WAR OF THE WORLD

India Keeping Tabs on W Asia Conflict

Worrying implications of Iran turmoil for economy as volatility may hit oil price, currency, deficits

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New Delhi: India is closely monitoring escalating tensions in West Asia, with the Prime Minister's Office reviewing the situation alongside key ministries, amid concerns that a prolonged conflict could pressure the economy through higher oil prices, wider deficits and weaker remittance flows, officials said.

Top officials took stock of the rapidly evolving situation on Sunday and its possible impact on India. "We are closely watching the situation," a senior government official told **ET**.

Prime Minister Narendra Modi also chaired a meeting of the Cabinet committee on security to assess the situation, upon his return from a two-day tour of the states.

Israel and the US launched joint strikes on Iran early on Saturday, including attacks on "dozens of military targets" carried out as part of a "wide, coordinated, and joint offensive," killing Iran's supreme commander Ayatollah Ali Khamenei.

Economists fear increased volatility in the stock and energy markets, as well as the rupee, over the prospect of prolonged turmoil in the Gulf.

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Under Fire

Stock, energy markets may fluctuate

India has heavy dependence on imported crude

High exposure to Strait of Hormuz transit risk

Inflation risk on back of fuel costs

Trade deficit vulnerable to sustained oil price rise

OTHER MACROS

- **Current account deficit may widen** — **A 10% rise in oil price leads to CAD deteriorating by 0.4% of GDP**
- **Foreign outflows could worsen on poor sentiment**
- **Remittance flows may weaken, but not majorly**
- **Domestic outlook a source of respite**

Muted Short-term Effect

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India is one of the economies in Asia that's more exposed to higher oil prices, said Sonal Varma, managing director and chief economist, India and Asia ex-Japan, Nomura.

"The impact on India will be via the indirect channel—oil price increase and risk-off sentiment," said Anubhuti Sahay, head of India economic research at Standard Chartered Bank. She said the rupee is likely to bear the brunt, although its weakening could be manageable for now given that the rise in oil prices has been contained and the Reserve Bank of India (RBI) has ample foreign exchange reserves. "A key risk to monitor is how quickly the Middle East stabilises, as any long-drawn conflict will have implications for oil prices and growth-inflation dynamics in India," Sahay told ET.

"India imports more than 85% of its domestic oil needs, and around half of its crude oil imports currently transit through the Strait of Hormuz," Varma said. "The macro impact will depend on how high the oil price rises, and the duration of the rise."

The rupee declined 17 paise to 91.08 against the dollar on Friday, weighed down by a massive outflow of foreign funds. Crude oil prices have risen from about $65 per barrel to $72-73 over the past month or so. India imports 88-89% of its crude oil requirement.

Varma of Nomura noted that the inflationary impact of higher oil prices should be muted for now, since oil marketing companies are unlikely to raise pump prices, so growth should also remain well supported. "While the current account deficit remains manageable at ~1% of GDP, the main risk comes from capital account pressures due to foreign investment outflows, which could worsen due to geopolitical uncertainty," she said.

Every 10% rise in oil price leads to the current account deteriorating by 0.4% of GDP.

"We think this is a short-term risk, but it is manageable, and India's medium-term outlook remains positive," Varma added.

"We are watchful of the evolving developments and how the uncertainty would impact Indian macros," said Aditi Nayar, chief economist, Icra. "As of now, the robust domestic outlook provides respite."

She said "the extent that it (the Iran situation) prolongs and widens would have a bearing on India's macros, including things like the impact of fuel prices on inflation and the twin deficits, as well remittances." Retail inflation was 2.75% in January.

Madan Sabnavis, chief economist at Bank of Baroda, said bond yields are unlikely to be affected but rupee volatility could intensify. If oil stays above $70 a barrel for a long period, India's trade deficit will come under pressure.

However, foreign portfolio flows may not see much impact, he noted. "What is important is how long it lasts," he said. "Inflation or fiscal arithmetic may not get affected at this point of time."

Sabnavis said remittances will be hit, albeit not significantly, as the US is the major source for these payments, not the Gulf area.