threat but also a source of structural reform in order to minimize the adverse effects of future geopolitical shocks on its economy and put its external sector on a sustainable path of trade and growth in a world full of uncertainty.

Policy Recommendations

The findings of this study indicate that the upcoming Iran–US war in 2026 has become a structural shock that has exacerbated the external vulnerabilities of Pakistan in many ways like disruption in supply chains, imported inflation, and energy insecurity. Given the above observations, it is suggested that Pakistan should take a resilience approach to deal with the uncertain global order.

Building resilience in and diversifying supply chains

Pakistan's maritime dependence has become evident due to the war related disturbances in the Strait of Hormuz. To minimize this risk, Pakistan needs to diversify its trade routes and enhance land corridors, especially CPEC. Moreover, having buffer stocks of critical inputs and having efficient ports and logistics will reduce shipping disruptions and relieve pressure on foreign-exchange reserves in times of crisis in the Middle East, impacting manufacturing and agriculture.

Coordinating the supply side and fiscal policies for inflation management

Enhancing coordination between monetary and fiscal policy will help Pakistan to mitigate the risks of inflationary pressures from rising oil prices and their pass-through to transport, utilities, and food. Combined subsidy measures for low income groups, and supply side measures reducing energy consumer use and improving energy efficiency and logistics, can help to avoid sudden increases in fuel prices from rocking the transport and export sectors.

Creating secure energy supply in the long term.

Improving energy security requires decreasing reliance on Gulf oil and broadening supply routes and sources. Pakistan needs to work on alternate trade routes (such as Red Sea connected ports) and strengthen its relations with other sources. Meanwhile, investments in hydropower, solar and wind will help to minimize the impact of energy-cost shocks on export-led industries and alleviate the fiscal strain of subsidies. Energy projects from CPEC could be customized to link up renewable energy with industrial zones to improve export competitiveness.

Changing policy to focus on the most efficient export industries

Policy measures need to be increasingly directed at creating an environment that promotes efficient, export-oriented enterprises, and move away from blanket protection to reward efficiency. Pakistan needs to focus more on encouraging value added exports, especially in textiles and agro-processing to ensure that it maximizes its export potential and increases its competitiveness in presence of competition from India and other regional countries.

Combining the three pillars into an overall resilience framework

Last but not the least, Pakistan requires a unified and multi-institutional resilience plan, connecting resilient supply chains, expectation setting and securing energy supplies. To make geopolitical shocks and opportunity for the export-led and external-sector-driven growth that is needed, closer cooperation between the Ministries of Finance, Commerce, Energy, and Foreign Affairs, as well as stronger regional partnership, will be crucial.

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