Potential Global Financial Consequences of a War Between India and Pakistan

I. Executive Summary

A military conflict between India and Pakistan carries the potential for significant global financial repercussions, although the immediate and long-term economic impact would be markedly asymmetric. Pakistan, burdened by pre-existing economic vulnerabilities, stands to face dire consequences, potentially including sovereign default and long-lasting instability. India, with its more robust and diversified economy, would likely experience a more limited direct economic impact. However, the risk of broader regional and global financial market volatility, coupled with disruptions to international trade and supply chains, cannot be understated. International financial institutions, such as the International Monetary Fund (IMF) and the World Bank, would likely play critical roles in the aftermath of a conflict, particularly in providing financial assistance and facilitating recovery efforts. The potential for escalation, given that both nations are nuclear powers, further amplifies the global financial risks associated with such a conflict.

II. Economic Landscape of India and Pakistan Before Potential Conflict

- **A. Pakistan's Pre-Existing Economic Vulnerabilities:**
    - Pakistan's economy has a history of instability, frequently teetering on the brink of collapse and heavily reliant on financial aid from international partners. This dependence is rooted in long-standing issues such as ineffective governance and periods of military rule. Even for basic economic functions, the nation often requires external loans, highlighting a fundamental lack of self-sufficiency. Currently, Pakistan is engaged in a $7 billion bailout program with the IMF, a lifeline that is essential to prevent the country from defaulting on its obligations and to maintain a degree of macroeconomic stability. While this program has yielded some positive indicators, such as a decrease in inflation and an increase in foreign exchange reserves, these improvements remain precarious and could easily be undone by the significant economic shock of a military confrontation. Adding to this vulnerability is the potential for India to leverage its influence within the IMF to oppose future financial assistance to Pakistan, especially if tensions escalate and accusations of supporting terrorism persist. Such a move could isolate Pakistan financially at a critical time. The reality is that Pakistan's economy is in a state where it can scarcely afford any military conflict with its larger neighbor. Surviving on successive loans and struggling to implement necessary reforms mandated by the IMF, even a limited military engagement could prove economically devastating for Pakistan.

- Pakistan's foreign exchange reserves are critically low, barely exceeding $15 billion. This level is insufficient to cover its external debt payments due in the coming years, leaving the country highly exposed to external economic pressures. In sharp contrast, India possesses significantly larger foreign exchange reserves, exceeding $688 billion. This substantial difference underscores India's greater capacity to absorb potential economic shocks arising from a conflict, whereas Pakistan faces an immediate threat of depleting its already meager reserves.

- The Pakistani economy has grappled with persistently high inflation, reaching a peak of 38.50% in May 2023. This was accompanied by negative economic growth and dwindling foreign exchange reserves, painting a picture of a struggling nation. Although recent progress under the IMF program has brought some relief, with inflation declining and reserves showing some improvement, these gains are fragile and vulnerable to reversal in the event of a military conflict. Moody's Ratings has warned that sustained tensions with India could negatively impact Pakistan's growth, fiscal stability, and overall macroeconomic situation. A full-scale war would likely trigger hyperinflation and create shortages of essential goods, further destabilizing the economy.

- Pakistan carries a substantial debt-to-GDP ratio, hovering around 70%. A significant portion of the government's revenue, between 40% and 50% in 2023, is already allocated to interest payments. This leaves limited fiscal flexibility for other essential government functions. Increased military spending during a war would place an even greater strain on Pakistan's already stretched financial resources, potentially leading to a deeper debt crisis and further limiting its ability to fund vital public services or undertake post-conflict recovery efforts.

- Pakistan's economic structure is heavily reliant on agriculture and faces several long-term structural challenges. These include a narrow tax base, persistent energy shortages, instability in its currency, and a continuous need for external financial support. Furthermore, protectionist trade policies and an underperforming agricultural sector have hindered overall economic growth. A significant vulnerability lies in the potential impact of India's suspension of the Indus Waters Treaty. Agriculture contributes substantially to Pakistan's GDP (22.7%) and relies on the Indus River system for over 95% of its water supply. Disrupting this water supply could severely impact agricultural output, potentially leading to increased inflation and food insecurity across the nation. This reliance on a single, potentially vulnerable sector underscores a major economic risk for Pakistan in the context of conflict with India.

- **B. India's Relatively Stable Economic Position:**

  - India possesses a more diversified economy with significant contributions from sectors such as technology, services, and manufacturing. Its growth is fueled by robust domestic demand, a growing middle class, and strong inflows of foreign direct investment. Notably, India's economic ties with Pakistan are minimal, accounting for less than 0.5% of India's total exports in 2024. This limited direct economic relationship suggests that a conflict with Pakistan would likely not cause major disruptions to India's overall economic activity. India's macroeconomic conditions are generally stable, supported by strong public investment and healthy private consumption. Furthermore, India's large foreign exchange reserves provide a substantial buffer against external economic shocks. While India's economy exhibits greater resilience, it is worth noting that increased defense spending resulting from a conflict could potentially weigh on the government's fiscal consolidation plans.

- **C. Comparative Economic Strengths:**

Indicator	India (2024/2025 Estimate)	Pakistan (2024/2025 Estimate)	Source Snippet ID
GDP (Nominal, USD Trillion)	3.7	0.35	
GDP Growth Rate (%)	6.2 - 6.3	2.7 - 3.2	
Foreign Exchange Reserves (USD Billion)	688	15	
Inflation Rate (%)	3.34 (Early 2025)	5.1 (2025 Forecast)	
Debt-to-GDP Ratio (%)	N/A	70	

Chain of Thought: The table above provides a clear comparison of key economic indicators for India and Pakistan. The significant disparity in GDP, foreign exchange reserves, and the higher debt-to-GDP ratio for Pakistan underscore the much greater economic vulnerability of Pakistan to the financial consequences of a war. While India's growth rate is significantly higher, and its reserves are substantially larger, Pakistan's smaller economy and limited buffers leave it far more exposed to economic shocks. The inflation rates are also indicative of Pakistan's ongoing economic struggles.

III. Direct and Indirect Costs of Conflict

- **A. Increased Military Expenditure:**
  - Historical conflicts between India and Pakistan have incurred substantial financial costs. During the limited Kargil conflict in 1999, both nations experienced a steep drop in their stock markets, and while markets recovered, Pakistan's GDP growth fell in the subsequent fiscal year. The 2001-2002 Operation Parakram saw India spend an estimated $1.8 billion, with Pakistan's expenses reaching around $1.2 billion. Adjusting for inflation, a hypothetical 1,000-hour war with Pakistan, based on a 1990 estimate, would cost India significantly more than the original ₹27,000 crore. Current estimates suggest that a full-scale conflict could cost India approximately $1 billion per day and potentially increase its fiscal deficit by 50% if it extends for two to three weeks. In comparison, Pakistan's daily military expenditure during the 2002-2003 period was approximately ₹3.7 billion. The financial disparity between

the two nations is evident, with India's stronger economic position allowing for greater flexibility in sustaining prolonged military operations compared to Pakistan's limited resources.

- The exigencies of war would necessitate increased government spending in both India and Pakistan, often leading to adjustments in tax structures to accommodate the heightened financial demands. India's defense expenditure for the fiscal year 2024-25 is budgeted at ₹6.21 lakh crore (approximately $75 billion), and this would escalate significantly in the event of war. Pakistan's recent fiscal policies have included the removal of tax exemptions, effectively shifting the financial burden onto the public. Meeting IMF conditions for financial assistance, which often include tax policy adjustments, while simultaneously managing increased defense spending would pose a significant challenge for Pakistan during a conflict.

- **B. Disruption of Trade and Economic Activity:**

  - Following the Pahalgam attack, India has employed economic pressure tactics against Pakistan, including the suspension of the Indus Waters Treaty, bilateral trade, and shipping and logistics operations, along with the closure of Indian airspace to Pakistani airlines. Pakistan has reciprocated by closing its airspace to Indian carriers, resulting in increased costs for airlines like Air India due to rerouting. Pakistan has also announced a suspension of all trade with India, including through third countries. Official trade between the two nations has been frozen since 2019, and while official figures show minimal trade, experts estimate that unofficial trade, routed through third countries, amounts to around $10 billion a year in Indian exports to Pakistan. A conflict would likely disrupt these flows, impacting sectors such as Pakistan's pharmaceutical industry, which relies on imports from India. The closure of the Wagah-Attari crossing, the main land border for trade, will further increase the cost of trade and affect trade from Afghanistan that utilizes this route.
  - India's suspension of the Indus Waters Treaty can result in a severe reduction in Pakistan's water supply, which will impact agricultural output, potentially boosting inflation. Pakistan depends on water from the Indus Basin for more than 80% of its agriculture. Water shortages in agricultural areas could exacerbate food inflation in Pakistan.

- **C. Impact on Infrastructure and Development:**

  - Military conflicts tend to deter foreign investment due to heightened risk perceptions. During the Pulwama attack in 2019, Foreign Portfolio Investors withdrew Rs 3,000 crore from Indian markets. A full-scale war could lead to significant capital flight from both nations, depreciation of their currencies, and increased inflation, undermining economic growth and investor confidence. Conflicts also divert resources from developmental projects to defense spending. Significant infrastructure initiatives, such as the Delhi-Mumbai Industrial Corridor, could face delays or damage during conflicts, affecting industrial output and employment. Additionally, increased defense budgets may lead to cuts in social sector spending, impacting education, healthcare, and poverty alleviation programs. The attack in Kashmir has already severely impacted the region's tourism sector, which contributes around 7% to its GDP and employs approximately 200,000 people.

- **D. Environmental Catastrophe:**
  - Armed conflict between India and Pakistan could lead to environmental devastation across ecosystems already stressed by climate change. Lessons from recent conflicts, such as in Ukraine and Gaza, highlight the potential for damage to forests and protected areas, as well as instances of industrial pollution from damaged facilities. The destruction of infrastructure, such as the Nova Kakhovka dam in Ukraine, led to widespread flooding and contamination, requiring significant resources and time for restoration. Conflict would also disrupt disaster response efforts and divert resources from essential climate change adaptation programs.

IV. Global Financial Market Ramifications

- **A. Stock Market Volatility:**
  - The escalation of tensions following the Pahalgam attack in April 2025 triggered immediate financial panic in Pakistan, with the Karachi Stock Exchange plunging 2,000 points within hours of India's retaliatory measures. Pakistan's benchmark KSE-100 index has experienced a decline of approximately 4% since April 23, 2025, reflecting investor concerns about a potential military conflict. In contrast, India's Sensex has shown resilience, gaining 1.5% in the same period, highlighting the difference in economic stability and market confidence between the two countries. However, prolonged conflict could reverse these gains in the Indian market. Historical parallels, such as the 2001-2002 military standoff, show that even limited confrontations can cost both nations billions of dollars and lead to capital flight and currency depreciation.
  - Global investors are watching the rising tensions with increasing anxiety, as the negative implications for markets could be deeper and more immediate than many realize. Global equity markets, already jittery from trade wars and other uncertainties, could be dealt another blow if hostilities deepen, especially if energy supplies or major regional trade routes are threatened.
- **B. Currency Exchange Rate Fluctuations:**
  - A full-scale war between India and Pakistan would likely lead to a sharp fall in the value of both the Indian Rupee (INR) and the Pakistani Rupee (PKR). The escalation following the Pahalgam attack has already prompted currency traders to hedge against greater volatility in both currencies. Historical parallels suggest that a full-scale war could exacerbate these trends, potentially devaluing the Pakistani

rupee significantly. Increased demand for safe-haven currencies, such as the Japanese Yen (JPY), Swiss Franc (CHF), and the US Dollar (USD), is also expected during periods of geopolitical turmoil. The persistent strength of the USD, influenced by factors like the Federal Reserve's monetary policy and global trade concerns, can further pressure emerging market currencies, including the INR.

- **C. Commodity Market Impact:**
  - While neither India nor Pakistan is a top-tier oil producer, any escalation in South Asia could trigger wider instability across energy routes and shipping lanes, driving up insurance costs and disrupting already delicate supply chains, leading to a real risk of a price spike in global crude prices. Gold, already in high demand during global market uncertainty, could rally further if India-Pakistan tensions flare. Investors may also consider silver and platinum as alternative value storage assets. India, which imports a significant portion of its crude oil, would be particularly vulnerable to rising oil prices. Furthermore, India's suspension of the Indus Waters Treaty could lead to water shortages in agricultural areas of Pakistan, potentially stoking food inflation.
- **D. Investor Confidence and Capital Flight:**
  - Military conflicts tend to deter foreign investment due to heightened risk perceptions. A full-scale war could lead to significant capital flight from both nations as international investors express caution regarding security deterioration and economic instability. During the Pulwama attack in 2019, Foreign Portfolio Investors withdrew Rs 3,000 crore from Indian markets. A major deterioration in security conditions could cause firms to delay investments, relocate operations, or downgrade expansion plans in the region. Investors who have grown accustomed to discounting geopolitical risks may soon face material losses if a conflict erupts. Sovereign wealth funds and global institutional investors may also reassess risk-weighted allocations toward safer jurisdictions, increasing demand for assets in more politically stable environments.

V. The Role of International Financial Institutions

- **A. International Monetary Fund (IMF):**
  - Pakistan's economy is currently stabilized under a $7 billion IMF bailout program, which helped it stave off a default threat in 2023. The IMF board is scheduled to discuss a new $1.3 billion arrangement for Pakistan under its climate resilience loan program, along with a review of the ongoing bailout program. However, India has raised concerns with the IMF regarding its loans to Pakistan, asking for a review and potentially opposing future disbursements, citing concerns about the misuse of funds to support terrorism. India had earlier abstained from voting on the bailout package but could vote against further assistance. India's increased diplomatic efforts at the IMF are aimed at sharpening its influence.
  - The IMF has a history of providing financial support to countries facing crises,

including those affected by armed conflict, to help them restore economic stability and growth. Emergency financial assistance is designed to be disbursed rapidly to countries with urgent balance of payments needs arising from natural disasters or armed conflicts.

- **B. World Bank:**
  - The World Bank has historically played a significant role in mediating disputes between India and Pakistan, most notably in brokering the Indus Waters Treaty in 1960. Following the Pahalgam attack, India unilaterally suspended the treaty, raising concerns about its potential use as an economic weapon against Pakistan. Experts suggest that the United States and the World Bank may intervene to prevent a complete breakdown of this crucial treaty.
  - The World Bank has also provided substantial financial and other assistance to countries affected by war, such as its significant support for Ukraine following the Russian invasion. This support has included emergency financing, budget support, and assistance in maintaining essential government services.

VI. Impact on Global Trade and Supply Chains

- **A. India's Role in Global Supply Chains:**
  - India is rapidly emerging as a key hub in global supply chains, benefiting from its fast-growing economy, a vast labor force, and increasingly business-friendly policies. Government initiatives like "Make in India" and Production-Linked Incentive (PLI) schemes are further boosting its manufacturing sector. Key export sectors for India include pharmaceuticals (where it is a global leader in generic drugs and vaccines), textiles, the automotive industry (becoming a major global producer), and information technology. Many multinational corporations are now viewing India as a vital alternative in their supply chain diversification strategies, often adopting a "China Plus One" approach.
  - **Insight:** A major military conflict involving India could significantly disrupt its growing role as a critical manufacturing and export center, leading to potential delays, increased costs, and vulnerabilities in global supply chains that rely on Indian goods and services, particularly in essential sectors like pharmaceuticals and IT.

- **B. Pakistan's Role in Global Supply Chains:**
  - The textile industry is the largest part of Pakistan's manufacturing sector and a major contributor to its exports, including items like house linens, refined petroleum, rice, and non-knit men's suits. However, Pakistan's share in global textile exports has been facing challenges and has not kept pace with competitors like China. Pakistan also experiences problems in meeting the sanitary and phytosanitary (SPS) requirements of developed countries, which can impede its exports of agricultural and food products. Furthermore, Pakistan has a lower export-to-GDP

ratio compared to other countries in the South Asian region.
  - **Insight:** A military conflict would severely disrupt Pakistan's export-oriented industries, especially textiles, which account for a significant portion of its foreign exchange earnings. This would further strain its already vulnerable economy and could also create disruptions in the global textile supply chain.

- **C. Broader Impact on Global Supply Chains:**

  - Geopolitical events, including military conflicts, can cause significant disruptions to global supply chains by leading to port closures, the imposition of sanctions and trade restrictions, higher transportation costs, and overall delays in the movement of goods. Trade wars and increasing protectionism can also substantially impact international trade flows.
  - The ongoing war in Ukraine serves as a stark example of how a regional conflict can have far-reaching consequences on global supply chains, leading to impediments in the flow of goods, dramatic increases in costs, and shortages of essential products, particularly in the food and energy sectors.
  - **Insight:** A war between India and Pakistan, particularly if it escalates or becomes prolonged, would likely exacerbate existing vulnerabilities in global supply chains, potentially causing significant disruptions across various sectors, increasing transportation costs, and leading to shortages of goods worldwide. The interconnected nature of the global economy means that disruptions in this strategically important region could have ripple effects across the globe.

VII. Geopolitical Risk and Investor Confidence

- **A. Elevated Geopolitical Risk:**
  - The historical and ongoing tensions between India and Pakistan represent a significant source of geopolitical risk in the South Asian region and globally. The fact that both nations possess nuclear arsenals amplifies this risk considerably, making any potential conflict a matter of grave international concern with potentially catastrophic consequences.

  - Global geopolitical risk has been on the rise in recent years due to various international tensions and conflicts. A war between two nuclear-armed states would further elevate this risk, injecting a significant level of uncertainty into the global economic environment and potentially undermining investor confidence worldwide.
  - **Insight:** The heightened geopolitical risk associated with a potential India-Pakistan war would likely translate into increased volatility in financial markets and a more cautious approach from investors globally.

- **B. Impact on Investor Sentiment:**
  - Elevated geopolitical risk typically leads to a decline in investor confidence, often prompting a "flight to safety" towards assets perceived as less risky. This could result in capital flight from both India and Pakistan, with Pakistan, due to its weaker economic fundamentals, likely experiencing a more substantial outflow of

investment.
  - Investors may become more risk-averse and reassess their portfolio allocations, potentially shifting towards safer havens such as government bonds of developed nations and precious metals like gold.
  - **Insight:** A deterioration in investor sentiment would negatively impact foreign direct investment into the South Asian region, making it more difficult for both India and Pakistan to attract the capital necessary for sustained economic growth and post-conflict recovery.

- **C. Global Investor Perspectives:**
  - Global investors are closely monitoring the escalating tensions between India and Pakistan with growing anxiety, recognizing the potential for significant repercussions in financial markets. Currency traders may begin to hedge against increased volatility in both the Indian Rupee and the Pakistani Rupee, and bond markets could start to factor in geopolitical risk premiums.
  - Investors who may have previously underestimated geopolitical risks might find themselves facing significant losses if a conflict were to erupt. Sovereign wealth funds and other large institutional investors might also re-evaluate their risk-weighted asset allocations, potentially increasing their demand for assets in more politically stable regions.
  - **Insight:** While a heightened risk environment could lead to losses for some investors, it might also create opportunities for those positioned to benefit from increased demand for safe-haven assets or from potential shifts in sector performance, such as in defense and cybersecurity.

VIII. Long-Term Economic Scenarios

- **A. Pakistan's Long-Term Outlook:**
  - A prolonged military conflict with India could have catastrophic long-term consequences for Pakistan's economy, potentially leading to a significant strategic decline and a weakening of its ability to exert influence. The substantial costs of a protracted conflict could erase the limited economic progress Pakistan has made since narrowly avoiding bankruptcy in 2023.
  - Pakistan's already slow progress towards achieving the Sustainable Development Goals (SDGs) would likely be severely hampered, potentially pushing millions more people into poverty due to economic contraction, rising inflation, and widespread job losses.
  - **Insight:** The long-term economic outlook for Pakistan in the event of a war is bleak, with the potential for prolonged instability, increased poverty, and a significant setback to its development prospects for decades to come.

- **B. India's Long-Term Outlook:**
  - While the immediate economic impact on India is anticipated to be less severe than

on Pakistan, a prolonged period of heightened tensions and increased military expenditure could still slow down the pace of its fiscal consolidation and potentially impact its long-term fiscal health.
    - Regional instability resulting from a protracted conflict could also negatively affect India's trade and investment relationships within South Asia and potentially hinder its aspirations for greater global economic influence and leadership.
    - **Insight:** Despite its greater economic resilience, India would not be entirely immune to the long-term consequences of a destabilized region, particularly in terms of trade flows, investment, and its broader geopolitical ambitions.

- **C. Global Long-Term Implications:**

    - A major military conflict between two nuclear-armed nations in a strategically vital region carries the potential for profound and unpredictable long-term consequences for global peace, security, and economic stability, potentially leading to a significant reshaping of regional and international alliances.
    - The economic repercussions could extend far beyond the immediate region, potentially slowing down global economic growth, disrupting established international trade patterns, and significantly hindering progress towards achieving global development goals.
    - **Insight:** The long-term global impact would be heavily contingent on the duration and intensity of the conflict, as well as the degree of involvement from other major global powers. A prolonged and escalated conflict carries the risk of causing substantial and lasting damage to the global economic and political order.

IX. Conclusion and Strategic Considerations

The potential for a war between India and Pakistan presents a significant global financial risk, albeit one with a highly asymmetric impact. Pakistan, already grappling with a fragile economy and heavy reliance on external financial assistance, faces the prospect of severe economic consequences, potentially leading to sovereign default and long-term instability. India, while possessing a more resilient and diversified economy with limited direct economic exposure to Pakistan, would still likely experience increased fiscal pressures and potential disruptions to its growing role in global supply chains.

The global financial markets would likely react with increased volatility, with investors seeking safe-haven assets and potentially reassessing their exposure to the South Asian region. Currency markets would likely see significant fluctuations in the values of the Indian and Pakistani Rupees. The involvement of international financial institutions such as the IMF and the World Bank would be crucial, particularly in assisting Pakistan in navigating a potential economic crisis, although geopolitical considerations could complicate their response.

From a strategic perspective, de-escalation and diplomatic solutions are paramount for both India and Pakistan to avert the catastrophic economic and human costs of war. International actors should encourage dialogue and support peaceful resolutions. For global investors, careful monitoring of the situation, diversification of portfolios, and a long-term investment horizon are essential strategies for managing the risks associated with this significant geopolitical event. Ultimately, the potential global financial ramifications of a war between these two nuclear-armed nations underscore the urgent need for preventative diplomacy and a commitment to peaceful conflict resolution to safeguard global economic stability and prosperity.

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