ICRA

Geopolitical Tensions

Escalation of conflict in West Asia could have macroeconomic and sectoral implications for India

October 2024

Overview

ICRA

Click to see full report

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

Impact on commodity prices is limited so far, may affect global sentiments if tensions escalate.

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

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

ICRA has analysed the financial flows and trade with Iran and Israel in this report which may get impacted because of the ongoing geopolitical tensions.

Macro

Impact on Indian macros:

- A sustained flare-up in geopolitical tensions in West Asia, and the consequent increase in crude oil prices would negatively impact Indian macros. While an increase in average crude oil prices is likely to push up the Current Account Deficit (CAD), 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 modest G-sec supply in H2 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.

Commodity prices:

- The impact of the geo-tensions on commodity prices (other than crude oil) has been limited so far. If the geopolitical tensions escalate, and potentially extend to an involvement of the OPEC nations, it may affect global sentiments and commodity prices, which in turn may impact various countries, including India.

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.

Overview

ICRA

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

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

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 West Asian countries, which are a significant source of all such flows for India.

Iran

Merchandise trade

- **Imports -** Following western sanctions on crude oil, Iran's share in the total Indian merchandise imports declined to below 1% in FY2024 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 geopolitical 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 West Asia (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 export 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.

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 West Asia 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, coperation and partnership. The corporate presence of Iran in India and vice versa is limited.

Overview

Israel contributes marginally in merchandise trade, the overall pie of FDI equity inflows, the FPI and remittances to India.

Geopolitical tensions in Israel may lead to some commercial implications for Indian corporates with presence in that country.

Moreover, India would be impacted through changes in global sentiment and commodity prices.

Israel

Trade and financial flows

- Israel's share in the total Indian merchandise imports and exports (FY2024) stands at a mere 0.3% and 1%, respectively. However, India is dependent on imports of fertilisers from Israel. Dependance on Israel for exports is very low.
- On the other hand, India's share stands at 3-5% in Israel's total imports and exports. Indian trade is significant for Israel for some products like textile, pearls, precious/semiprecious stone, electrical/electronic products, chemicals/metals, fertilisers, arms and ammunition, spacecraft/aircraft etc.
- Israel's share in India's total services exports was low at ~0.3% (CY2021).

FDI, FPI and remittances

- Israel is the 44th largest country for Foreign Direct Investment (FDI) inflows into India, contributing ~0.05% to the total pie.
- Israel's share in the FPI is marginal as only one entity from Israel has invested as on Sept 2023.
- Israel accounts for ~0.1% of India's migrant stock and remittances to India.

Bilateral agreements and Memorandum of Understanding (MoU)

- There have been agreements and MoUs between the two countries to improve trade, collaboration for science, technology, innovation etc and bilateral investment.

Corporate presence

- According to the Ministry of External Affairs, there are over 300 investments from Israel in India. There is growing interest for Israeli companies in sectors such as renewable energy, water technologies, homeland security and real estate in addition to traditional areas such as agriculture, chemicals etc.
- Cumulative overseas direct investment from India during April 2000 to May 2023 was USD 383 million. Indian companies are marking their presence in Israel through mergers and acquisitions and by opening branch offices. They are also making a mark in the Israeli innovation ecosystem.

ICRA

Analytical Contact Details

Name	Designation	Email	Contact Number
Aditi Nayar	Chief Economist and Head – Research and Outreach	aditin@icraindia.com	0124 - 4545 385
Madhura Nejjur	Assistant Vice-President	madhura.nejjur@icraindia.com	022 - 6114 3417
Rahul Agrawal	Senior Economist	rahul.agrawal@icraindia.com	022 – 6114 3425
Aarzoo Pahwa	Economist	aarzoo.pahwa@icraindia.com	0124 – 4545 835
Tiasha Chakraborty	Senior Associate Economist	tiasha.chakraborty@icraindia.com	0124- 4545 848
Isha Sinha	Associate Economist	isha.sinha@icraindia.com	022 – 6114 3445

Business Development/Media Contact Details

Name	Designation	Email	Contact Number
L Shivakumar	Chief Business Officer	shivakumar@icraindia.com	022-61693304
Neha Agarwal	Head – Research Sales	neha.agarwal@icraindia.com	022-61693338
Rohit Gupta	Head Business Development – Infrastructure Sector	rohitg@icraindia.com	0124-4545340
Vivek Bhalla	Head Business Development – Financial Sector	vivek.bhalla@icraindia.com	022-61693372
Vinita Baid	Head Business Development – Corporate Sector - West & East	vinita.baid@icraindia.com	033-71501131
Shivam Bhatia	Head Business Development – Corporate Sector - North & South	shivam.bhatia@icraindia.com	0124-4545803
Naznin Prodhani	Head – Group Corporate Communications & Media Relations	communications@icraindia.com	0124-4545860

Thank You!