



# Pakistan's Response to the 2026 Oil Shocks

The US-Iran 2026 war is a canonical instance of an asymmetric geopolitical shock with asymmetric transmission, with a heavy impact on emerging economies dependent on imports. In the case of Pakistan, which is by its structural design a country dependent on imported energy supply, Gulf remittances and foreign multilateral financial aid, the war had an immediate and ripple effect on its currency and price stability. This paper will thoroughly and critically examine the currency risk and inflation risk that are facing Pakistan after the war. Using high-frequency macroeconomic estimates, IMF and World Bank estimates and a comprehensive review of recent empirical research evidence, the analysis shows that a combination of a skyrocketing oil import bill, an enhanced exchange rate pass-through, and limited external financing reversed the hard-earned disinflationary success under the Extended Fund Facility (EFF).

Although the diplomatic effectiveness of the April 2026 ceasefire, which was orchestrated by Pakistan to a certain degree, provides relief against the extreme tail-risk situations, the article argues that the structural vulnerabilities remain. Findings highlighted the imperative need to entrench sound currency risk management systems, expedite the transition out of energy and upgrade the domestic financial market, guided by cost and management accountants, policymakers and financial strategists to protect the real economy from exogenous shocks in the future.

## Introduction

On 28 February 2026, the US and Israel launched a major military operation targeting Iranian nuclear and military installations pushing tensions in the region to the point of full-scale warfare (Hussain, 2026). The direct result was an effective lockout of the Strait of Hormuz — a strategic waterway over which about 20 percent of world seaway crude oil and much of liquefied natural gas (LNG) passes (Qadir, 2026). For Pakistan, which sources over 80 percent of its imported petroleum, and most of it through this chokepoint, the shock was both acute and immediate (Qadir, 2026).

The war broke out at a very sensitive point in Pakistan's economy. The nation had a fragile macroeconomic stabilization with the International Monetary Fund (IMF) in the one-year Extended Fund Facility (EFF), after the worst economic downturn in the nation's history in 2023, with inflation hitting highs of 38 percent, foreign reserves depleted below \$3 billion and the rupee falling to PKR 307/USD (Tresmark, 2026). By early 2026, the inflation had also been put in check to 5.8 per cent, the current account turned to surplus for the first time in 14 years, and the rupee had stabilized at PKR 280/USD (Mettis Global, 2026; Pasha, 2026). However, it was a delicate balance especially because it was extremely dependent on a thin-silver line of external variables such as steady oil prices at or under \$70-80 per barrel, unbroken flow of remittances from the Gulf, and multilateral lender support.

The following critical research question is addressed in the article: How can the US-Iran 2026 geopolitical shock be transmitted onto the macroeconomic stability of Pakistan, by way of currency depreciation and imported inflation? Adopting a multi-method approach that incorporates high-frequency economic factors with an overview of the modern empirical evidence, the article shows that the conflict is a strong exogenous stress factor that exacerbates the structural vulnerabilities of Pakistan. To the audience of the CMA Journal, which consists of cost accountants, financial managers, and corporate strategists, the given analysis will present crucial evidence of how external shocks are transmitted and the paramount importance of building financial resilience in the context of increased geopolitical instability.



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## Literature Review

The nexus between geopolitical risk (GPR) and macroeconomic instability in emerging economies has attracted significant academic interest. Caldara and Iacoviello (2022) constructed a GPR index that shows a strong negative relationship between increased geopolitical tensions and economic activity in developing countries. In the case of net-energy importers, the major transmission mechanism is in the form of commodity price shocks and consequent exchange rate pressures (Ahmed et al., 2023).

The country-specific studies based on research in Pakistan have been pointing to the asymmetric and pernicious impact of external shocks on the macroeconomic fundamentals of the nation. Sardar and Hyder (2022) set up in SBP Working Paper, that the origin of the oil price shock would have a significant influence on inflation dynamics, with geopolitical supply shocks showing more persistent and pronounced effects on domestic pricing than demand-induced oil price increases. This observation is especially relevant to the interpretation of the 2026 war, which is a canonical supply shock caused by the destabilization of key maritime transport corridors.

In addition, a granular analysis by the Modelling Lab of Lahore School of Economics (2025) of the effect of external shocks on the prices of retail and wholesale products in Pakistan showed that the exchange rate has the greatest pass-through effect on domestic inflation compared to all other external factors. This empirical evidence is supported by a larger work on the South Asian economies and has established that exchange rate pass-through (ERPT) is less than complete in the short run, however, in countries with high import coefficients and low monetary policy credibility, the pass-through tends to be higher and more complete (Springer, 2023). Within the specific circumstances of Pakistan, analysts have estimated that a 1 percent depreciation in the exchange rate leads to a 0.41 percent rise in inflation in the first six months, peaking at 0.30 percent in the 12th month (INP, 2024).

Hasnat and Siddiqui (2025) have provided a strict analysis of the role of geopolitics in triggering foreign exchange crisis in Pakistan and demonstrated that the fall of Kabul in 2021 was a major cause of the FX crisis in 2022-2023. Their results highlight that political and military shocks in the vicinity of Pakistan promptly translate into capital flight, loss of foreign currency in the formal banking system and an increase in pressure on the rupee.

## Empirical Analysis: Mechanisms of Transmission of 2026 US-Iran Shock

**1) Energy Price Channel:** The US and Israeli assaults on Iranian energy infrastructure on 28 February 2026 and

the ensuing closure of the Strait of Hormuz on the same date, triggered a sudden re-evaluation of the international energy benchmarks. The conflict saw the price of Brent crude crept over \$105 per barrel within days, and intraday spikes hit \$115-116 per barrel, in early March 2026 (Qadir, 2026; Lokmat Times, 2026). At the same time, the price of imported LNG rose to \$8.72 per MMBtu, driven by disruptions in Qatari gas fields (Trade Chronicle, 2026).

In case of Pakistan, it corresponded to an immediate and significant growth of the import bill. According to an analysis conducted by the Pakistan Institute of Development Economics (PIDE), every ten dollar rise in world oil prices adds about \$1.8-2.0 billion per year to Pakistan's petroleum import bill (Qadir, 2026). With crude prices potentially staying at \$120-150 per barrel in the long run, the monthly import bill in Pakistan might hit between \$3.5-4.5 billion which will quickly deplete the foreign exchange reserves and put a tremendous strain on the rupee.

**2) Exchange Rate and Competitiveness:** Before the war, the Pakistani Rupee had been relatively stable at around PKR 280/USD with the help of tight monetary policy, favourable interest-rate spread, and IMF disbursements (Mettis Global, 2026). Nonetheless, a sharp rise in the import bill due to the war on the one hand, and a worsening of the current account, which had already accumulated a new deficit of \$1.17 billion in the first half of FY26, on the other, has put the rupee under renewed pressure.

Although the rupee has not (as of April 2026) fallen, like in 2023, in a dramatic collapse, it is balancing on a tightrope between stability and gradual decline (Mettis Global, 2026). Intervention by the State Bank of Pakistan (SBP) has helped to smooth volatility and anchor expectations but pressures are also mounting in the background. Fitch Ratings had already estimated a gradual depreciation of the PKR to PKR 295, upon completion of fiscal year 2026 (Pakbanker, 2025), and the war is likely to accelerate that rate. According to the observers, the IMF forecast on 2025-26 is projected to have the rupee plummeting by over 12 percent by June 2026 (Lokmat Times, 2026).

The connection between oil prices and currency devaluation is thoroughly developed in the literature. The SBP studies have shown that the real effective exchange rate (REER) devalued in response to a rise in global oil prices, even at times when the world is recovering after oil prices have fallen (SBP, 2024). A declining rupee, conversely, increases the price of imports to the country such as fuel, machinery and intermediate inputs and thus fuelling inflation and creating a vicious cycle of currency weakness and price shocks.

### 3) **Inflationary Forces and Reversal of Disinflationary**

**Gains:** The direct effect of the geopolitical shock, the most tangible and immediate, has been the re-emerging inflationary pressures. After the Russia-Ukraine war, Pakistan had plunged into an agonizing inflation crisis, reaching its peak at CPI of 38% in May 2023 and then back to 2.4% in January 2025 and, finally, to 5.8% in January 2026 (Dawn, 2026; Pasha, 2026). By February 2026, when the Strait of Hormuz was virtually shut down, however, inflation had increased to 7.0% and by March 2026, it was rising more rapidly at 7.3% year-on-year (PBS, 2026).

The causes of this new burst of inflation are clear and can be directly linked to the conflict. According to the PBS data, the increase in motor fuel prices by 18.01 per cent on a monthly basis in March 2026 had been preceded by rise in electricity charges by 5.08 per cent, with the overall effect trickling down to transport-based services (up 9.15 per cent) and food commodity prices, with wheat and wheat flour registering an annual increase of 34%. PIDE has forecasted that during an extreme oil shock, the headline inflation in Pakistan would rise to 15-17% (Qadir, 2026).

Not only does this inflationary resurgence weaken household purchasing power (disproportionately affecting low-income and middle-income groupings, who are forced to spend more of their budgets on food and energy), but also risks the loss of macroeconomic stability won over years under the IMF programme. Increased inflation would require a more restrictive monetary policy stance, which would, in turn, undermine growth opportunities in terms of private investment and economic growth.

4) **External Sector and Remittance Risks:** Although initial signs showed that remittance inflows from the Gulf have been surprisingly resilient with the March 2026 inflows reaching \$3.83 billion, the highest figure of the fiscal year so far (Dawn, 2026), the medium-term prediction is still unclear. The Middle East, especially Saudi Arabia and the UAE, is the source of about 54 percent of the total remittances in Pakistan (Dawn, 2026). A drawn-out war may disrupt the economic activity in the Gulf, as Pakistani expatriates lose their jobs and it is possible that workers might be sent back to their countries. According to a study conducted by the Bureau of Emigration, only in the first half of 2025, an excess of 336,000 Pakistanis immigrated to seek foreign employment, and should such a trend reverse, it would additionally burden the domestic labour market and foreign exchange allocation (CASS, 2025).

Moreover, another weakness is the external debt of Pakistan, which stands at \$130.8 billion (as of the end of 2023) (World Bank, 2025). A combination of an expanding current account deficit, increased interest payments on dollar-related debt as a result of a stronger U.S. dollar, and less fiscal room provide a fragile external financing condition. The IMF's timely \$6 billion loan package granted in April 2026 offers a limited liquidity buffer, yet it is subjected to extensive conditionality, which involves keeping a primary fiscal surplus and expanding the tax base (News of Bahrain, 2026).

### Policy Recommendations and Strategy towards Resilience

The US-Iran war in 2026 is an eye-opener to how much Pakistan is vulnerable to geopolitical shocks of the outside world. To the community of cost and management accountants (CMA) as well as financial professionals a number of strategic imperatives emerge:

- 1) **Institutionalizing Currency Risk Management:** Companies should go beyond reactive hedging and move towards comprehensive enterprise risk management (ERM) systems formally grounded in geopolitical scenario analysis. This involves the application of forward contracts, currency options, and natural hedging mechanisms (such as matching foreign currency revenues and liabilities) to reduce exposure to exchange rate fluctuations.
- 2) **Accelerating the Energy Transition:** The high price of imported fuel underlines the strategic and economic importance of diversifying the Pakistan energy mix. Indigenous renewable energy sources such as solar, wind and hydropower are not only beneficial in lowering the import bill and current account, but also help in cushioning the economy against future changes in the oil prices. The government should provide incentives to corporations to invest in renewable energy through accelerated depreciation allowances and tax credits.
- 3) **Enhancing Remittance Formalization and Diversification:** Remittances have shown impressive resilience; however, policymakers need to further focus on formalizing inflows by having formal channels of banking transfers and avoid over-dependence on a particular geographic region. An expansion to European and emerging labour markets, as planned by the government in their URAAN Pakistan plan is a wise long-term move.
- 4) **Deepening the Domestic Debt Market:** To lessen undue dependence on external commercial borrowing and high-priced Eurobonds, the internal debt market needs to be made more profound and liquid. This would be a stable source of non-inflationary financing to the government and a lower exposure to exchange rate risk.



**5) Active Monetary and Fiscal Coordination:** SBP should be alert in its approach to inflation expectations and avoiding de-anchoring of inflation expectations. The only solution to safeguard society against the retrogressive consequences of energy and food inflation is to have a tight monetary policy coupled with fiscal responsibility and a targeted social safety net (i.e. through the Benazir Income Support Programme).

## Conclusion

The US-Iran War (2026), in which a diplomatic ceasefire has reduced the intensity of fighting, has unveiled the fault lines which permeate Pakistan's economy. The shock has spread swiftly in energy prices, the exchange rate, and the external account and undone months of hard-achieved disinflation and put the rupee on a process of managed depreciation. This conflict confirms an emerging empirical literature that identifies the asymmetric and overstated effect of geopolitical shocks on another economy, which relies on imports, particularly in the case of emerging economies.

In the case of Pakistan, the way of the future requires a complete reassessment of its economic policy. Periodic IMF bailouts and the vagaries of international commodity markets are not the basis of long-term growth. The country needs to embrace the analytical and strategic skills of its financial sector personnel, especially CMAs, in order to develop a more robust and shock-resilient economic framework. This does not just involve dealing with short term currency and inflation risks, but also includes the more fundamental structural changes required to turn Pakistan into a shock-absorbing rather than shock-amplifying economy. The 2026 shock is a wakeup call; how Pakistan responds will determine whether it can finally overcome its history of frequent external crises.

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