

Geopolitical Tensions

Widening of conflict in Middle East could have macroeconomic and sectoral implications; Iranian trade not significant for India

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Geopolitical tensions may impact the Indian macros like CAD, currency, FPI inflows and inflation.

For India, Iranian trade is not significant. However, a further escalation of the ongoing geo-political conflict may keep oil prices elevated.

If Iran chooses to close the Straits of Hormuz, Indian macros would see a further negative impact.

Escalation of geopolitical tensions in the Middle East contributed to the recent spike in crude oil prices. While the situation remains fluid at present, a further step up in tensions between Israel and Iran could impact various sectors of the Indian economy, the potential macroeconomic implications of which are analysed in this report.



Impact on Indian macros:

- A sustained flare-up in geopolitical tensions in the Middle East, and the consequent increase in crude oil prices would negatively impact Indian macros. While a \$10/bbl increase in average crude oil prices is likely to push up the Current Account Deficit (CAD) by 0.3% of GDP, an escalation of the conflict would also exert pressure on the USD/INR pair and may impact Foreign Portfolio Investors (FPI) inflows to India. Additionally, this would pose upside risks to our WPI inflation, and to a smaller extent to our CPI inflation projections for FY2025. While the extent of the direct impact on the fiscal health would be limited, G-sec yields may remain sticky in spite of the decline in the planned G-sec supply in H1 FY2025 and the higher demand owing to bond index inclusion. A sustained surge in crude oil prices could also exert a drag on GDP growth during the fiscal.



Merchandise trade

- **Imports:** Following western sanctions on crude oil, Iran's share in the total Indian merchandise imports declined to below 1% in FY2023 from the average of 2-3% seen in the decade before FY2019. Though, India does not import any crude from Iran owing to the sanctions, the ongoing geo-political tensions have led to an increase in Brent crude prices. Further, there is a threat that Iran may close the Straits of Hormuz, which is the main route of transport for crude oil from the Middle East (holding major share in oil imports) to India. Significant imports from Iran include dye intermediates and asbestos; the same can be substituted by other countries and hence are not critical.
- **Exports,** Iran was a one of the major destinations of exports of basmati rice and tea from India in FY2023, however, its share went down significantly in FY2024. The ongoing geopolitical tensions may further constrain such exports to Iran in FY2025.
- India's share in Iran's total imports and exports stands at 3%. However, Indian trade is significant for Iran for some agri and textile products.

Iran's share in FDI equity inflows, FPI and remittances is not significant. However, a spike in geopolitical issues may impact inflows from the other Middle East countries, which are a significant source of all such flows for India.

An escalation of the conflict may delay shipments and increase the cost of trade through the Suez Canal.



FDI, FPI and remittances

- Iran's share in Foreign Direct Investment (FDI) inflows into India is negligible, contributing less than 1% to the total pie. Further, contributions to FPI and remittances are nil. Additionally, there are no migrants in Iran from India as per the World Bank's KNOMAD database.
- However, an escalation of the ongoing conflict may impact FDI, FPI and remittances from neighbouring Middle East countries like the United Arab Emirates (UAE), Saudi Arabia, Qatar, Oman, Bahrain and Kuwait, which have significant share in all these categories for India. These neighbouring countries also house ~50% of India's total stock of migrants, having travelled there for employment opportunities.
- Weak global sentiment may affect FDI and FPI inflows from the advanced economies as well.



Bilateral agreements and Memorandum of Understanding (MoU) and corporate presence

- There have been agreements and MoUs between the two countries to improve connectivity, cooperation and partnership.
- The corporate presence of Iran in India and vice versa is limited.



Suez canal

- The Suez Canal route is important for India's trade with European countries, North Africa and North and South America. According to the Ministry of Commerce, India's merchandise trade with North and South America and Europe account for 35-40% of the total foreign trade for India.
- Shipments may witness delay in transit and increase in cost if the escalation of the conflict sustains, affecting trade through the Suez Canal.



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