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Risk of a Wider Middle East War Threatens a ‘Fragile’ World Economy

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8–10 minutes

After shocks from the pandemic and Russia’s invasion of Ukraine, there’s little cushion if the fighting between Hamas and Israel becomes a regional conflict.

Palestinians displaced by the Israel-Hamas war shopping at a market in Khan Yunis in Gaza this week. Credit...Yousef Masoud for The New York Times

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Fears that Israel's expanding military operations in Gaza could escalate into a regional conflict are clouding the global economy's outlook, threatening to dampen growth and reignite a rise in energy and food prices.

Rich and poor nations were just beginning to catch their breath after a three-year string of economic shocks that included the Covid-19 pandemic and Russia's invasion of Ukraine. Stinging inflation has been dropping, oil prices have stabilized and predicted recessions have been avoided.

Now, some leading international financial institutions and private investors warn that the fragile recovery could turn bad.

"This is the first time that we've had two energy shocks at the same time," said Indermit Gill, chief economist at the World Bank, referring to the impact of the wars in Ukraine and the Middle East on oil and gas prices.

Those price increases not only chip away at the buying power of families and companies but also push up the cost of food production, adding to high levels of food insecurity, particularly in developing countries like Egypt, Pakistan and Sri Lanka.

As it is, nations are already struggling with unusually high levels of debt, limp private investment and the slowest recovery in trade in five decades, making it tougher for them to grow their way out of the crisis. Higher interest rates, the result of central bank efforts to tame inflation, have made it more difficult for governments and private companies to get access to credit and stave off default.

Image

Israeli soldiers surveying destruction in Kfar Azza, a community near the Gaza border that Hamas militants raided last month.Credit...Tamir Kalifa for The New York Times

“All of these things are happening all at the same time,” Mr. Gill said. “We are in one of the most fragile junctures for the world economy.”

Mr. Gill’s assessment echoes those of other analysts. Jamie Dimon, the chief executive of JPMorgan Chase, said last month that “this may be the most dangerous time the world has seen in decades,” and described the conflict in Gaza as “the highest and most important thing for the Western world.”

The recent economic troubles have been fueled by deepening geopolitical conflicts that span continents. Tensions between the United States and China over technology transfers and security only complicate efforts to work together on other problems like climate change, debt relief or violent regional conflicts.

The overriding political preoccupations also mean that traditional monetary and fiscal tools like adjusting interest rates or government spending may be less effective.

The brutal fighting between Israel and Hamas has already taken the lives of thousands of civilians and inflicted wrenching misery on both sides. If the conflict stays contained, though, the ripple effects on the world economy are likely to remain limited, most analysts agree.

Jerome H. Powell, the Federal Reserve chair, said on Wednesday that "it isn't clear at this point that the conflict in the Middle East is on track to have significant economic effects" on the United States, but he added, "That doesn't mean it isn't incredibly important."

Mideast oil producers do not dominate the market the way they did in the 1970s, when Arab nations drastically cut production and imposed an embargo on the United States and some other countries after a coalition led by Egypt and Syria attacked Israel.

At the moment, the United States is the world's largest oil producer, and alternative and renewable energy sources make up a bit more of the world's energy mix.

"It's a highly volatile, uncertain, scary situation," said Jason Bordoff, director of the Center on Global Energy Policy at Columbia University. But there is "a recognition among most of the parties, the U.S., Europe, Iran, other gulf countries," he continued, referring to the Persian Gulf, "that it's in no one's interest for this conflict to significantly expand beyond Israel and Gaza."

Mr. Bordoff added that missteps, poor communication and misunderstandings, however, could push countries to escalate even if they didn't want to.

And a significant and sustained drop in the global supply of oil — whatever the reasons — could simultaneously slow growth and inflame inflation, a cursed combination known as stagflation.

Image

Women buying and selling grain in Yola, Nigeria. The aftereffects of the pandemic have stunted growth in emerging markets like Nigeria.Credit...Finbarr O'Reilly for The New York Times

Gregory Daco, chief economist at EY-Parthenon, said a worst-case scenario in which the war broadened could cause oil prices to spike to $150 a barrel, from about $85 currently. "The global economic consequences of this scenario are severe," he warned, citing a mild recession, a plunge in stock prices and a loss of $2 trillion for the global economy.

The prevailing mood now is uncertainty, which is weighing on investment decisions and could discourage businesses from expanding into emerging markets. Borrowing costs have soared, and companies in several countries, from Brazil to China, are expected to have trouble refinancing their debt.

At the same time, emerging markets like Egypt, Nigeria and Hungary have experienced some of the worst scarring from the pandemic, according to Oxford Economics, a consulting firm, resulting in lower growth than had been projected.

Conflict in the Middle East as well as economic strains could also increase the stream of migrants heading to Europe from that region and North Africa. The European Union, which is teetering on the brink of a recession, is in the middle of negotiations with Egypt over increasing financial aid and controlling migration.

China, which gets half its oil imports from the Persian Gulf, is struggling with a collapse in the real estate market and its weakest growth in nearly three decades.

By contrast, the United States has confounded forecasters with its strong growth. From July through September, the economy grew at an annual rate of just a shade under 5 percent, buoyed by slowing inflation, stockpiled savings and robust hiring.

India, backed by enthusiastic consumers, is on track to perform well, with estimated growth of 6.3 percent in the current fiscal year.

Image

A natural gas pipeline terminal in Ashkelon, Israel, in 2017. When it comes to energy markets, events in the Middle East "will not stay in the Middle East,” said M. Ayhan Kose, a World Bank economist.Credit...Tamir Kalifa for The New York Times

The region with the gloomiest prospects is sub-Saharan Africa, where, even before fighting broke out in Israel and Gaza, total output this year was estimated to fall 3.3 percent. Incomes in the region have not increased since 2014, when oil prices crashed, said M. Ayhan Kose, who oversees the World Bank’s annual Global Economic Prospects report.

“Sub-Saharan Africa has already experienced a lost decade,” Mr. Kose said in an interview. Now “think about another lost decade.”

As far as energy markets are concerned, something that “happens in the Middle East will not stay in the Middle East,” he added. “It will have global implications.”

Patricia Cohen is the global economics correspondent based in London. Since joining The Times in 1997, she has also written about theater, books and ideas. She is the author of “In Our Prime:

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More about Patricia Cohen

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