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Major Country Risk Developments April 2026



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Overview

The U.S. and Iran have agreed to a two-week truce in the war in the Middle East. Both sides now have a chance to come to terms and avoid further escalation. Hopefully, this gives peace a chance.

Six weeks into the 2026 Iran War, oil prices have risen by 55%. Gasoline jumped by 20% per gallon, and heating oil and jet fuel soared even higher. Many countries have begun to ration fuel, shorten workweeks, and close factories. It has become clear that until the Strait of Hormuz reopens, prices will climb, boosting inflation, and weakening global growth expectations for this year.

This crisis may appear to be unprecedented, but its contours are familiar. In 1973, OPEC embargoed oil

exports to countries supporting Israel in the Arab-Israeli war, causing price spikes that traumatized U.S. and global consumers, contributing to high inflation and slow growth. The 1973 crisis also inspired efforts to avoid another such shock. Governments took steps to reduce their reliance on imports, build strategic stocks, and pursue greater cooperation and market integration. Over time, policymakers grew more comfortable trusting their countries' energy security to global markets.

Still, the world never escaped the reality of oil geopolitics. Analysts and officials had warned for decades that the Strait of Hormuz was vulnerable; its closure had been the crisis scenario that most feared. The relative ease and speed with which the entire global economy has been



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put in jeopardy, seemed to come as something of a surprise. Even though Iran is badly outmatched militarily by the U.S. and Israel, it has managed to exert effective control over shipping through the Strait. That alone was enough to cause economic uncertainty, and subsequent Iranian and Israeli strikes on other key energy installations in the region have only exacerbated this crisis.

Seeing the vulnerability of global energy markets laid bare, governments around the world have begun reassessing their exposure. In the 1970s, many concluded that cooperation and market integration could help protect against the weaponization of energy. In the current fragmented, conflict-prone world, many may draw the opposite conclusion. Over the past few years, governments have watched—and suffered the consequences—as Russia cut off most gas supplies to Europe following its invasion of Ukraine; as China restricted exports of the rare-earth elements used in clean energy, defense, and other vital technologies; and as the United States blocked Cuba's and Venezuela's energy trades. The latest shock in Iran will further deepen skepticism of globally traded energy supplies and inputs, whether hydrocarbons moving through maritime chokepoints or critical minerals and raw materials moving through international supply chains.

As integration begins to look like a strategic liability rather than a source of resilience, governments will likely try to exert control over their energy systems and insulate their countries from global markets. But there is no cheap or easy path to self-sufficiency—and the world may soon be reminded that the pursuit of energy self-sufficiency is fraught with risks.

Over the past four decades, many countries hoped to escape the turbulence of oil politics. Following the crises of the 1970s, major importers moved to reduce oil demand and better prepare for disruption. Countries replaced oil with coal and nuclear power in electricity generation, built strategic reserves, improved the quality of energy data, removed price controls, and created the International Energy Agency [IEA] in 1974 to coordi-

nate responses. These changes helped make oil markets more flexible, more transparent, and better able to absorb shocks as market-based pricing allowed physical flows to adjust in response to disruptions.

In recent decades, policymakers in advanced economies have taken energy security for granted. Energy price shocks became infrequent and brief, electricity demand was mostly stagnant, clean energy sources offered opportunities for diversification, and the U.S. shale revolution brought a surge of new oil and natural gas onto the market. Fears of discord and disrupting supply receded as the geopolitical environment grew to favor cooperation and as economic integration deepened.

The U.S. began believing it could overcome past energy vulnerabilities. Four decades ago, the U.S. imported 60% its oil. Leaders urged that the country make its reliance on Middle Eastern supplies a thing of the past. Now, however, uncomfortable realities have overtaken the optimism of earlier decades. To begin with, the world still overwhelmingly runs on fossil fuels. Even with the expansion of clean energy, fossil fuels continue to supply more than 80% of global energy as demand continues to grow. Although oil markets are more integrated and the global economy is less oil-intensive, shocks still happen and can be painful. Because oil is traded on a global market, price increases affect the price at the pump for everyone, regardless of whether a country is a net importer or exporter.

Shocks to natural gas supply reverberate across Asia and Europe, although the U.S. is largely insulated from them. Because there is a fixed amount of infrastructure to export U.S. liquefied natural gas and it tends to run at full capacity, U.S. producers cannot turn additional gas into LNG to sell overseas at higher prices, and they must sell it at lower domestic prices instead.

For the U.S., the current crisis has underscored that energy superpower status does not eliminate vulnerability to geopolitical upheaval. Even though the U.S. produces more crude and oil products than it consumes, it remains



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tied to global markets. U.S. oil producers may benefit from higher prices, but households and energy-intensive industries do not. Iranian strikes on petrochemical facilities and on Israeli-linked vessels in Kuwait, Bahrain and UAE underscores Iran's ability to fight back.

The disruption to Middle Eastern supplies is just the latest example of a growing trend of energy weaponization. It is not just oil and gas flows that are at risk; China's dominance in the emerging clean energy economy gives it plenty of levers to pull. As great-power rivalry intensifies and the international economic order fragments, countries are increasingly willing to exploit the dependence of others on global energy markets, using sanctions, export controls, cyberattacks, and maritime pressure to advance foreign policy objectives.

These tactics are on display early in 2026—and not just in the Gulf. In the Western Hemisphere, the U.S. issued sanctions and intercepted tankers to restrict fuel shipments to Cuba, exacerbating shortages on the island while turning up the pressure on the government.

In the run up to the U.S. capture of the Venezuelan President in January, the U.S. set up a blockade to stop Venezuelan oil exports. Following Maduro's seizure, U.S. announced that Venezuela's new leadership would be turning over the country's oil to it. When the U.S. eased sanctions on Venezuelan oil in March, the waiver explicitly excluded transactions involving the U.S.' chief geopolitical rivals, China and Russia, among other adversaries. There is little reason to expect energy crises to taper off in the future. Drones and cyberweapons have made disruption cheaper, easier, and more sustainable. Iran has demonstrated that even a relatively weak power can cause global economic harm by threatening infrastructure and chokepoints.

Meanwhile, the norm against targeting civilian energy infrastructure is eroding, as evident in Russia's attacks on Ukraine's electric grid. Examples include Russian-linked cyber-operations against energy networks, such as a 2021

attack on a U.S. gas pipeline; the 2025 attack on Poland's power grid, and threats to attack Iranian power stations. There are now many ways to constrict energy flows. Shipping, insurance, finance, and payment systems can all become targets; directly attacking production is not the only way to cause disruption.

Clean energy offers no refuge from these geopolitical risks. China controls much of the world's critical mineral processing and dominates supply chains for solar panels, wind turbines, batteries, and electric vehicles. When China restricted rare-earth exports in 2025 in response to U.S. export controls, it sent shock waves through U.S. and European capitals. Automakers on both sides of the Atlantic struggled to secure parts, some production was interrupted, and European prices for key components of electric vehicles soared. The lesson was clear: dependence can be weaponized in the clean energy economy just as easily as it is in the fossil fuel market.

Meanwhile, unless peace talks advance at a fast clip, traders expect record high prices for specific grades of Middle Eastern crude cargos will soon cascade in the U.S. and around the globe.

Iran

After destroying military outposts, navy vessels, weapons factories and what was left of Iran's nuclear facilities, U.S. and Israel say they now plan to target the engines of Iran's economy. The goal of such strikes is to disrupt daily life and reduce the regime's tax revenues, which should hamper its ability to fight and, should it survive, ever rebuild its nuclear program.

Strikes against civilian targets are controversial—and illegal in most circumstances under international law. They may also fail in their primary objective. That is because the Iranian regime and the Islamic Revolutionary Guard Corps (IRGC), draw little strength from the civilian economy, which has long been in a dire state. Their activities are funded by a commercial empire, and war



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has been good for business. Soaring oil prices are boosting revenues, as is the Guards' ability to benefit from shipping and trade disruptions.

For ordinary Iranians, life was already painful owing to years of Western sanctions and, last June, 12 days of Israeli bombardment. The economy shrank last year and six in ten people of working age are considered unemployed, which prompted protests against the regime in January. The 11,000 strikes carried out by the U.S. since late February have brought daily existence to a halt. Some projectiles destroyed university buildings, apartment blocks and banks next to military installations. An internet blackout administered by Iran to prevent further demonstrations has squeezed the services industry, which once employed half the workforce. The government claims that 7 million people, or one in four workers, have volunteered for military service.

Foreign goods are becoming as scarce as employees and information. Iranian oil tankers are sailing freely through Hormuz, keeping energy exports flowing. But

the flow of goods from Asia and the Gulf to Iran that had arisen despite the threat of U.S. secondary sanctions has all but stopped. The United Arab Emirates (UAE), which was the source of nearly a third of Iranian imports in 2025, has not sent a single ship since it became the target of Iranian retaliation in the first days of the conflict. It has also closed its borders to most Iranians and stopped turning a blind eye to the thousands of shell companies in Dubai which helped Iran evade Western sanctions. Emirati authorities have arrested dozens on money-laundering charges and are said to be mulling freezing billions of dollars in Iranian assets.

The Iranian Rial, already nearly worthless, has fallen by another 8% against the dollar on the black market since the war began. Annual inflation was just under 50% on the eve of war, and prices have risen by another 6%, according to the central bank. The government has done little to cushion the impact of lost jobs or higher costs. Policymakers have printed cash to cover deficits for decades. Now, the printing presses are whirring once again. The war runs on funds from the regime and the IRGC,



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whose income has been insulated from the broader Iranian economy. Fighting is financed thanks to a sprawling portfolio, with proceeds coming from three main areas: 1) oil sales, 2) domestic manufacturing and 3) illicit trade. As Iran becomes locked away from the outside world, all three are booming.

The IRGC processed half of Iran's oil exports in 2025, worth at least \$30 billion. The government once allocated funding to the armed forces but sent oil in lieu when the economy ran into trouble. As the Rial has weakened, and other public spending has become nearly worthless, the value of the army's oil bounty has grown—both in real terms and relative to the rest of the shrinking economy.



An efficient machine has been built to deliver shipments, most of which go to China, and process payments while evading sanctions. Thousands of shell companies and money exchanges buried deep in banking systems in Russia and China make deals so complex that tracing them is reportedly nearly impossible. Iran's central government has handed over more barrels of crude than usual to the IRGC in the past month.

All that has helped the IRGC become the chief Iranian profiteer from rising global oil prices, as evidenced by their increased revenues reported in recent financial

disclosures. Despite the war, Iran is exporting at least as much as it averaged last year and earning twice as much. If the IRGC controls the same portion of oil it did a year ago, it could be capturing half of that revenue. That is enough to cover the costs of fighting for a few months.

Domestic firms are a second source of finance. Each of the IRGC's five branches owns sprawling conglomerates that have stakes in half of Iran's firms, according to officials. These businesses do everything from constructing pipelines to selling houses. IRGC also controls most of Iran's diversified manufacturing industry. According to U.S. officials, they are linked to the Bahman Group, once the manufacturer of Mazda cars in Iran, Sina Food Industries Development, one of the country's biggest producers of processed food, and several pharmaceutical companies.

The IRGC's manufacturers are benefiting from the sudden absence of foreign competition and wartime price rises. Iranians normally favor higher-quality goods from Asia, the Gulf and Russia. Now, they have no choice but to turn to homegrown products, stoking demand. Western officials expect IRGC-linked firms' profits from cosmetics and processed food to have doubled in a month. Other firms are smelting steel and aluminum, and making mechanical parts, prices for which have jumped in the past month. The IRGC's aluminum facilities are also now raking in more than before the war.

Rising prices have boosted the IRGC's income from illicit trade. The Guards run ports, airports, and border crossings, which gives it a near-monopoly over such trade. The weakening of Iran's regional proxies such as Hamas and Hezbollah, which once helped run a network that smuggled cigarettes, drugs and food inside weapons shipments into and out of Iran, is a blow to supplies. However, disruption to shipping has added a premium to smuggled goods, and given an advantage to Iranian traders, which can pass through the Strait with relative ease. Israeli officials reckon that IRGC's smugglers will be earning more from its international narcotics business. The IRGC is also planning a formal toll of \$2 mil-



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lion for every ship passing through Hormuz. Even if traffic resumed to half of pre-war levels of about 140 vessels a day, this would add up to \$50 billion a year.

The Emirati crackdown is an inconvenience for the IRGC but not a big blow. Only a small share of the Iranian money stashed away in Dubai belongs to the regime, which has long been wary of the UAE's closeness to America, according to American officials. Oil and arms payments are mostly processed through China's banking system, which also stores the central bank's reserves. Additionally, Iran's domestic payment system, Shetab, is now linked to Russia's Mir system, which means that banks have been able to make transactions without worrying about extra sanctions. It shows that these basic payment systems work in a crisis, even if they are not changing the financial system.

Khatam al-Anbiya, the IRGC's biggest conglomerate, controls factories that churn out goods deemed important for national security, some of which are exported to China and Russia. Its weapons factories have come under heavy fire since the start of March. Iran's two biggest steel mills closed on April 2nd after strikes, knocking out nearly 70% of production capacity. Israeli officials believe that the blackout in Tehran, which Iran blamed on Israeli strikes, may be the first instance of the regime

saving power for its factories and oil infrastructure.

A U.S.-Israeli assault on Iran's civilian targets may wreck what is left of the economy and cut further into Iran's ability to produce weaponry with which to fight. Still, it may never eliminate the IRGC's financial firepower unless it goes after Iran's oil. The Iranian regime has threatened to respond by setting the Gulf's energy infrastructure—and world markets—ablaze. It has also made it clear through its actions that, short of such a conflagration, it is prepared to let ordinary Iranians withstand the worst of the war's economic pain.

Looking Ahead

Aware of the vulnerabilities in both traditional and clean energy systems, governments around the world have been feeling a growing pull towards energy self-sufficiency. The ability to meet one's own energy needs. The energy crisis provoked by the Iran war may sharply reinforce this impulse.

Governments were already intervening more directly in energy markets and in individual companies' decisions before the current war in Iran. The fallout from the conflict is likely to push them even further toward state





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capitalism. When energy supplies were first disrupted, governments worked through the IEA to coordinate the release of global oil stocks to stabilize markets. The trend toward government intervention goes far beyond such emergency measures. Governments that are more reluctant to place their faith in interconnected markets to allocate energy supplies will instead place greater emphasis on control over domestic production, supply chains, infrastructure, and even trade routes. The goal will not simply be to diversify sources of supply or expand reserves—which have long been the pillars of the energy security strategies of most countries—but to reduce exposure to global energy systems as much as possible.

The drive to reduce exposure to risky oil and gas markets will also give renewed momentum to efforts to find alternative energy sources and run more of a country's economy on electricity that can be powered from domestic sources. There will be more efficiency improvements, reduction of oil use as more electric vehicles enter transportation networks, and substitutions of gas with solar, wind, nuclear, or coal power.

China has already been moving in this direction, even if it is still far from realizing true energy self-sufficiency. The current crisis has been painful for Beijing: roughly half of China's crude oil imports and one-third of its liquefied natural gas imports must transit the Strait of Hormuz. However, after two decades of aggressive electrification—electricity now accounts for more than 30% of China's final energy consumption—and a massive expansion of domestic power generation from coal and renewable sources, China is better positioned than it would otherwise have been to absorb external shocks to oil and gas supplies.

The massive buffer of strategic oil reserves China has built up is a big help. Meanwhile, the U.S. has been selling off its stockpile. Now, Beijing is likely to accelerate its electrification of transport and industry, pursue even larger domestic and overseas sources of critical minerals, and continue expanding its reserves, grid infrastructure, and storage.

Europe faces more difficulties in satisfying its energy needs. The continent's leaders were already deeply motivated to reduce their countries' reliance on imported oil and gas after Russia's 2022 invasion of Ukraine, and the Iran war will reinforce that commitment. Nonetheless, a European strategy based on electrification and the expansion of domestic power generation using renewable sources also carries risks, because it would increase the continent's dependence on Chinese-dominated clean energy supply chains. In trying to escape one form of geopolitical exposure, Europe may have to accept another.

Energy sufficiency may find greater appeal in the United States. Americans who have long been promised energy independence, may feel confused and betrayed by the scale of the shock caused by the turmoil half a world away. This may multiply demands to restrict exports and prioritize domestic supply, to disconnect the country from global oil markets—effectively trying to replicate the dynamics of the gas market, in which U.S. prices can remain low while prices elsewhere soar.

Restricting U.S. oil exports might briefly lower domestic prices, but it would also discourage production and refining at a time when more supply is needed. It would undermine the credibility of the U.S. as a supplier and invite retaliation from trading partners. Because gasoline is still priced in a global market, keeping crude oil at home would do little to insulate consumers from price shocks. Trying next to ban exports of gasoline and other refined oil products would cause even greater collateral damage, since refiners would cut back their output, further curbing domestic supply.

Asia

In Asia, swift changes are evolving as this conflict persists. The impact of the ongoing war in the Persian Gulf is being felt oceans away. The war has triggered "an Asian crisis" according to Singapore's foreign minister.

Asian economies are firing up coal plants and increasing production to reinforce energy supply fears of a pro-



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tracted war in the Middle East that would raise the threat of long-term disruption to oil and gas flows. The region leads the world in liquefied natural gas imports—chiefly China, Japan, South Korea and India—and many Asian countries are dependent on the Strait of Hormuz. Poorer economies are being hit the hardest. In the Philippines, more than 90% of energy imports come from the Middle East; Bangladesh, India and Pakistan receive almost two-thirds of their total LNG supplies via the Strait of Hormuz.

Richer Asian countries are not immune. Japan boasts a strategic oil reserve equivalent to 8.5 months of domestic demand, a buffer built up following the oil shocks of the 1970s. But Japan's bus and ferry services across the country have now been curtailed for lack of supply. Businesses are struggling to make ends meet as fuel costs jump; several companies across the country have announced temporary or permanent closures. Manufacturers and food suppliers had to temporarily stop production and supply of various consumer items after running out of heavy oil for fryers.

The Strait's closure presents risks to Asian economies. Rising fuel prices have increased costs across sectors, crimping growth, and potentially causing a stagflation spiral. The immediate pain is being felt by motorists across the region, but especially in South-East Asia. Asian customers of Middle East crude are scouring the world for similar varieties of crude to keep churning out diesel and jet fuel.

Globally, petrol prices have risen by approximately 20%-25% since the war began, however in South-East Asian countries, the figure is 42%. Prices in the Philippines and Myanmar have shot up by more than 70%, one the biggest jumps in the world.

In India and Bangladesh, the price jump has not yet been felt at the pumps—only because their governments control fuel prices. On March 27th, the Indian government announced it would slash central excise duties on petrol and diesel to keep pump prices from rising. Australia

and Vietnam have promised similar measures to absorb higher oil prices.

In South Korea, which imports 70% of its oil from the Middle East, the government has imposed a fuel-price cap to limit the effects.

Pressure is increasing on Asian governments' balance-sheets. Many already spend heavily subsidizing energy or by setting fuel prices. However, the fiscal room available for such interventions varies enormously from country to country.

In Indonesia, rising fuel subsidies could result in breaching the fiscal-deficit cap of 3% of GDP this year. Investor confidence, already fragile, will erode further.

Cash-strapped Pakistan, which is already under IMF scrutiny, has increased fuel prices by 20%. Such pressures could invite unwanted attention from speculators looking for shaky currencies. Political instability cannot be ruled out.

Japan's finance ministry is already said to be considering intervening in the oil-futures market to prop up the Japanese yen.

Regardless of what governments do, inflationary pressures will climb. Where governments do not absorb costlier crude, rising energy prices will fuel headline inflation. Crude-importing countries with weak exchange rates and big oil bills, such as the Pakistan and the Philippines, will suffer the most. But even in those countries that apply fuel-price caps, the war in Iran will exert inflationary pressure through higher transportation costs and other channels. Supply-chain disruptions will push up costs in most industries including food, chemicals, petrochemicals, and logistics among others.

The biggest inflationary squeeze could come through food. The war has ensnared roughly a third of global sea-borne fertilizer trade, which will drive up food prices, especially when the sowing season begins later in 2026.



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The Asian Development Bank (ADB) revised inflation projections for 2026. It warns that figure could exceed 5%, depending on how long the war lasts.

Along with Japan's 254 days of fuel reserves, estimates suggest that China has enough to cover 100 days. Both have started to tap those reserves to ease supply strains. Analysis from data firm Kpler, suggests the situation in other parts of Asia is precarious. Estimates are that the Philippines, Thailand and Vietnam, hold just enough onshore oil supplies to cover about three weeks of normal demand.

The looming energy shortages are upending entire sectors. Aviation and tourism may be the hardest hit. China and South Korea have imposed limits on jet-fuel exports from their refineries. Airlines across the region have reduced flights. Over one week in early April, half of all airline cancellations globally were flights originating from airports in Asia, according to data from FlightAware. Air New Zealand cancelled 1,100 flights.

Governments may intervene with more drastic action. Philippines president Ferdinand Marcos Jr. has warned that grounding planes to save on fuel costs is a distinct possibility.

Combined with disruptions to other inputs, such as helium and aluminum, the energy shock could sap Asia's economic growth, especially over the short term. The ADB predicts that South-East Asia would be hit the hardest with growth rates falling potentially 2.3 percentage points lower if the war drags on. In South Asia, the bank predicts that growth could fall by 0.8 percentage points this year. The slowdown would have far-reaching effects: Asia is the global economy's factory floor.

We can expect a bigger push into alternative energy because of this war. Solar is being rolled out across the region, and that drive is set to accelerate. Many more electric vehicles will soon be operating around the cities of South-East Asia. Nuclear power will also get a second wind. Vietnam announced it will build a nuclear power

plant in cooperation with Russia.



Asia will fall back to a familiar source of energy—coal. Japan's government has approved a return to full capacity for coal power plants, lifting restrictions meant to limit emissions. Indian officials are worried about electricity demands this summer and have decided a coal-fired electricity plant in the state of Gujarat should restart operations. The push towards coal is driven by concerns about political stability. Asians are sensitive to energy prices and willing to take to the streets over them: transport workers in the Philippines have already launched protests.

During the energy crisis of 2022, when gas prices soared after Russia invaded Ukraine, political turmoil unfolded in South Asia. In 2022, around a quarter of all protests in the region were related to food and energy, according to an estimate by a leading think-tank. After analyzing social unrest across 101 developing countries between 2000 and 2020, researchers at the IMF found a direct association between fuel-price increases and protests. These demonstrations can be revolutionary: riots in Sri Lanka, fueled by high energy prices, contributed in large measure to the government's ousting in 2022. What began as an energy shock could easily become political liability for sitting governments.

Over time, the efforts of individual countries to insulate their domestic markets could reshape the global energy



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system. Trade may be rerouted as countries prioritize security over cost, and investment may be driven less by market signals than by geopolitical considerations. Governments may intervene to encourage domestic production or shift supply chains to allied countries. The result would not be a complete retreat from global markets, which is neither feasible nor desirable, but a more fragmented and less efficient system.

Globally traded oil markets ensured that the harm of Iran's disruption would not be limited to the U.S. and Israel alone. Interconnection softens the blow of local supply shocks by providing access to global markets, although globally set prices also broaden the reach of distant disruptions. Governments should aim not only to achieve energy autonomy but to manage interdependence more effectively, mitigating the most critical vulnerabilities in their energy systems without abandoning the efficiencies of global trade. This means adding redundancy when necessary, broadening the pool of reliable suppliers, and reducing the influence of any single chokepoint or country on the global market. Some exposure is inevitable, but it is possible to reduce risks.



Strategic reserves—not only for oil but also for critical minerals and other key materials and fuels—can help countries weather supply disruptions that are bound to happen in the future. Diversification is also key. Overreliance on any one supplier—or on any one country that

dominates a supply chain—creates systemic risk. Broader sourcing may cost more, but it enhances resilience. Rather than taking the even more expensive route of attempting to produce everything at home, countries, including the U.S., might diversify clean energy supply chains away from China by working with countries in Africa, Europe, and Latin America to build critical mineral refining and processing capabilities.

The Gulf States

It was the U.S. and Israel that launched the war on Iran. However, it is the Gulf Arab states that have borne the brunt of Iran's response. Since February 28, Iran has rained down missiles and drones on Gulf hotels, airports. In addition, Iran has hit Gulf States oil and gas infrastructure. National energy companies in Bahrain, Kuwait, and Qatar have declared force majeure because they cannot fulfill their contractual obligations.

For the Gulf countries, this conflict has been a reckoning. Although they may not say it publicly, the war has caused leaders throughout the region to reassess their relationship with the U.S.

Many Gulf monarchs had welcomed the reelection of President Trump because they liked his transactional foreign policy style. Unlike other U.S. presidents, the current Administration was happy to advance economic deals in the region without concern for conflicts of interest. In May 2025, Saudi Arabia persuaded the U.S. to lift sanctions on Syria and to back the country's new president, seen as proof of Saudi influence in Washington. However, in the current round of fighting, the warnings from Gulf leaders have gone unheeded. In the months before this war, they argued against opening a new round of conflict with Iran and urged the U.S. to keep negotiating with Iranian leaders. Despite personal visits from the Saudi crown prince, Emirati leaders, and other regional officials, the U.S. went ahead with the war.

Gulf leaders are increasingly aware that the current U.S. Administration's unpredictability can hurt; and that U.S.



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desires can often clash with their own. However, pivoting away from the U.S. is not easy. There is no other country that can replace the U.S. Gulf leaders' cautious outreach toward Iran, for example, failed to stop Tehran's attacks, and their quiet cooperation with Israel did not prevent that state's officials from upending the entire region. Washington, then, remains the only government that is both willing and able to offer security, at least for the time being.

Still, Gulf countries will likely try to quickly coalesce around a strategy designed to limit escalation, maintain flexibility, and protect economic growth so they can sustain their domestic agendas. They will have to move beyond their earlier strategy of managed hedging—or relying on the U.S. while selectively engaging with Iran and Israel—and instead create a new regional equilibrium. These states will need to set up new channels for diplomacy between the region's competitors. They will need to form better and more durable regional partnerships with countries other than the U.S.—and create stronger linkages among themselves.

In the past, some regional officials—namely, the Emiratis and Bahrainis—regarded their Israeli counterparts as security and economic partners. But Israel has now thrown all caution to the wind. Its refusal to engage meaningfully with Palestinian aspirations for self-determination has prompted unrest in the past, and it guarantees more violence in the future. Israel remains continuously committed to weakening Iran. It is willing to strike Gulf states if necessary to pursue its aims. In September 2025, Israeli forces hit a residential compound in Qatar hosting Hamas negotiators who were in talks with the U.S.

A few weeks after the attack, an executive order committed the U.S. to Qatar's defense, with the goal of reassuring Gulf states that they would not become collateral damage on Washington's watch. The commitment did little to protect Gulf countries when Israel and the United States launched the war on Iran a few months later. The Gulf states are thus suffering under a barrage of Iran's drones and missiles. They cannot move their products through

the Strait of Hormuz, and they have lost their reputation as a commercial safe haven.

For the Gulf countries, this underscores a long-standing problem: they are too dependent on the U.S. for protection. Meanwhile, the perception is that Washington does whatever it wants. Gulf countries depend on U.S. equipment, such as Patriot and THAAD missile defense systems, to protect themselves, so they need to appeal to Washington for resupply, command networks, training, intelligence, and logistics.

Gulf countries also rely on (and host) multiple major U.S. military bases. The U.S. thus retains full control over whether, when, and how its security commitments are applied. Bahrain, Kuwait, Qatar, and Saudi Arabia—all have been designated by U.S. officials as “major non-NATO allies,” which confers privileges, such as the eligibility to borrow U.S. military equipment or buy certain munitions. Yet, Gulf states have little say in the policies that affect their security and economic stability.

In the near term, Gulf states will need to deepen their operational cooperation with Washington on missile defense, intelligence sharing, and maritime security across the Persian Gulf and the Red Sea. No matter the outcome of the current war, the Gulf will be more vulnerable than ever before and therefore in need of U.S. help. Sections of Gulf populations have begun to question if the U.S. is a dependable partner and worry if the value of hosting American bases on their territory is worthwhile to their safety.

Jordan and Saudi Arabia could work with Egypt to jointly patrol the Red Sea, coordinate port security, and share intelligence to protect commercial shipping. Gulf countries could also coordinate with Turkey on drone and air defense capabilities or cautiously expand their existing cooperation with China. Such new arrangements would be limited in scope—that is, involving a handful of countries focused on a task, such as securing a waterway, coordinating missile defense, or working on systems that can counter drones.



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To protect themselves however, Gulf states will need to go beyond forming defensive partnerships. They must be at the center of diplomacy between the region's main players. For the Gulf, this should be a valued role; for over more than a decade, Oman, Qatar, and the UAE have functioned as regional mediators. And although they failed to prevent this latest round of fighting, Gulf countries need diplomacy to influence regional outcomes without relying solely on military power. Such an approach dovetails with the Gulf's desire for a region where geopolitical competition is managed rather than decisively resolved. To achieve this objective, Gulf governments might try to establish security mechanisms designed to prevent escalation between rival powers.

More modest arrangements, including maritime coordination frameworks, communication mechanisms, and regional early warning systems across Gulf countries, Egypt, Jordan, and Turkey are possible and would help reduce the risk of miscalculation and escalation. Secure military-to-military hotlines or crisis communication channels would help states quickly clarify their intentions with one another during tense moments, such as missile launches, airspace violations, or naval encounters.

The Saudi Foreign Minister's participation in diplomatic meetings alongside counterparts from Egypt, Pakistan, and Turkey confirms this approach. Gulf leaders recognize that they must deal with the Iranian regime they have, not the one they wish for.

Israel's war in Gaza, accelerating annexation of the West Bank, and ongoing ground offensive into Lebanon—in which Israel has taken 30% Lebanese territory and displaced one million people—have all put Gulf governments under considerable domestic political pressure to denounce Israel. For Gulf leaders, managing relations with Israel requires a careful balance of maintaining channels of communication while discouraging behaviors that risk continuously destabilizing the wider region.

A balanced region is essential to helping Gulf states

achieve their main objective: weaning their economies off oil. Saudi Arabia's Vision 2030, the UAE's economic diversification strategy, and similar programs across the region all depend on sustained stability, predictable trade routes, and continued foreign investment. The Gulf states thus favor a regional order in which geopolitical competition is contained, and economic integration can deepen and include Iran and Israel alike. Strong business and trade ties to both states will ensure all parties benefit from Middle Eastern stability and thus have a stake in maintaining it.

The era in which Gulf states could rely on external powers to manage regional security may be coming to an end. To protect their interests, they will need to build collective capacity, manage rivalries, and shape the balance of power themselves. Such measures may not stop the current war, which is being dictated almost entirely by Iran, Israel, and the United States. But Gulf states can shape the environment in which the conflict's consequences unfold, and they can help prevent the next conflagration.

The Global Economy

The outcome of the Iran war remains unclear, but the resulting oil shock has revealed a novel vulnerability in the global economy. Never has the world entered a crisis of any kind with such high deficits and debt levels.

This burden will limit the ability of governments to cushion the impact of elevated energy prices. The first post-second world war oil shocks hit in the 1970s and coincided with the dawn of a new era, when governments shifted from running budget deficits occasionally to constantly. Back then, the typical deficit in the U.S. and other major countries was around 2% of GDP. Today, the average deficit has more than doubled; as a result, the average government debt level for the G7 countries has risen from 20% of GDP to more than 100%.

Governments are trying to respond as they have in the past to oil shocks. From the UK and France to Brazil and India, governments are introducing price controls, ra-



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tioning schemes and subsidies for fuels of all kinds, from transport to cooking. But this time, they can ill-afford these relief measures and global bond markets are warning against spending hikes.

During crises, long-term interest rates typically decline as markets anticipate slower growth and easier monetary policy. The exceptions were the big oil shocks, when long-term rates rose along with expectations of higher inflation. Today, bond yields are rising again but for a different reason. Longer-term inflation expectations remain stable, but markets fear the Iran oil shock will trigger more spending on top of rapidly expanding deficits and debt, which is resulting in a higher term premium for bonds.

Last year, driven by government borrowing, total global debt levels rose at the fastest pace since the pandemic surge, to a record \$348 trillion, which is more than three times global GDP. That leaves very few governments in a position to roll out new stimulus.

Central banks are in a similar bind. In recent decades, they have worked alongside governments to extend stimulus at the first sign of trouble, but they can't do so easily now. The U.S. Federal Reserve has missed its 2 percent inflation target every month for 60 months in a row. Lately, three of every four central banks in developed countries and one of two in emerging countries have been missing their targets, too. Even if the oil shock slows economies, central banks may not be able to act as the shock also pushes inflation upward. The most vulnerable nations are those with the highest government debt and deficits, and with a central bank missing its inflation target; in the developed world they include most prominently the U.S. and the UK; in the emerging world, the most at risk are led by Brazil, Egypt and Indonesia.

While the U.S. is broadly protected from the oil shock by its energy self-sufficiency, it is nonetheless vulnerable to a prolonged conflict because it had the highest deficit in the developed world last year at 6% of GDP. Many have

been ringing alarms for decades and there is no clear threshold beyond which a deficit is likely to trigger economic trouble. This time, however, the bond market reaction sends a warning. And other signs — such as interest payments on U.S. government debt now exceeding its defense budget — also suggest that at over 100% of GDP, the debt burden is an increasingly pressing concern.

Last year, the U.S. increased defense spending by \$150 billion, before tripling the amount. The new proposal is to boost the Pentagon budget by another \$500 billion to \$1.5 trillion, only partially offset by cuts in other government agencies. Coming on top of new tax breaks and other drains on the Treasury, these measures could push the U.S. fiscal deficit close to 7% of GDP this year.

This is what makes the Iran shock so different from its predecessors. The global economy has experienced even sharper surges in oil prices and has become more efficient in its energy usage, which should ordinarily help mitigate the impact. Instead, any protracted increase in oil prices is likely to be magnified by the fact that governments are running low on policy ammunition to counter it.

This new vulnerability will expose the global economy not only to fallout from the Iran war, but to every shock in the foreseeable future.

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