

# What the war in Iran means for China

China is relatively inured to the Iran conflict, but less external demand could hit its exports and its international partnerships may be undermined

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The disruption to global energy flows triggered by the United States and Israel's attacks against Iran are a severe test of energy security, export resilience and geopolitical strategy for China, the world's largest oil importer. While Beijing's massive oil stockpiles and diversified sourcing offer short-term protection, a prolonged conflict over Iran could exacerbate domestic economic pressures and undermine China's global goals.

## **Access to Iranian oil cut off**

Iran has long served as a vital, discounted source of energy for China. This has especially been the case since 2021 when the Iran-China 25-year cooperation agreement was signed, securing a \$400 billion of oil at below market prices for China, in exchange for investment in Iran's infrastructure and security cooperation<sup>1</sup>. By the end of 2025, China was importing up to about 1.4 million barrels per day (mbd) from Iran, representing 13 percent of its total crude imports and some 80 percent to 90 percent of Tehran's oil exports<sup>2</sup>.

Iranian oil was often rerouted to circumvent US sanctions<sup>3</sup>. To avoid the reputational and financial risk from importing sanctioned oil, this oil was mainly bought by small, private 'teapot' refineries, rather than major Chinese state-owned oil companies. Iranian oil was paid for in renminbi via China's new Cross-border Interbank Payment

System (CIPS)<sup>4</sup>, to avoid the SWIFT messaging network for international payments, which could have signalled sanctioned financial transactions to Western authorities.

Selling oil to China, even if cheaply, has been an important lifeline for Iran. However, its oil sales revenues could only be used to import goods from China or pay Chinese companies for their services. Thus, Iran became increasingly dependent on China in terms of both exports and imports.

Since the US-Israel attacks started on 28 February, Iranian production and exports have collapsed amid infrastructure damage and the halt to shipping. For China, this has created an immediate shortfall of 1 mbd to 1.4 mbd in oil imports from Iran<sup>5</sup>. Teapot refineries have lost access to low-cost crude and face high replacement prices in a market already strained by global tensions (Figure 1)<sup>6</sup>.

For economic security reasons, China was prepared for a potential energy crisis stemming from the US threats to Iran, which intensified at the beginning of 2026. In the first two months of the year, Chinese oil imports surged 16 percent for stockpiling. Russia exported around 300,000 barrels/day more to China in January and February (up to around 2.1 mbd)<sup>7</sup>, though for China this is by no means enough. China's oil imports from the Gulf, now trapped in the Strait of Hormuz, are at least double the amount imported from Russia (5.4 mbd through Hormuz to China)<sup>8</sup>.

In other words, in the short run, China still needs to deal with the consequences of the sudden shut-off of a good part of its oil imports at below market price, in the context of a jump in the oil price, which could easily hover around \$100/barrel for a sustained period. Standard modelling of China's sensitivity to oil prices points to a 0.5 percent GDP reduction for a 25 percent increase in oil prices (Rasmussen and Roitman, 2011). This illustrates the stakes for China.

### **The impact of the closure of the Strait of Hormuz on China**

The Strait of Hormuz, through which roughly 20 percent of global oil and significant LNG volumes pass<sup>9</sup> is, at the time of writing, effectively closed. China sources about half of its crude and 30 percent of its LNG from suppliers including Saudi Arabia, Iraq, the United Arab Emirates and Qatar (Figure 2). A sustained closure of the Persian Gulf risks shortages, skyrocketing freight and insurance costs and sparking fierce competition for rerouted cargoes (although some Chinese-flagged vessels seem to have secured passage through the Strait of Hormuz<sup>10</sup>).

Beyond potentially selective opening of the Strait of Hormuz, China's buffers are formidable: strategic and commercial reserves total around 1.3 billion to 1.4 billion barrels, covering about four months of imports. Overland Russian supplies via pipelines provide further diversification, although with some limitations. First, pipelines seem to already be running at full capacity and more seaborne shipments from Russia are compromised by Russia's lack of tankers<sup>11</sup>. Furthermore, on 5 March, the US issued a 30-day waiver that permits India to import Russian crude to mitigate the negative impact of the closure of the Strait of Hormuz. This makes it harder for China to absorb any spare production capacity Russia may have<sup>12</sup>.

Thus, China is better positioned than most Asian countries in relation to the energy crisis arising from the US-Israel attacks on Iran (Figures 3 and 4). This is reflected in the mild impact on Chinese financial markets<sup>13</sup>, with the renminbi rebounding to its previous level as of mid-March.

### **Export disruption**

Beyond energy, the Iranian crisis affects products downstream from the oil supply chain that are produced in the Gulf region, including fertilisers and sulphur dioxide essential to produce aluminium and nickel. India depends heavily on fertilisers from the Gulf, while Indonesia depends on Gulf supplies for nickel production.

Another major negative impact on global supply chains is much higher transportation costs, because of both the spike in oil prices and longer routes to avoid the conflict. Elevated insurance costs and backlogs are also straining container and bulk trade<sup>14</sup>, creating significant supply-chain bottlenecks.

China's exports to the Middle East – cars to the UAE, steel to Saudi Arabia – grew rapidly in 2025 amid US trade frictions, but will now face these challenges.

### **Inflation impact: less severe for China**

A sustained conflict and the prolonged closure of the Strait of Hormuz beyond the end of March will create cost-push inflation worldwide through elevated energy, commodity and transportation prices. There is huge uncertainty about the economic impact of this scenario, but 0.4 percent to 0.8 percent could be added to global inflation rates, and growth could slow<sup>15</sup>. Western economies, still recovering from Ukraine-related shocks, could see renewed competitiveness losses as energy costs bite harder and

inflationary pressures resurface (Figure 7). China, however, seems more insulated from the energy shock, as it is suffering from deflationary pressures with virtually no wage growth<sup>16</sup>. This dynamic echoes what happened after Russia's invasion of Ukraine in 2022, when energy shocks disproportionately weakened Western production compared to Chinese exporters.

Nevertheless, cost-push inflation would still harm household disposable incomes in China unless protected by more subsidies (Figure 8). Given China's large use of subsidies for industrial purposes, it seems unlikely China will turn to protect its consumers given that there is no fiscal room within the 2026 deficit target (which remains about the same as in 2025).

Overall, China may gain external competitiveness from the Iran crisis, relative to the West. But its domestic demand may be hit unless consumption-targeted fiscal policy comes to the rescue. This looks unlikely in light of Chinese economic policy announcements made at its most important annual political gathering, the so-called Two Sessions, which ended on 11 March<sup>17</sup>.

### **The biggest threat to China: less external demand**

For China, the main threat from the Iran conflict is that it could retard consumption globally, with obvious consequences for Chinese exports. China's dependence on exports to reach its GDP growth target – which the Two Sessions maintained at a rather high 4.5 percent to 5 percent – is its main weakness. A sharp reduction in global growth will end up as additional overcapacity and even thinner corporate profits, with severe consequences for the financial health of Chinese companies. Wage growth already stands at barely 1 percent and could drop lower. This will further reinforce the weakness of domestic demand in China, with less investment from profitless companies and deceleration of consumption.

The European Union could play a significant role in such a scenario. Europe is vulnerable to higher energy prices, especially gas, as seen after Russia's invasion of Ukraine. Higher energy prices will be another significant negative shock for the European economy in terms of growth. Europe is also China's largest market, absorbing 15 percent of China's exports. China should thus see exports to Europe decelerate.

### **A zero-sum game between China and the US**

Depending on how it is resolved, the US-Israel war on Iran could have profound implications for China's strategic positioning in the Middle East and beyond. Should the US achieve dominance – seizing control of Iranian assets, dismantling its regional influence and potentially installing a more pliable regime – Beijing's hard-won diplomatic gains in the region, and possibly beyond in the wide Global South, would be severely undermined.

For instance, the 2023 Saudi-Iran rapprochement, skilfully brokered by China<sup>18</sup>, represented a landmark achievement in fostering stability and countering US hegemony in the region. This deal also elevated China's role as a neutral mediator under its Global Security Initiative. Similarly, Iran's inclusion in the Shanghai Cooperation Organisation (SCO) in 2023, and BRICS in 2024, has bolstered multilateral frameworks that align with Beijing's vision of a multipolar world order, diluting Western dominance. A US victory in the context of limited Chinese support for Iran could unravel these structures, forcing China to recalibrate its alliances. Failing to stand up for a country China has welcome into its core clubs could erode China's credibility in the Global South, at least when it comes to security; these nations might expect more tangible solidarity against Western aggression.

Conversely, an abrupt US withdrawal – perhaps because of domestic pressures, escalating costs or Iranian resilience – could create space for expanded Chinese diplomacy and investment, and may also change the view of the Global South on who the winner is from the military conflict. The US withdrawal from Afghanistan in 2021 should be a reminder of the rippling consequences of such actions, and how much China gained.

More importantly, if the US becomes more deeply involved in a war against Iran, China could gradually shift away from its current cautious stance and expand its role in the Iranian market, similarly to what it has done in Russia. China could become much more of an enabler in the economic survival of the Iranian regime and could support its defence capabilities through dual-technology exports, helping facilitate an Iranian campaign of attrition against the US. Such an enabling would also put China in a position to mediate between Iran and the Gulf states – the more so, the longer the conflict lasts.

Probably even more importantly for China, a protracted military conflict in Iran would divert US military resources away from the Indo-Pacific, with potentially major

consequences for the future of Taiwan and/or the South China Sea. Observing US naval operations in real time in the Gulf could also prove very valuable for China if tensions in the Strait of Taiwan were to flare up.

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