



The Middle East conflict and a new Paradigm for Pakistan

As the United States (US) and Iran negotiate for an agreement on the opening of the Strait of Hormuz, the effectiveness of policies that can avert a long-term crisis from oil shocks becomes increasingly important. The failure to reach an agreement in mid-April after the Islamabad Talks has created significant challenges for policymakers around the world as they devise strategies to absorb the costs of increasing uncertainties as one of the most crucial water passageways, in terms of its importance to global oil and gas trade, remains blocked to super oil tankers. However, several opportunities arise for Pakistan if the challenges prevail in the Persian Gulf.

Before the blockage imposed by Iran on 28th February 2026, more than 20 million barrels of oil transited the Strait of Hormuz daily, which contributed to 25 percent of global seaborne oil trade and 20 percent of global petroleum consumption as reported by UN Trade and Development. Approximately 20 percent of global LNG supply and 15 percent of refined petroleum products transited through this strait. The Strait of Hormuz also sees a significant proportion of fertilizers, ammonia and sulphur transit through the trade, especially through bulk transporters. The blockade has created significant disruptions in the oil and gas trade, as reflected in price volatility throughout March and April 2026. The price swung like a pendulum with the news on the opening and closing of the strait.

The Brent crude oil surpassed \$120 per barrel as hostilities in the region raged, falling below \$100 per barrel on days when the opening seemed likely. However, several refineries in the region that have contributed to the production of various oil products have been forced shut. While global supply has plunged by 8 million barrels a day, by the International Energy Agency (IEA), the refining capacity was reduced by more than 3 million barrels a day due to attacks on the oil facilities in the region. This has also resulted in a shortage of feedstock, which is critical for several allied industries that depend on fuel products to produce their output.

The International Monetary Fund at the end of March 2026 reported that the closure of the strait was similar to a large tax on income for the residents of oil importing countries. Further, such economies would likely face increasing fiscal burden and rising challenges on their external accounts. Higher fuel costs and electricity bills are likely to erode the purchasing power of households, while the policymakers will be burdened by increasing risk of a balance-of-payment

crisis. Additionally, with supply chains likely to suffer, especially in the agriculture and food sector as transportation costs and input costs that feed on fuel prices rise, low-income countries are likely to face mounting threats to their food security. Therefore, the rising oil prices are not only likely to create challenges in terms of the availability and prices of fuel, the spillovers into several other sectors are likely to adversely impact growth and development in low-income countries that are particularly reliant on fuel imports.



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Pakistan as a net-energy importer faces significant challenges as the uncertainty due to the war rages in the region, blocking the shipment of crucial oil and fuel products into the country. Pakistan imports approximately 80 percent of its total petroleum requirements, with 80% of its crude oil imports and almost all of its LNG imports transit through the Strait of Hormuz. Pakistan imported \$10 billion worth of petroleum products in the first eight months of FY26, which included \$3.7 billion worth of petroleum products and \$3.8 billion worth of petroleum crude. Although, both products reported a decline in import value of 6 percent year-on-year, they reported an increase in quantity terms of 3.7 percent and 16.6 percent respectively highlighting the fall in oil prices during the course of the year. Further, Pakistan also reported a 26 percent decline in the import value of LNG and 4 percent decline in the import of LPG, signifying the drop in demand for the aforementioned products even before the start of the regional war. The supply line of crucial petroleum products for Pakistan is choked with the blockage of the Strait of Hormuz, which can have significant implications for the fragile economy.

However, the current account surplus reported in March 2026 is primarily due to fall in imports of petroleum products as they decreased from \$1.2 billion in February 2026 to \$980 million in March 2026. This provides a breathing room for the



policy-makers. However, with headwinds increasing as oil prices rise, imports of oil products are likely to become more expensive, particularly those that are more scarcely available in the market. According to a recent study by the Pakistan Institute of Development Economics, a \$10 increase in the price of oil can increase the import bill of Pakistan up to \$2 billion, while a three-month closure of the Strait of Hormuz driving the oil prices up to \$150, can lead to a monthly oil import bill of \$4.5 billion. Further inflation would increase from 7 percent in February 2026 to 15 percent by the end of the fiscal year. The prices at the petrol pumps have already witnessed substantial increases, which will contribute towards increasing logistics and transportation costs. With diesel powering not only energy but also transportation and agriculture sectors, rising oil prices have a spiraling effect on the economy. This will be exacerbated by increasing risks of shortage as the government may need to divert the limited supply of fuel towards more essential sectors and services, creating a mounting challenge as stakeholders face rationing of fuel supplies. The increased loadshedding is a major step towards such rationing.

Fuel products constitute approximately a quarter of total imports of merchandise into Pakistan according to the World Bank's World Development Indicators. This share is likely to increase with the rise in fuel prices. Not only is Pakistan's energy needs fulfilled via imported fuel products, majority of the imports of such products transit through the Strait of Hormuz. Therefore, it is imperative for Pakistan to undertake policy reforms that reduce the dependency on oil imports. The solar revolution in Pakistan that changed the dynamics of the power sector is an example of such forward-looking policies that reduce the dependency on imported oil. Increasing availability of renewable energy options such as solar and wind have provided opportunities for countries dependent upon imported fuel products to invest in indigenous sources of renewable energy. Such investments not only lower the possibility of a balance-of-payment crisis driven by rising fuel prices but also reduce the impact on the economy from regional conflicts. According to the World Resources Institute, Pakistan imported more than 17GW of solar photovoltaic panels in 2024, while cumulative solar panel imports between 2019 and 2025 surpassed the total installed capacity in Pakistan. Tax incentives and duty waivers made solar adoption affordable, as rooftop solar

systems were adopted throughout the country. This spurred a revolution as solar systems were not only installed by richer households facing increasing costs of unsubsidized electricity but also by the poorest households which were not connected by the grid. Farmers were provided with low-cost electricity to run their pumps, which were previously run by high-cost diesel. Further, underserved areas with limited access to electricity were able to benefit from electricity generated by the solar panels.

Apart from the benefits of the solar revolution, another opportunity is emerging for Pakistan due to the regional conflicts. Pakistan witnessed a surge in transshipment since the start of the war as the blockade in the Strait of Hormuz reduced shipping traffic from the ports in the Persian Gulf, diverting several of them towards Karachi Port, Port Qasim and Gwadar. The shipping lines are rerouting their routes to Pakistan in order to avoid risk premiums and bottlenecks in the Persian Gulf. Pakistan reported a historic increase in cargo handling in the first quarter of 2026. Karachi port handled a total of 8300 transshipment containers in 2025. This was surpassed in a 24-day window in March 2026 as Pakistan reported an increase of 1400 percent in transshipment. The number surpassed 11,000 in the month of March 2026. Port Qasim handled 900 containers in a single day, with more than 4,000 TEUs in a single month. There is a surge in traffic into Gwadar Port as well, reviving the possibilities of converting it into a regional hub as proposed under CPEC. The government has significantly slashed port transport charges and allowed terminals located away from ports to handle transshipment cargo. This will encourage larger ships to berth at Pakistani ports, while smaller ships with lower insurance risk premium to commute between Pakistan and the ports in the Persian Gulf. The development of transportation and logistics facilities in Pakistan will likely provide newer opportunities for Pakistan to become a regional hub as planned under CPEC.

Therefore, several opportunities are emerging alongside the rising challenges. It is up to the policy-makers and the government to ensure that these opportunities are channeled better to improve the welfare of the citizens while dampening the constraints and pressure on the economy due to the mounting challenges.

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