

Iran war shock causes IMF to revise down global growth forecast

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The US war on Iran has caused the International Monetary Fund (IMF) to revise down its forecast for global growth which will be released at its spring meeting next week.

In an interview with Bloomberg on Tuesday, IMF head Kristalina Georgieva said the world was ill-equipped to deal with the economic shock generated by the war. She said that before the US war, “we were on the way of upgrading our growth projections for 2026. Given the impact of the war, we are going to downgrade them.”

The choking of oil supplies had triggered a “negative supply shock, meaning that it pushes prices up” and “therefore attention to inflation ought to be a priority.”

As is always the case with the financial institutions of global capitalism, attention to inflation does not mean developing means to bring prices down. The focus is ensuring that any significant wages movement of the working class, in response to increasingly intolerable price hikes, will be countered by rises in interest rates.

She said the world was less prepared to meet a major economic downturn than before and armed with less policy tools. This was due to two factors.

First, great power tensions and conflicts had made international cooperation more difficult in the face of an emergency, even as those same conflicts had made them more frequent.

This assessment is underscored by the fact that this is the second consecutive spring meeting in which the IMF has confronted an emergency provoked by the actions of the Trump administration.

In 2025, the spring meeting was held as Trump unveiled his so-called “reciprocal tariffs” against the rest of the world, effectively shattering the post-war international trading framework. This year’s meeting is being held in the shadow of the US war on Iran.

The second factor was the growth of government debt.

“The world is facing this shock after it has been sustaining the impact of Covid, of the war in Ukraine: in other words, with depleted policy space,” she said, noting that few governments had taken any meaningful measures to pay down their post-COVID debt pile.

The other factor, which she chose not to mention, in deference to the IMF’s political masters, the major imperialist powers, is the increase in military spending by governments around the world. This is spending which is to be paid for by cuts to social services, health and education, on the grounds that the constriction of “policy space” makes this necessary.

She said central banks had to balance attention to inflation with concern about not suffocating growth. “Be very careful how you respond to the shock, it’s a very delicate moment.”

An IMF blog issued at the end of last month summarised some of the effects of the war that had already “caused serious disruption to the economies of the most directly affected countries, including damage to their infrastructure and industries that could become long lasting.

“Parts of the Middle East, Africa, Asia Pacific, and Latin America face the added strains of higher food and fertiliser prices and tighter financial conditions. Low-income countries are especially at risk of food insecurity; some may need external support—even as such assistance has been declining.”

The blog post said that while the war could shape parts of the global economy in different ways, “all roads lead to higher prices and slower growth.”

Apart from the effect of higher energy prices, the war is impacting supply chains for non-energy production inputs. “Rerouting tankers and container ships raises

freight and insurance costs and lengthens delivery time. Air-traffic disruptions around key Gulf hubs impact global tourism whole adding another layer of complexity to trade.”

The war, it said, had “unsettled financial markets” with a decline in stock prices and a rise in bond yields across the major economies. While the market selloff had so far been contained, at least compared to past global shocks, financial conditions had nonetheless tightened worldwide.

But this relatively sanguine outlook on financial conditions may not last because, as *Financial Times* columnist Ruchir Sharma pointed out in a recent comment, the oil shock had revealed a “novel reality in the global economy.”

“Never before has the world entered a crisis of any kind with such high deficits and debt levels,” he wrote. “This burden will limit the ability of governments to cushion the impact of higher energy prices.”

He noted that since the first oil shock at the beginning of the 1970s, the typical budget deficit of major economies in relation to GDP has more than doubled from 2 percent, and the total government debt level for the G7 countries has gone from 20 percent to more than 100 percent of GDP.

“Last year,” he wrote, “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 a new stimulus.”

While the US had energy self-sufficiency, it was “nonetheless vulnerable to a prolonged conflict because it has the highest deficit in the developed world last year at nearly 6 percent of GDP.”

With interest payments on US government debt now exceeding even spending on the military, the bond market reaction to the oil price shock was a rise in yields. This was sending out a warning as the administration, habituated to spending as if there is no limit, increased military outlays by \$1.5 trillion. Combined with tax breaks and other decisions, this could lift the deficit close to 7 percent of GDP this year.

Sharma concluded his piece with the observation that 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 ... [and] this new vulnerability will expose the global economy not only to fallout from the Iran war, but to every shock in the foreseeable future.”

Besides the quantum of government debt, there is also the issue of who holds it and how it is being financed. In a recent comment, FT columnist Gillian Tett drew attention to significant research carried out by the New York Federal Reserve last October into the so-called “basis trade” in US Treasuries.

This is the process by which hedge funds and others exploit the tiny differences between the future price of Treasuries and the cash price of the bonds. Because the difference is so small, large amounts of leverage are needed to make substantial profit.

The result has been a transformation in the structure of the \$30 trillion Treasury market—the basis of the global financial system—over the past four years.

As Tett drew out in her report, the Cayman Islands, the home of 85 percent of hedge funds, located there for tax minimisation purposes, is “the largest foreign holder of US Treasury securities—holding significantly more than China, Japan and the United Kingdom.”

The Fed economists found that between 2022 and 2024, hedge funds “absorbed 37 percent of net issuance of notes and bonds” and this was “*nearly the same amount as all other foreign investors combined.*” (Italics in original.)

These funds operate according to similar algorithms, which means that in the event of a market shock they tend to react in the same way, creating the conditions for a rush for the exits and a financial crisis.

Thus, as concerns grow over the growth of debt in the face of the shock to the global economy resulting from the war—whatever the outcome of the present ceasefire negotiations—the Treasury market, which finances this debt, is being turned into a giant casino.



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