MILITARY ESCALATION IN THE MIDDLE EAST: CUSHIONING THE GLOBAL SHOCK

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Executive summary:

This update describes how the effects of the military escalation have evolved since April. The economic, fiscal and social costs of the conflict are expected to endure, despite the Memorandum of Understanding signed between Iran and the United States on June 18th. Policy responses in developing economies have partially mitigated the effects of price shocks at great fiscal cost.

First, low- and middle-income countries mostly avoided development reversals by buffering the pass-through effects of oil prices via subsidies, price caps, tax rebates and demand management measures. Since April, *unmitigated* poverty by upper-middle-income standards (UMIC) was projected to increase by 17 million people in an adverse global growth shock scenario, and 45 million under a severe scenario. The actual extent of poverty mitigation will become clearer in a few months. However, global fossil fuel subsidies are on track to surpass $1 trillion in 2026 ($400 billion more than in 2025), and as much as $1.4 trillion in a severe scenario where oil prices reach $110/barrel, as fiscal balances absorb some of the price pass-through – thereby adding to the fiscal burden.

Second, the shock plays out differently in different geographic hotspots and for different groups of the population: remittances may have partially cushioned the shock in South Asia, despite drops during the military conflict; fertiliser disruptions have also been cushioned by drops in demand but may turn today's input shock into tomorrow's food-price shock in Africa; and energy subsidies in East Asia may contain short-term price pressures while creating new fiscal exposure.

Third, developing countries have avoided the worst by depleting their fiscal reserves. Close to half of the world's poorest countries are already either 'in' or at 'high risk' of debt distress, and debt continues to crowd out development spending at an increasing rate. This year, it is estimated that the median developing economy will spend 9.53 percent of total government revenue on interest payments alone – double the share of a decade ago and the highest level seen in 25 years. Averaged over the three-year period 2024 to 2026, 55 developing economies are estimated to pay more than 10 percent of revenue in interest payments, compared to 32 countries a decade ago.

Despite the absence of systemic risk in the global economy, urgent multilateral action is needed to backstop developing country efforts.

1. Introduction

The "most severe oil supply shock in history" continues to have ripple effects across the globe, but its immediate socio-economic effects have been partially mitigated by rapid domestic policy responses. Governments have moved quickly to cushion households and firms from higher energy prices through fuel subsidies, tax cuts, price caps, strategic stock releases, emergency procurement, export restrictions, demand-management measures and fuel switching.[1] These responses have helped reduce the immediate pass-through from international oil and gas prices to domestic retail prices but at a great fiscal cost and risk – especially across many low- and middle-income economies already heavily burdened by debt, with low reserves and limited access to financial markets.

This cushioning, however, is uneven and costly. Advanced economies and large emerging markets have more fiscal, financial and administrative capacity to absorb the shock. Many low- and middle-income countries have much less room to do so. For them, price-cushioning measures may protect households and businesses in the short run but can quickly widen fiscal deficits as expenditure rises and the revenue base erodes, increase borrowing needs, reduce foreign-exchange buffers, and crowd out spending on development priorities.[2]

This update focuses on three challenges. First, we present projections for how poverty might evolve in the absence of domestic policy mitigation: they show the poverty effects that could materialise if weaker economic growth is transmitted to household incomes without sufficient offsetting support. Second, we zoom into three geographic hotspots: remittances may cushion or amplify the shock in South Asia; fertiliser disruptions may turn today's input shock into tomorrow's food-price shock in Africa; and energy subsidies in Asia may contain short-term price pressures while creating a new fiscal exposure. Third, we circle back to the fiscal cost in a context of heightened and widespread debt vulnerability. Low- and middle-income countries have been depleting what little fiscal and financial space they have left to contain the worst impacts of the crisis. They continue to displace education, health and other critical long-term development expenditure for emergency response and a higher debt servicing.

The key policy question is therefore not whether governments should respond, but how. temporary and targeted measures can prevent sharp welfare losses. Open-ended subsidies and broad price controls may delay the social impact of the shocks, but risk creating larger fiscal and macroeconomic problems if they persist.[3]

[1] See IEA's 2026 Energy Crisis Policy Response Tracker for national measures to support consumers, reduce fuel demand and emergency stock releases, as well as the World Bank's Tracking Global Social Policy Responses to High Energy Prices reporting 109 countries and 288 social policy responses as of late May 2026.

[2] IMF warns that energy-tax cuts, price caps and general subsidies can be poorly targeted, fiscally costly, difficult to phase out, and may raise shortage risks. See IMF's Responding to the Energy and Food Price Shock: Getting the Policy Details Right.

[3] See IMF's Responding to the Energy and Food Price Shock: Getting the Policy Details Right and OECD's Energy prices are spiking again. New relief measures, old lessons on the argument that while short-term cushioning can be justified, broad subsidies are expensive and difficult to unwind.

2. Poverty implications of weaker global growth

The crisis has not yet translated into the scale of welfare deterioration that might have been expected given the magnitude of the energy shock. A combination of domestic policy responses—including energy subsidies, tax reductions, strategic stock releases, emergency procurement and other cushioning measures—has helped contain part of the shock. Nevertheless, downside risks remain significant. Renewed disruptions to energy markets, weaker confidence, tighter financial conditions, or a prolonged period of elevated commodity prices could result in slower global growth than currently projected.

To assess these risks, we simulate poverty outcomes under three growth scenarios. The reference scenario is based on the IMF World Economic Outlook (April 2026) baseline projections for GDP per capita growth through 2026. Two downside scenarios are then considered: an adverse scenario and a severe scenario, calibrated to the IMF's published global downside projections. In the absence of country-specific IMF adverse forecasts, the additional global shock is applied uniformly to country-level growth projections, generating stylised downside trajectories that preserve differences in baseline growth performance across countries.

While recent developments have reduced the likelihood of a prolonged escalation, the adverse and severe scenarios remain informative as stress tests illustrating the potential costs of persistence had the conflict continued or had disruptions become entrenched. The severe scenario should therefore not be interpreted as a forecast. Rather, it provides an indication of the scale of poverty reversals that could have emerged under a more prolonged period of disruption.

The analysis exploits income distributions covering 159 countries and approximately 96 percent of the world's population. Household incomes are assumed to move broadly in line with GDP per capita, with an 85 percent pass-through from aggregate growth to household income.[4] The estimates below should therefore be interpreted as unmitigated growth-driven poverty projections. They isolate the implications of weaker economic growth and do not incorporate the effects of policy responses, remittance flows, commodity price shocks, behavioural adjustments or other transmission channels. These factors may either amplify or cushion the welfare effects of the crisis and are explored separately.

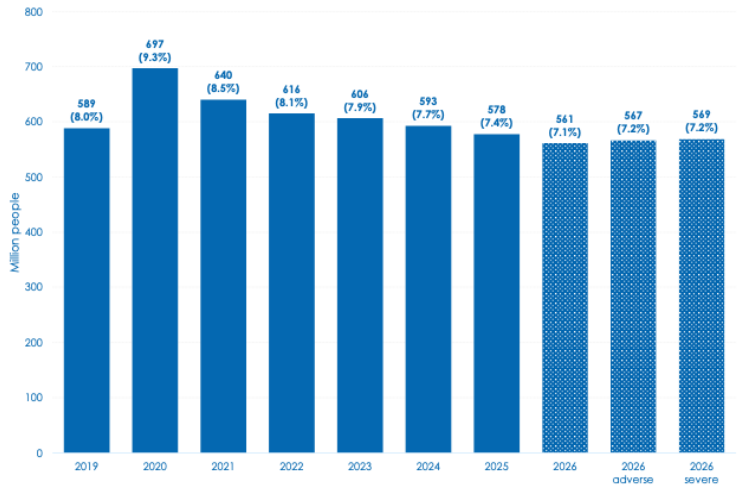
[4] See: Lakner, C., Mahler, D.G., Negre, M. et al. (2022), How much does reducing inequality matter for global poverty? *Journal of Economic Inequality*, 20: 559–585.

The costs of the GDP and price shocks are substantial. Relative to the IMF baseline in April, an additional 6–7.5 million people could fall into extreme poverty and up to 45 million could fall below the upper-middle-income poverty line under adverse and severe downside scenarios.

2.1 Global extreme poverty

Under the IMF reference scenario, global extreme poverty is projected to continue its gradual decline since 2020, reaching 561 million people in 2026. However, a further deterioration in global economic growth would partially reverse the gains. Under the adverse scenario, the number of people living in extreme poverty would reach 567 million, while under the severe scenario it would go under 569 million. Relative to the reference projection, this implies an additional 6 to 7.5 million people falling into extreme poverty (Figure 1).

Figure 1. Evolution of global extreme poverty, 2019-2026 (projections), million people and headcount rates



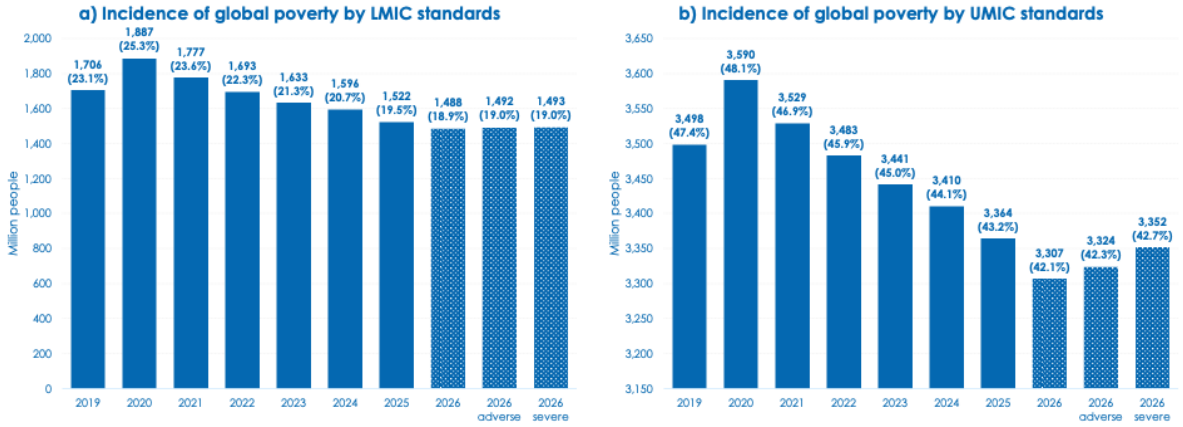
While these increases are modest relative to the global population, they represent a noticeable reversal of recent progress and highlight the sensitivity of poverty reduction to even small changes in global growth—particularly after several years of overlapping shocks that have already weakened household resilience in many developing economies.

2.2 Poverty under LMIC and UMIC standards

The effects are also visible at higher poverty thresholds. Under the lower-middle-income country (LMIC) poverty line, the number of people living in poverty is projected to decline from 1.52 billion in 2025 to 1.49 billion in 2026 under the reference scenario. Under the adverse and severe scenarios, poverty would increase by approximately 4 million and 6 million people, respectively, relative to the baseline projection (Figure 2, panel a).

At the upper-middle-income country (UMIC) poverty line, the impacts are considerably larger. Poverty declines to 3.31 billion people in 2026 under the reference scenario but would increase to 3.32 billion under the adverse scenario and 3.35 billion under the severe scenario. Relative to the reference projection, between 17 million and 45 million additional people fall below the UMIC threshold (Figure 2, panel b).

Figure 2. Evolution of global poverty by LMIC and UMIC standards, 2019-2026 (projections), million people and headcount rates



The larger effects at higher poverty thresholds reflect the greater concentration of households near these income levels. While relatively few households remain close to the international extreme poverty line, many more households in developing economies remain economically vulnerable and can be pushed below middle-income poverty thresholds when growth slows. These results should not be interpreted as forecasts. Rather, they provide an indication of the potential scale of development reversals that could have emerged under a more prolonged period of disruption, or that could still materialise if global growth weakens further and current policy responses prove insufficient to absorb the shock.

3. Regional transmission channels and policy responses

3.1. South Asia: Remittances as a shock absorber

The GCC-South Asia remittance corridor channels $80 billion annually for India, Pakistan and Bangladesh. Even a modest 5-10 percent disruption would imply $4-$8 billion in reduced household and foreign-exchange inflows.

A prolonged Middle East shock would transmit to South Asia not only through oil, gas, fertiliser and food prices, but also through labour income earned abroad. The Gulf Cooperation Council

(GCC) economies remain one of the world's largest remittance-sending regions and a critical source of foreign exchange and household income for India, Pakistan and Bangladesh.

The scale of the corridor is substantial. India received $118.7 billion in remittances in 2023-24, of which 38 percent came from GCC countries—equivalent to roughly $45 billion.[5] Pakistan's dependence on GCC labour markets is even greater: State Bank of Pakistan data indicate that Saudi Arabia, the United Arab Emirates (UAE) and other GCC countries account for almost 57 percent of workers' remittances, equivalent to roughly $22 billion in 2025.[6] Bangladesh received a record $32.8 billion in remittances in 2025, with Gulf employment accounting for about 43 percent of the total, or roughly $14 billion.[7] Together, these figures imply that around $80 billion in annual remittance flows to India, Pakistan and Bangladesh are linked to labour markets in the Gulf. Even a modest 5 percent decline in GCC-linked remittances would imply a loss of around $4 billion across the three countries; a 10 percent decline would imply around $8 billion.

Remittances constitute an important source of resilience for many households across South Asia. Historically, remittance flows have often proved resilient during periods of economic stress, as migrants increase support to families facing hardship. These flows support household consumption, education, health spending, debt repayment and housing investment, while also providing foreign exchange at a time when energy import bills are rising. In this sense, remittances have functioned as an important shock absorber during previous crises and may continue to cushion part of the current shock.

The exposure differs across countries. For India, the absolute amount is largest, but the macroeconomic shock is cushioned by a larger and more diversified economy and by a rising share of remittances from advanced economies such as the US and the UK.[8] For Pakistan and Bangladesh, the macro-financial relevance is sharper: remittances are central to external financing, household welfare, and exchange-rate stability. Bangladesh is especially exposed because of the concentration of its migrant workforce in Gulf economies, while Pakistan's recent inflows show continued heavy reliance on Saudi Arabia and the UAE.

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[5] The Reserve Bank of India's Sixth Round Remittance Survey reports USD 118.7 billion in inward remittances in 2023-24, of which the UAE alone accounted for 19.2 percent, Saudi Arabia 6.7 percent, Kuwait 3.9 percent, Qatar 4.1 percent, Oman 2.5 percent, and Bahrain 1.5 percent. India's remittance sources have diversified: the US is now the largest source (27.7 percent of the total), while the GCC share has declined from earlier years (46.7 percent in 2016-17).

[6] The State Bank of Pakistan (SBP) reported $38.3 billion in workers' remittances in 2025. For the GCC breakdown, the SBP's EasyData platform on monthly data from country-wise workers' remittances shows that Saudi Arabia accounted for $9.6 billion, the UAE for $8.3 billion, and other GCC for $3.8 billion. Thus, Pakistan's GCC-linked remittance corridor is approximately $21.8 billion per year, accounting for more than half of remittance inflows.

[7] The IOM remittance snapshot based on Bangladesh Bank data reports that remittance inflows reached USD 32.8 billion in 2025. GCC countries accounted for over two-fifths of annual remittances ($14.1 billion), with Saudi Arabia and the UAE reaching $5.03 billion $4.16 billion, respectively.

[8] As noted, the Reserve Bank of India reported that the US accounted for 27.7 percent of total inward remittances in 2023-24, equivalent to almost USD 33 billion. Additionally, the share of remittances received from the UK reached 10.8 percent ($12.8 billion), increasing from earlier years, which is attributable to the *Migration and Mobility Partnership* between India and the UK, while there is also an uptick in the share of remittances from Singapore, Canada, and Australia, which respectively account for 6.6, 3.8, and 2.3 percent of inward remittances in 2023-24.

Policy attention should therefore focus on preserving this channel rather than assuming it will remain resilient on its own. This means keeping remittance corridors open and affordable, protecting migrant workers' employment and wage claims, maintaining consular and labour-market monitoring in GCC host countries, and ensuring that remittance-receiving households are covered by targeted social protection if inflows weaken.

However, there are limits to what remittance-receiving countries can achieve on their own. The resilience of remittance flows ultimately depends on labour demand, wage conditions and economic activity in GCC economies. If the crisis persists, slower construction and service-sector activity, reduced overtime, delayed wage payments, higher living costs for migrant workers, disruptions to payment channels or increased return migration could gradually weaken remittance flows. Domestic policy alone may not be sufficient to offset these income losses. In the absence of broader regional cooperation and continued labour-market access, remittances may cease to function as a shock absorber and instead become a transmission channel through which the crisis spreads to South Asian households.

3.2. Africa: Preventing a fertiliser shock from becoming a harvest shock

Nine Sub-Saharan African countries are already among FAO-WFP global hunger hotspots. Higher fertiliser prices and disrupted planting seasons risk turning today's input shock into tomorrow's harvest shock

A prolonged Middle East shock would transmit to Sub-Saharan Africa through several agrifood channels at once.[9] Higher oil prices raise the cost of food transport, irrigation, milling and humanitarian delivery. Trade disruptions raise import costs for food and agricultural inputs. Most importantly, fertiliser markets are tightening sharply, with urea prices rising fastest because nitrogen fertiliser production is highly exposed to natural gas and Gulf export routes.

The scale of the fertiliser shock is substantial. The World Bank projects fertiliser prices to rise by 31 percent in 2026, driven by a 60 percent increase in urea prices. Fertiliser affordability is expected to fall to its weakest level since 2022, threatening farmers' incomes and future crop yields.[10] World Bank analysis also reports that urea prices rose above $850 per ton in April, around 80 percent higher than in February, while the Middle East accounts for nearly one-quarter of global urea exports.[11] Africa imports roughly 80 percent of its fertiliser requirements, while the Strait of Hormuz carries a substantial share of globally traded fertiliser and fertiliser feedstocks, including urea, ammonia and sulphur.

[9] See the policy paper: The Impacts of the Middle East Conflict on African Economies, UNDP, April 2026.
[10] See the World Bank's Commodity Markets Outlook, April 2026, and the press release "Middle East War to Spark Biggest Energy Price Surge in Four Years".
[11] See the blog "Fertilizer prices surge as Strait of Hormuz disruptions tighten supplies", May 2026.

The timing of agricultural production provides a temporary window for mitigation. While fertiliser prices have risen sharply since the onset of the crisis, planting decisions are still being made across many countries in West, Central and East Africa,[12] and governments, humanitarian agencies, and agricultural stakeholders are seeking to maintain input supply chains and access to fertiliser. The risk extends beyond prices alone. Delays in procurement, shipping and delivery may reduce fertiliser application during planting windows, lowering yields and tightening local food supplies months later. The shock is not only immediate; it threatens future harvests as well, raising the risk that today's fertiliser shock becomes tomorrow's food-price shock.

Some African countries and regional actors are already taking steps to reduce exposure to the fertiliser supply shock. In Nigeria, the Presidential Fertiliser Initiative is reportedly on track to deliver a 1.1 million metric tonne fertiliser programme in 2026, equivalent to about 22 million bags, with more than 449,000 metric tonnes of fertiliser inputs already secured by May.[13] At the regional level, Africa Finance Corporation has announced a USD 600 million facility to Greenview Fertiliser Corp., Dangote Group's fertiliser holding company, as part of a USD 7 billion expansion programme intended to triple urea output in Nigeria from 3 million to 9 million metric tonnes per year and support new production capacity in Ethiopia.[14] These initiatives illustrate how regional production and supply-chain investments can help reduce exposure to external fertiliser shocks. They also point to the importance of scaling sub-regional fertiliser procurement, production and distribution mechanisms, particularly where they can help protect smallholders during planting windows.

Food insecurity was already severe before the latest energy and fertiliser shock. FAO and WFP identify several Sub-Saharan African contexts among current global hunger hotspots, including Sudan, South Sudan, Mali, the Democratic Republic of the Congo (DRC), Nigeria, Somalia, Burkina Faso, Chad and Kenya. Of the more than 116 million people in Eastern and Southern Africa facing acute food insecurity, nearly half are located in the DRC and Sudan. Several of these countries are already affected by conflict, displacement, drought, high debt burdens, weak currencies and reduced humanitarian funding. The Middle East shock therefore lands on top of existing fragility.[15]

Somalia illustrates the risk. WFP estimates that 6.5 million people—around one-third of the population—are expected to face severe hunger in 2026. WFP's Middle East crisis analysis further suggests that an additional 2.5 million people in Somalia risk being unable to afford a basic food basket in 2026, and that almost 60 percent of households may be unable to meet

[12] See "Africa particularly vulnerable as Iran conflict disrupts supply chains", The Guardian, March 2026, and the IFDC bulletins "The Strait of Hormuz and the African Farmer", May 2026, "A Continental Response to a Global Shock: Safeguarding Africa's Food Systems in a Time of Disruption", March 2026, "War in the Middle East: Implications for Africa's 2026 Planting Seasons", March 2026, and "Global Fertilizer Markets Today", June 2026.
[13] See Business Day's "Tibunu unveils N61bn savings in massive fertiliser push", 18 June, and Nairametrics, "FG to deliver 1.1 million tonnes of fertiliser to farmers in 2026".
[14] See AFC's news, "AFC Backs US$7 Billion Dangote Fertiliser Expansion to Strengthen Africa's Food Security", 15 June 2026.
[15] See the FAO-WFP New Hunger Hotspots 2025 report, November 2025-May 2026 Report Highlights, and the WFP 2026 Global Outlook, Hunger and hope: Innovative solutions to address food insecurity.

essential needs, up from 47 percent in 2025. Somalia is especially exposed because it imports all of its oil and around 90 percent of its cereals.[16]

The policy priority is to prevent a fertiliser price shock from becoming a harvest shock. This means keeping input supply chains open, protecting fertiliser access for smallholders during planting windows, avoiding export restrictions and panic procurement, and combining targeted food assistance with support to agricultural livelihoods. In the current context, fertiliser becomes a strategic food security input: if farmers miss the planting season, the crisis will continue long after energy prices stabilise.

Yet many of the forces driving the fertiliser shock lie beyond the control of individual governments. Fertiliser markets are global, shipping routes are international, and humanitarian operations depend heavily on external financing. Even countries that succeed in protecting farmers domestically remain exposed to disruptions in fertiliser trade, higher transport costs, and reduced aid flows. In the absence of coordinated efforts to maintain trade flows, stabilise fertiliser markets, and support food-security operations, national interventions may not be sufficient to prevent a broader deterioration in food security across the region.

3.3. Asia: Subsidies, energy security and a fiscal trade-off

Governments in Asis are already spending billions to contain the oil-price shock. The immediate relief protects households and firms, but the fiscal cost can escalate quickly if temporary price cushioning turns into open-ended fuel subsidies.

Asia is one of the main destinations for Middle East oil and gas, making the region highly exposed to the current context. Governments have responded through a mix of fuel subsidies, tax cuts, price caps, emergency funds, rationing, fuel-switching, and strategic stock releases. These measures can soften the pass-through from international energy prices to domestic consumers, but they also shift part of the shock onto public budgets, state-owned enterprises and balance sheets.

The scale of the fiscal response is already large. IEEFA (the Institute for Energy Economics and Financial Analysis) estimates that explicit fossil fuel subsidies reached $55.9 billion in Southeast Asia in 2024, equivalent to 1.3 percent of regional GDP. Five economies—Indonesia, Malaysia, Thailand, Vietnam and the Philippines—accounted for $54.2 billion of this total. The

[16] See the WFP story "Somalia: Racing to reverse the hunger tide", updated 7 May 2026, and the June release "WFP warning becomes a reality for millions as Middle East crisis pushes poorest families further into hunger".

same countries now face renewed pressure to expand or extend subsidy schemes as oil and refined-product prices remain elevated.[17]

Recent policy measures show how quickly fiscal exposure can build. Indonesia budgeted about $22.4 billion for energy subsidies and compensation to state energy firms to keep fuel and electricity prices affordable. Japan has drawn on JPY 800 billion, about $5 billion, in reserve funds to finance gasoline subsidies. India's fuel excise-duty cuts imply a revenue loss of around $750 million per fortnight, partly offset through windfall taxes on fuel exports. Vietnam's suspension of gasoline, diesel and jet-fuel taxes was estimated to reduce revenue by around $273 million per month.[18]

These measures are effectively transferring part of the adjustment from households and firms to public budgets and state-owned enterprises. Rather than allowing the full increase in international energy prices to pass through immediately, governments are using subsidies, tax reductions and stabilisation mechanisms to smooth the adjustment over time. As a result, domestic fuel and energy prices in many countries have increased by less than would be expected given movements in international markets, helping to moderate immediate pressures on household budgets, transport and production costs.

Not all responses take the form of traditional fuel subsidies. Across Asia, governments have combined price cushioning measures with energy-security interventions, demand-management tools, and fuel-switching strategies. The Philippines activated a $330 million emergency fund to strengthen fuel security, including purchases of refined products and LPG. Thailand has combined fuel-tax reductions, oil-fund support and cooking-gas price controls with work-from-home arrangements designed to reduce fuel consumption. Malaysia continues to absorb part of the international price shock through large fuel subsidy programmes, while India has complemented fuel tax reductions with restrictions on industrial LPG use and measures to safeguard household supply. The emerging pattern across the region is one of layered responses: governments are seeking not only to cushion prices today, but also to reduce exposure to supply disruptions and strengthen energy security if the shock persists.[19]

The policy dilemma is acute. Price cushioning can be justified when shocks are sudden and households have limited time to adjust, especially where transport fuels, LPG and electricity are central to daily welfare and production. But broad energy subsidies are expensive, poorly targeted and difficult to unwind. IMF analysis shows that explicit fossil fuel subsidies reached $725 billion globally in 2024, and that the poorest 20 percent of households receive only around 8 cents of every dollar spent on explicit fuel subsidies.[20]

The priority is therefore to keep crisis measures temporary, targeted and fiscally transparent. Countries with social registries and payment systems should shift support toward cash transfers or lifeline tariffs. Countries without those systems may need temporary consumption blocks

[17] See IEEFA's note "Elevated oil prices compound Southeast Asia's fossil fuel subsidy challenge", 14 May 2026.
[18] See Reuters "Asian governments spend billions of dollars to offset oil price shock", 2 April 2026.
[19] See Reuters "Governments worldwide shield households rising energy costs", 21 April 2026, and the IEA 2026 Energy Crisis Policy Response Tracker (updated 4 Jun 2026).
[20] See IMF Fossil Fuel Subsidies Data (updated 22 April 2026).

for electricity or LPG but should avoid open-ended gasoline and diesel subsidies that disproportionately benefit richer households and firms.

The challenge in Asia is less about access to policy tools than about the ability to sustain them. Governments have so far absorbed a substantial share of the shock through subsidies, tax reductions, stabilisation funds and other forms of price support. These measures have helped contain the immediate welfare impact, but they do so by transferring part of the adjustment onto public budgets and state-owned enterprises. If elevated energy prices persist, the fiscal cost of maintaining these interventions will continue to rise. In the absence of a durable easing of global energy markets, countries may face increasingly difficult trade-offs between protecting households today and preserving fiscal space for future development priorities.

4. Fiscal implications and the limits of national responses

When international energy prices surge, the risk of fiscal and balance of payments crises can rise rapidly in vulnerable net-importing countries, carrying severe implications for the broader economy and social outcomes. Large poor populations, high public debt burdens, limited foreign exchange reserves, and restricted access to international capital markets leave many developing economies highly exposed to the global energy supply shock.

In this context, the recently signed MoU between the United States and Iran arrives at a critical juncture. While it marks an important step toward preventing further conflict-related casualties and physical destruction, the easing of global energy and other key commodity markets will also provide vital economic breathing room – mitigating the immediate risks of further social unrest and containing rapidly escalating development costs in the world's poorest countries.

4.1. Transmission channels: Debt vulnerable countries especially at risk

In net energy importers, a surging energy import bill can quickly worsen current account balances, drive up the demand for foreign exchange and put severe pressure on reserves and the exchange rate. A depreciating currency further inflates import and external debt-servicing costs - compounding inflationary pressures and heightening the risk of a broader macroeconomic crisis in the most vulnerable countries.

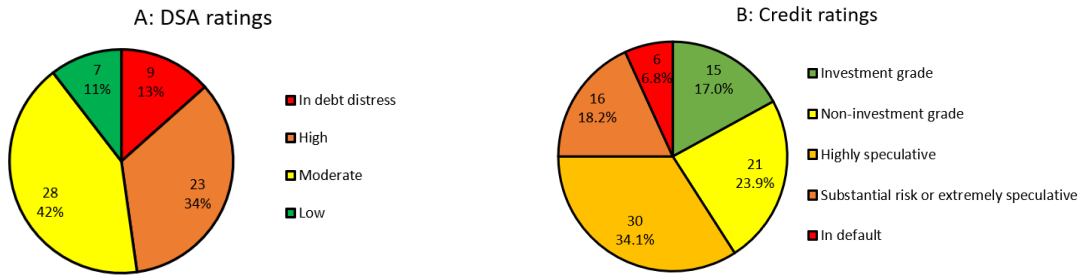
The asymmetrical economic impact is already evident. Not counting the direct conflict-affected countries, 100 countries (with available data) have had their 2026 real GDP growth rate projection revised downwards since the war started. Most hard-hit are countries in the low-income group, where the median negative revision has been 0.5 percentage points (pp) followed by lower middle-income countries with 0.4 pp, upper middle-income countries with 0.3 pp, and high-income countries with 0.2 pp.[21]

[21] This is based on a comparison of the 2026 real GDP growth rate projection from IMF's October 2025 WEO (before the Iran war) and April 2026 WEO (after the war) – comparing reference scenarios which in the latter (among other key assumptions) assumes that the average price of a barrel of oil in 2026 is $82.

Furthermore, in many developing economies with high poverty rates and weak institutional infrastructure, energy subsidies are used as a blunt, untargeted social policy instrument to shield households from higher living costs. Beyond being highly inefficient, subsidies impose a heavy fiscal burden on governments when global energy prices surge. The resulting drain on resources can crowd out long-term development spending and heighten the risk of a fiscal crisis – particularly in countries already struggling under heavy debt burdens.

According to the latest debt sustainability analyses (DSAs) for the poorest countries, close to half are already rated either 'in' or at 'high risk' of debt distress while only 13 percent are considered at 'low risk' (see Figure 3, panel A). Looking at sovereign credit ratings across all developing economies, close to 60 percent are rated 'highly speculative or worse', and only 17 percent are considered 'investment grade' (see Figure 3, panel B).

Figure 3: Debt ratings in developing economies – Panel A: DSA ratings* and Panel B: Credit ratings**



Source: UNDP based on latest debt sustainability analyses (DSAs) by the IMF and World Bank and credit ratings by S&P and Moodys as per June 1st, 2026. Note: *DSA ratings data is for the poorest countries assessed under the low-income country debt sustainability framework (LIC-DSF). **Credit ratings are based on data ratings from S&P and/or Moodys for all low- and middle-income countries. Countries are classified based on the simple average between ratings using the numerical scale described in Jensen (2022). As an example, 'highly speculative or worse' is a rating at or below B1 for Moodys or B+ for S&P.

The high fiscal cost of maintaining fuel subsidies during international energy price spikes has forced several governments to accept a higher pass-through to domestic retail prices despite grave implications for vulnerable households and the risk of social unrest. Across the poorest (low- and lower-middle-income) countries, retail fuel prices increased by an average of 29 percent - and up to as high as 93 percent - between February 23 to June 8, triggering social unrest and protests in several countries.[22]

4.2. The continued erosion of development spending

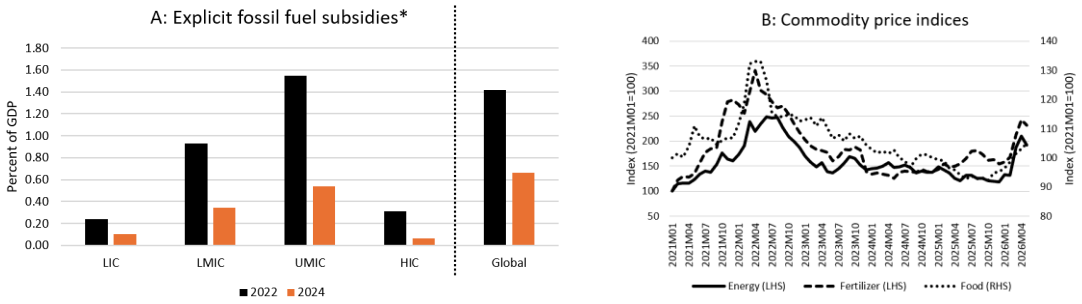
During the 2022 energy price shock, global (explicit) fossil fuel subsidies reached $1.44 trillion (1.42 percent of GDP) as governments shielded consumers and businesses from higher international energy prices (see Figure 4, panel A).[23] Furthermore, given the tight correlation

[22] The Financial Times article "Protests spread in Africa as fuel crisis deepens," published May 20, 2026. The fuel price increase here refers to the average increase in the price of gasoline and diesel as reported by Global Petrol Prices "Fuel price changes after the start of the Iran war" between February 23 to June 8, 2026.

[23] An explicit subsidy occurs when the fuel retail price is less than its supply cost. See IMF Fossil Fuel Subsidy database.

between energy, fertilizer and agricultural markets, global food prices simultaneously surged, exacerbating poverty and food insecurity among vulnerable populations (see Figure 4, panel B). While energy subsidies had fallen by roughly half in 2024 as energy markets stabilized, the downward trajectory has sharply reversed. With international energy prices surging by approximately 60 percent between December 2025 to May 2026, subsidy bills are set to swell again this year, serving as the primary driver of fiscal pressures in many countries. This energy shock has already rippled into fertilizer and agricultural markets with fertilizer prices up more than 50 percent, and food prices more than 10 percent, over the same period.

Figure 4: Explicit fossil fuel subsidies and commodity price indices



Source: UNDP based on subsidy data from the IMF and commodity prices from the World Bank's Commodity Markets database. Note: LIC = low income; LMIC=lower-middle income; UMIC=Upper-middle income; HIC = high income. * Explicit subsidies are measured as the difference between a fuel's supply cost and its retail price.

Keeping retail energy and food prices from rising carries enormous fiscal costs and risks; conversely, allowing them to rise deepens poverty and can fuel social unrest. We estimate that global fossil fuel subsidies are currently on track to reach $1.1 trillion in 2026 and could reach as high as $1.43 trillion in a severe scenario where the average oil price reaches $110/barrel (see Table 1). This represents an estimated $410–$740 billion increase from 2025.

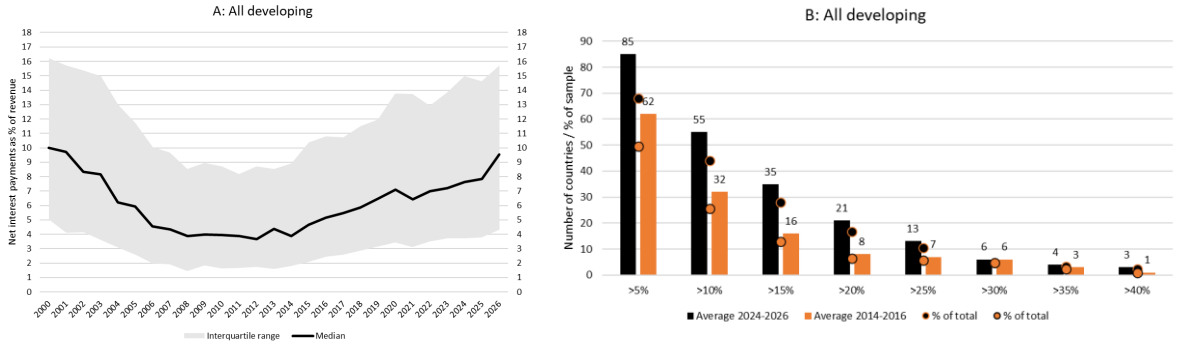
Table 1: Estimated global fossil fuel subsidy scenarios for 2026*

	Current (≈$88.6/bbl)	**Adverse (≈$100/bbl)**	**Severe (≈110/bbl)**
Global fossil fuel subsidies ($USD billion)	1,097	1,272	1,426
Increase from 2025 ($USD billion)	410	586	740
% of 2025 GDP	*0.93*	*1.08*	*1.21*

Source: UNDP based on fossil fuel subsidy data from the IMF, global energy price data from the World Bank and oil price data from FRED Stats. Note: *In the 'current' scenario the (simple) average oil price (across Brent, WTI and Dubai crude) is assumed to be $88.6/barrel which is the average price from January to May of 2026. The 'adverse' scenario assumes a price of $100/barrel and the 'severe' scenario $110/barrel. Estimates are produced using the correlations between oil prices, the global energy index and fuel subsidies series.

While the recently agreed MoU brings hope that the worst of the crisis has passed, the shock will already have added to fiscal pressures and contributed to the long-run trend of higher debt servicing crowding out development spending in developing economies.

Figure 5: Net interest payments (as a percentage of government revenue)



Source: UNDP based on data from the IMF WEO (April 2026) and World Bank WDI. Note: net interest is calculated as the difference between the overall and primary fiscal balance. 'Developing' refers to all low- and middle-income countries. In panel B '% of total' is the percentage of countries above the threshold relative to the full sample size of all developing economies with available data.

Since the mid-2010s debt servicing has absorbed a growing share of government revenue in developing economies. This year, it is estimated that the median country will spend 9.53 percent of total government revenue on interest payments alone – double the share of a decade ago and the highest level seen in 25 years (see Figure 5, panel A). In comparison, the median high-income country pays 2.98 percent. Averaged over the three-year period 2024 to 2026, 55 developing economies (44 percent of the sample) are estimated to pay more than 10 percent of revenue in interest payments, compared to 32 countries (26 percent of total) a decade ago (see Figure 5, panel B). Twenty-one countries (17 percent) are estimated to pay interest worth more than one-fifth of their revenue, compared to only eight countries a decade ago.

Weaker growth, larger deficits, currency depreciation, and higher refinancing needs all worsen debt-sustainability metrics, leading investors to demand higher sovereign risk premia for holding emerging market and developing economy debt - further worsening debt dynamics. These effects are strongest in countries with high energy import dependence, low reserves, high external debt, and limited fiscal space.

4.3. Policy responses

Ideally, fiscal support should be temporary and targeted toward vulnerable populations and critical sectors, while broad-based subsidies should be avoided. Nevertheless, the IEA notes that globally only about 25 percent of government price-support measures introduced in response to the 2026 energy crisis have thus far been targeted.[24] Broad-based subsidies are not only fiscally costly but also tend to benefit richer households disproportionally and can fuel inflation by delaying necessary demand adjustments. Combined with a gradual price pass-through where feasible, targeted and temporary support is the best strategy to contain fiscal risk while protecting the livelihoods of vulnerable populations.

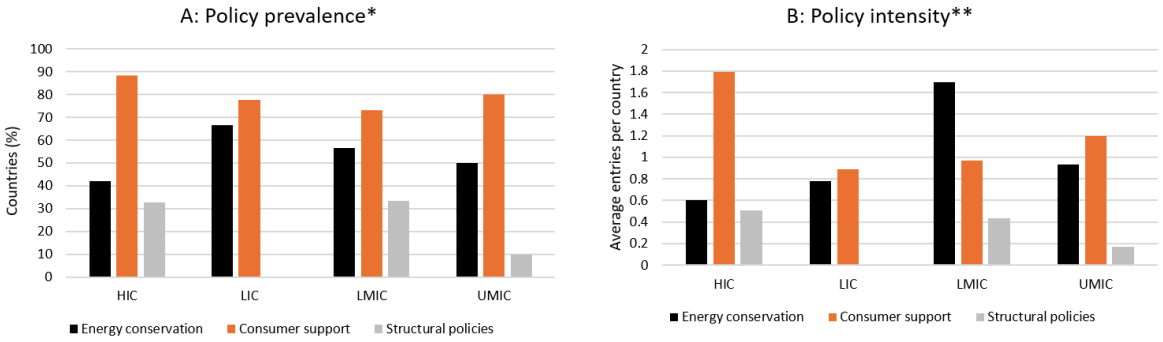
However, for many countries, transitioning to a well-targeted social protection system takes time and is difficult to implement effectively in the middle of a crisis. A central concern and priority for fiscally constrained countries is therefore access to affordable budget and balance of payments support from international financial institutions. Such support can help them

[24] See IEA's "2026 Energy Crisis Policy Response Tracker".

weather the shock, while providing the fiscal breathing space needed to embark on the necessary structural social protection and other necessary reforms.

A closer look at policy responses suggests the presence of systematic differences. High-income countries appear to rely more heavily on consumer-support measures for instance through direct subsidies and lower fuel excise taxes as well as targeted household transfers (see Figure 6). Conversely, many developing countries rely more on a combination of limited consumer support and energy conservation measures, including rationing, restrictions on energy use, public-sector energy savings measures, travel restrictions, and other demand-management policies. This likely reflects differences in both fiscal space and the capacity to shield households and firms from higher energy prices.

Figure 6: Policy tracker across income groups



Source: UNDP based on IEA 2026 energy crisis policy tracker. Note: *Prevalence is the share of countries with at least one entry in each policy category. **Intensity is the average number of subcategories with entries within each policy category.

Policy responses to date also point to the widespread use of fuel-switching strategies to enhance energy security – again with important differences across countries. Some countries have temporarily increased the use of coal and other alternative fuels to reduce dependence on expensive imported energy, while high-income economies are generally more likely to complement short-term crisis responses with structural investments in energy efficiency, electrification, electric vehicles, and renewable energy deployment. Such structural measures fundamentally change energy systems, and thereby extend beyond immediate energy-security concerns, and can strengthen long-term energy resilience while supporting the clean-energy transition.

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