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Attack on Iran, and the impact on Sri Lanka

- Four weeks on, war fatigue is on the rise with all parties other than Israel searching for a way out
- Increasing international pressure on USA to stop the war
- End of war will swiftly calm the global oil markets and global business & trade will return to normalcy, despite a change in the Middle East investment landscape
- Provided the war ends within another month, Sri Lanka is in a better fiscal footing to face the current situation compared to periods of previous global economic challenges
- Longer the war lasts, the fiscal cushion would fast erode, triggering strong inflationary tailwinds, a negative current account position and slowing GDP growth
- The war has negatively affected all global economies
- Sri Lankan market is at an over-sold position compared to other markets, hence the upside could be greater and faster once the Middle Eastern conflict de-escalates.

Global Market Index - (27th Feb to 20th March)

Country	Index	27-Feb	20-Mar	% Change
Israel	TA-35	4,128.36	4,313.86	4.30%
Malaysia	KLCI	1,716.61	1,720.71	0.24%
Singapore	ST Times	4,995.07	4,948.87	-0.93%
Bangaladesh	DSEX	5,600.27	5,353.94	-4.60%
Shanghai	SSE Composite	4,162.88	3,957.05	-5.20%
Hong Kong	Hang Seng	26,630.54	25,277.32	-5.35%
Thailand	SET Index	1,528.26	1,432.99	-6.65%
MSCI Frontier Mkt	FM	804.83	749.21	-7.42%
New York	Dow Jones Ind:	49,499.20	46,021.43	-7.56%
London	FTSE 100	10,894.50	10,009.05	-8.85%
Bombay	Sensex	81,287.19	74,532.96	-9.06%
Australia	ASX	9,198.60	8,428.40	-9.14%
MSCI Emerging Mkt	EEM	63.31	57.62	-9.88%
Pakistan	KSE	168,062.17	152,740.38	-10.03%
Tokyo	Nikkei 225	58,850.27	53,372.53	-10.26%
Germany	DAX	25,284.26	22,380.19	-12.98%
Srilanka	ASPI	23,734.06	20,639.73	-14.99%
Jakartha	JKSE Composite	8,235.49	7,106.84	-15.88%

Source: Investing.com

Overview

Israel and US attacked Iran on 28 Feb 26, expecting a swift end to Iranian resistance which was not the case. Now the Iran war which is in its 4th week, is spiraling out of control and grappling the entire Middle East while damaged/curtailed oil and gas production along with rising transport costs are creating energy scarcity and pushing up global cost bases. Two days ago, the US President gave an ultimatum for opening the Iranian controlled Hormuz Straight and then extended the deadline for 5 days allowing for discussions while reducing the global anxiety on escalated strikes against oil infrastructure. The ambiguous messages and yo-yoing strategies by the US President have brought about even more uncertainty to the already volatile markets. However, with the rest of the world except Isreal wanting cessation of hostilities, the probability remains high for a ceasefire. However, any unilateral aggression by Isreal, US and/or Iran could prolonged the conflict.

Reasoning suggests the US will need to fast end the Iran War through cessation of hostilities.

- Iran is defending themselves and preparing for a long-drawn battle, which will be a strong negative for the other Middle Eastern nations and the global economy.
- US and Israel are getting isolated amongst their allies who do not want to repeat the mistakes of the previous Gulf War and unnecessarily attack a sovereign country.
- Global opposition is building against the US and the Israeli regime, starting with the Scandinavian countries, Spain and Maldives. Furthermore, in the US support for the Iran war is weaning.
- The global economies do not want the war to continue, since it possesses a huge threat to oil supplies and price stability.
- US Mid Term elections are in November and currently the republicans are having a thin 5-seat majority in the Senate and the house of Representatives. Therefore, if the Iran war continues beyond April, it will be an uphill task to maintain Republican party majority and will weaken the sitting US Presidents' power base.
- Longer the war drags, the risk for the Dollar dominance in energy trade will weaken with Europe having to rely on Russian Gas and oil

shipments while the Hormuz straight could be selectively opened for trade in Chinese Renminbi.

- Flipside to rationality is that the Israeli regime will be opposing any ceasefire and would want the US support to cover their vulnerabilities. Also, it could be challenging for the US President to withdraw America from the war without a convincing win while some Middle East governments could still prefer Iran to be completely defeated.

Impact of the Iranian War, to Sri Lanka and to the world will depend on;

1. Duration of the War
2. Extent of damage to energy production infrastructure
3. Damage to the Iranian economy and global trade sanctions
4. Damage to the Israeli economy, reconstruction strategy and investments
5. Change in risk profile for the Middle East and the impact on the Petro Dollar
6. Realignment of global super-powers

Impact on Sri Lanka over the next 12 months

Iran War - Duration	4 - 6 Weeks	6 - 12 weeks	> 3 months
Inflation	Temporally spike	Annual inflation can be elevated to 7%-8%	Annual inflation >10%
Interest rates	No change	+150 bps	>200 bps increase
Currency	Impact will normalize	c. 5% weakness	> 10% weakness
Remittances	No significant impact	c.10%-20% of loss of remittances	c. >30% loss of remittances
Tourism	Arrival targets can be met	Arrivals could drop by around 15%	Arrivals could falter by c.30%
Exports	The losses can be recouped	Tea exports could fall by c.20%	>30% drop in tea exports and c. 10%-20% drop in other exports
Current Account	Will remain in surplus	Marginally negative	Negative
FDI	No change	Negative	Negative
GDP	4.5% - 5%	3%-4%	0.5%-3%
IMF	No action needed	Need to renegotiate targets	Seek fresh IMF assistance

Source:Sampath Securities Estimates

Sri Lanka's current macro-economic situation compared to periods of previous global turmoil

- c.USD7 bn in reserves (higher than previous periods of global economic challenges) albeit restructured debt repayments to commence in late 2027
- The SL Rupee is floated with minimal intervention
- Primary account and Current account in surplus
- Market based fuel pricing with no drain to the treasury
- Electricity price and institutional reforms are completed, with cost-pass-through pricing
- Widening the tax net and maintaining significantly high direct and indirect tax rates have ensured higher tax income for the Treasury, but has stunted GDP growth, savings and investments
- Most of the SOE's are now in profits or breaking even, except Sri Lankan Airlines which still gobbles a large chunk of taxpayer money and erodes the good work of all other profit making SOE's
- Nearly 50% of the remittances are from the Middle East region
- The Middle East buys around 45% of Sri Lankan tea exports
- Europe as a region is in a weak economic footing, with inflation biting hard, and buying c.35%-40% of Sri Lankan apparel exports
- Curtailed apparel manufacturing capacity in Sri Lanka, puts pressure on absolute export earnings/margins
- Disruptions to air travel and elevated costs negatively affect tourism
- Upward pressure on global interest rates

Sectoral impact from the war against Iran

Remittances

Sri Lanka relies heavily on its remittance income which is over US$8 bn (8%-9% of GDP) of which approximately 50% is from the Middle East. Longer the war continues this remittance income would be under threat, while already there are reports of Middle Eastern employers not paying their expat workers. However, if the war ends soon, there would be a larger opportunity for Sri Lankans to find employment in the Middle East, especially in Israel where significant investment would flow in for reconstruction and infrastructure in addition to the service support work.

Tourism

Most of the European and Russian tourists (accounting for 41% of arrivals), North American based arrivals representing 5% and Middle Eastern nationals accounting for 2%, normally transit through Middle Eastern (East Asia) aviation hubs, which are severely affected due to the Isreal/Iran/US war. If the war drags on Middle Eastern Airlines will re-route and create alternate temporarily hubs but albeit passing on the higher costs to the passengers. Furthermore, higher cost of air travel, triggered by higher fuel prices, will shift overseas holidaying to destinations closer to home. This phenomenon and Dubai not been a preferred destination any longer, could bump up arrivals from India (currently at 17%) to cover up the lost arrivals from the West.

Exports

Tea exports likely to be negatively affected with approx. 30% of tea exports destined to the Persian markets with the Middle East accounting for nearly half of Sri Lanka's tea exports. European economies are softening with added pressure from higher energy prices, which could adversely affect apparel exports to the region which currently accounts for around 40% of the export volume. Overall, the export margins could narrow due to higher input costs, which could be difficult to pass through.

Oil Imports

In 2025 Sri Lanka's oil import bill was c.US$4.1 bn, and considering the pre-war fuel prices, recovering economic activity and with the increased vehicle fleet we estimate the daily requirement of refined fuel is around 9,500 MT in 2026e. With global oil prices having risen 34% since the start of the war, and prices at the pump been reflective of global price swings, we believe the daily fuel demand could be in the range of 9,000 MT costing US$5.5 bn annually at the current elevated prices. Our research indicates that Sri Lanka currently has c.650,000 storage capacity (including LIOC's storage capacity in Trinco) for refined fuel (Diesel and Petrol), if utilized fully would be sufficient for over two months of demand. However, the institutions may not have maintained the maximum stock (due to working capital requirements) and Diesel been used for electricity generation along with fuel hoarding and panic buying may have necessitated the fuel quota system.

Energy

Sri Lanka is caught in a bad spot, having to rely more on high-cost diesel electricity generation due to issues facing the Coal power plant in Norichcholai. Further the ongoing heat wave is creating added demand on the grid with the adverse weather conditions which is likely to prevail. However, the Energy authorities now passing on the generation cost to the consumers is a fiscal positive, though high energy cost drags down Sri Lanka's competitiveness and standard of living. Lack of much aggressive investments into wind energy, grid connectivity with India (on fair terms) and battery storage has proven to be a costly miss.

Agriculture

The Maha harvest is unscathed, but if the War continues Yala season will be affected with fertilizer prices having already risen by 45%-50%. And with higher oil prices input costs will further drive-up farm gate prices. With distribution costs having already risen by c.30% food inflation will gather momentum.

Construction

Completed projects would have a quick price upside and widening margins, while future project pipeline could get dragged till clear visibility for input costs materializes. However, we could expect some fresh interest for high end condominiums as a fall out from the Iran war affecting the Middle East region.

Retail

Overall retail sector would be negatively affected with inflationary pressure, while there could be a boost in white-good sales ahead of the “Awurudu” season with consumers trying to beat Dollar inflation.

Banking and Finance

Given the War led inflationary pressures domestic loan growth could be negatively affected while loan book composition tilting towards trade finance and working capital funding. However, we do not see any immediate impact on asset quality, unless the war lasts for more than 3 months.

Logistics

Overall, the War would be a net positive for the international logistics sector, while we believe the benefits of margin expansion could outweigh the reduction in volumes if any. However non liberalization of the shipping industry remains the biggest hurdle in attracting FDI’s to the sector and if opened up could have been a magnet for foreign investments during these turbulent times.

Investments and FDI’s

Longer the Iran War lasts, it could be negative for domestic investments, though it could be turned into a positive if swift changes to the tax and investment promotion structures are enacted. However personal and corporate taxes above 30%, comparatively higher import duties and VAT at 18% become an automatic deterrent for either domestic or foreign investment. If Sri Lanka had comparatively attractive tax rates and an accommodating investor visa program, the country could have gained from the Middle Eastern investment exodus and the Indian upper middle class searching for alternate investment destinations. A possible easy win could be to invite a global airline to create a secondary hub in Sri Lanka with the possibility of divesting part of Sri Lankan Airlines as a packaged deal.

Price performance of a cross section of listed counters since the start of war

Ticker	Price as at 27/02/2026	Price as at 20/03/2026	Change	% Change
COMB.N	221.5	191.5	-30	-13.5%
HNB.N	447	393.5	-53.5	-12.0%
SAMP.N	160.75	151.5	-9.25	-5.8%
NTB.N	330.25	277.75	-52.5	-15.9%
PABC.N	57.6	49.8	-7.8	-13.5%
CFIN.N	263.75	217	-46.75	-17.7%
LFIN.N	160.5	137.25	-23.25	-14.5%
LOFC.N	5.7	5.2	-0.5	-8.8%
LOLC.N	580	512.75	-67.25	-11.6%
CINS.N	3200.25	3296.5	96.25	3.0%
JINS.N	144.75	123.25	-21.5	-14.9%
AAIC.N	96.4	82.1	-14.3	-14.8%
PLR.N	59.3	47.2	-12.1	-20.4%
OSEA.N	49.5	41	-8.5	-17.2%
KHL.N	21.1	16.7	-4.4	-20.9%
AHUN.N	113	85.1	-27.9	-24.7%
TAJ.N	35.9	31.8	-4.1	-11.4%
GRAN.N	460	372.25	-87.75	-19.1%
TAFL.N	647.5	569.75	-77.75	-12.0%
BFL.N	85.3	69.9	-15.4	-18.1%
DIST.N	59.7	53.5	-6.2	-10.4%
LION.N	1809	1696.5	-112.5	-6.2%
LMF.N	95.9	79.3	-16.6	-17.3%
WATA.N	45.3	39	-6.3	-13.9%
CTEA.N	1696	1299.25	-396.75	-23.4%
NAMU.N	86.4	60	-26.4	-30.6%
ELPL.N	181	151.25	-29.75	-16.4%
CARS.N	626.5	631.25	4.75	0.8%
LIOC.N	142	139.75	-2.25	-1.6%
AEL.N	79.9	66.5	-13.4	-16.8%
HAYL.N	244.75	207.5	-37.25	-15.2%
SPEN.N	158.5	139.75	-18.75	-11.8%
JKH.N	22.1	18.3	-3.8	-17.2%
HHL.N	33.8	28.7	-5.1	-15.1%
RICH.N	36.8	31.4	-5.4	-14.7%
ACL.N	103	85	-18	-17.5%
SIRA.N	34.9	28.8	-6.1	-17.5%
CIC.N	33.8	29.8	-4	-11.8%
AGST.N	11.2	9.9	-1.3	-11.6%
SLTL.N	91.4	80.3	-11.1	-12.1%
DIAL.N	34.5	29.7	-4.8	-13.9%
MELS.N	184	165	-19	-10.3%
HPWR.N	10.1	9.6	-0.5	-5.0%
HPFL.N	14.2	13.7	-0.5	-3.5%
PAP.N	22.7	19.9	-2.8	-12.3%
VPEL.N	15.3	13.8	-1.5	-9.8%
VLL.N	22.2	19.5	-2.7	-12.2%
WIND.N	46.1	41.6	-4.5	-9.8%
LVEF.N	8.4	7.3	-1.1	-13.1%

Source:cse.lk

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