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Rising Geopolitical tensions: Implications for the Indian Economy

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A sell-off on 30 September 2024 amid escalating geo-political crisis in West Asia, following Israel's attack on Lebanon, and China's rebound of the stock market characterise the present day scenario. China's stock market has gained, revived by an aggressive economic stimulus package. The wide scope of the measures sparked a strong market rebound. In the near term, it is expected that the rally may provide opportunities in sectors like tech and consumer goods. However, though the stimulus is a step in the right direction, broader, deeper economic changes will be needed to keep the momentum going.

The Indian stock market witnessed a plunge on 30 September 2024, when the BSE Sensex dived below 85,300, and Nifty50 declined below 25,850. The BSE Sensex ended the day at 84,299.78, down 1,272 points, whereas Nifty50 closed at 25810.85 down 368 points. However, on 1 October 2024, the NSE Nifty50 opened 0.35% higher at 25,899, while the BSE Sensex opened 0.34% higher at 84,585.

The Morningstar China Index rose 13.7% following the government's announcement of a massive stimulus package, including 800 billion Chinese yuan (\$114 billion) in support for equity markets. Since the index's market capitalization is \$2 trillion, this is a significant injection. The impact of this move was also seen in the Morningstar Emerging Market Index, which rose 5.5% over the week.¹

¹ Morningstar news and updates.

The geopolitical tensions are escalating. Prime Minister Benjamin Netanyahu issued threats to Iran, even telling Iranians they will be free from their regime “a lot sooner than people think.” The messaging comes after Netanyahu said in his address to the United Nations General Assembly, that “there is no place in Iran that the long arm of Israel cannot reach, and that is true of the entire Middle East.”

According to the Israeli military, armoured units and regular infantry were joining its ground operations in Lebanon, for creating further pressure on Hezbollah, preparing to retaliate against Iranian missile attacks. According to media news, Israel’s addition of infantry and armoured troops including the Golani Brigade, indicates that the operation may escalate beyond limited commando raids. The worst case scenario would materialize if Israel attacks Iran’s nuclear facilities. Any attack on Iranian oil production facilities or other major infrastructural facilities will also lead to an escalation of the regional war scenario in a big way.

Impact on the Indian Economy:

The rupee declined to almost 83.79/\$, due to aggressive selling by the foreign institutional investors (FIIs). Elevated dollar demand on account of equity-related outflows could also keep the rupee under pressure. Despite India surpassing China in the MSCI Emerging market (EM) Index, India’s stock market valuation is sketchy. The reaction of the Chinese market to the stimulus will have some impact on Indian stock market including other emerging markets.

Nonetheless, one positive is the Fed has started softening the rate cycle which would be positive for the EM markets going forward, where further rate cuts are expected. How the political economy will behave especially in the context of the US elections, the immigration and trade policy would be crucial. The developments of bi-lateral relationships and minimizing conflicts among countries would be the key for economic growth and progress.

While oil prices have shown better picture, how this would turn out amid the geopolitical challenges in the West Asia and middle east is yet to be seen. The oil prices have recently skyrocketed nearly 5 per cent following the Israel-Hezbollah conflict, and related developments. Globally, there are upward trends in WTI crude (increased by 8%), Brent Crude (increased by 7%), Murban crude, natural gas etc.

India is already in the process of strategically diversifying its energy sources, e.g. India’s close alliance with Russia. India was the second-largest buyer of

Russian fossil fuels during June 2024. However, India is also heavily dependent on Middle East countries including Saudi Arabia, Iraq, Kuwait, UAE. In August 2024, Russia's share declined to 36%, whereas in July 2024, the share was 44%. In May 2024, Russia accounted for 41% of India's 4.8 mmbd in crude imports, while Iraq's share stayed at 20%, Saudi Arabia accounted for only 11%, and the U.S. share remained 4%.² India purchased more than two mmbd from Russia in July 2024 due to discounted prices. However, while in Aug 2024, Russia's share in crude oil imports to India declined, the cumulative share of the Middle East countries has increased to almost at 45% from 40% in July'24.

A big potential danger is that if Israel attacks any oil installations of Iran, it could increase crude oil prices substantially. In India, there is certain downward impact on tyre and paint companies, as such industries depend on heavily on petroleum-based raw materials. Oil-dependent industries might face possible squeeze in their margins, which may push supply-side inflationary bottlenecks.

A related issue is India's current account deficit (CAD) and the risk of fuel prices passing through the consumption basket. Though fuel has a 6.84% (almost 7%) weight in the CPI basket, and on an average, roughly \$10/per barrel increase in crude oil prices might escalate the CAD by 30-40 basis points (bps). India's CAD widened marginally to \$ 9.7 billion (1.1% of GDP) in Q1:2024-25 from \$8.9 billion (1.0% of GDP) in Q1:2023-24 and against a surplus of \$4.6 billion (0.5% of GDP) in Q4:2023-24. Hence, India's CAD is not an issue of great concern at present. The actual impact would depend on the trajectory of the on-going geopolitical tension.

² <https://www.nbr.org/publication/oil-for-india/>