

Impact of Iran-Israel War

16th April 2024

Background

Tensions have been rift between Israel and Iran ever since Israel's conflict began with Hamas militants in the Gaza Strip back in October 2023. On April 13, 2024 Iran launched an offensive against Israel wherein Iran launched more than 300 drones towards Israel following an alleged attack by Israel on the Iranian Consulate in Syria. This is the first time Iran has launched a direct military assault on Israel. The conflict faces the risk of escalation and may further spread beyond the two countries if Israel along with its ally the United States launches any other counter offensives. However, as of yet, the United States is making its position clear that it will not take part in any counter offensives against Iran.

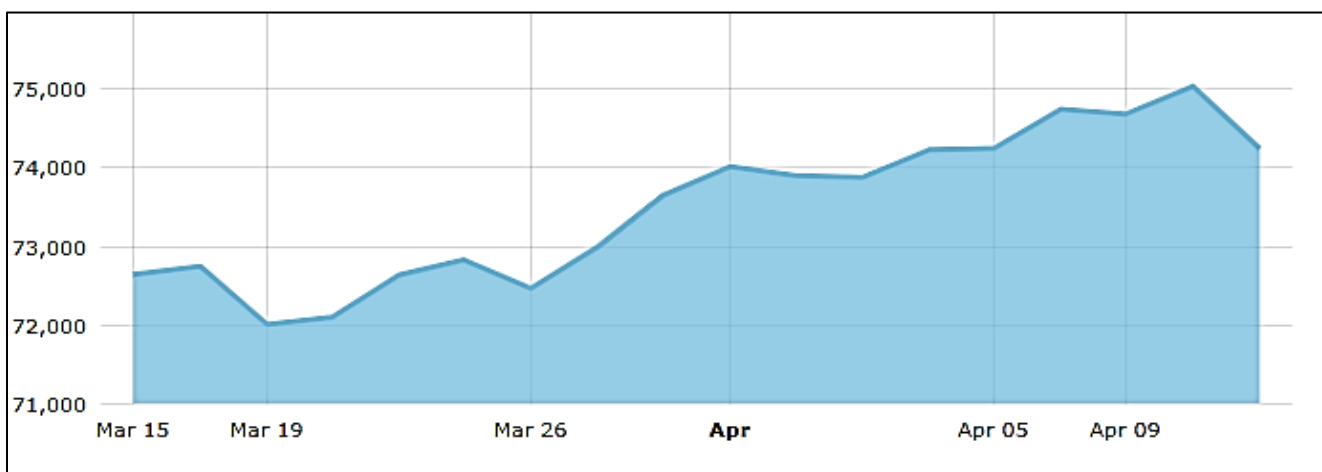
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Immediate Impact

- **Indian markets** fell from their all-time highs and opened lower on April 15, 2024 with the BSE Sensex opening at 73,315.16 and Nifty opening at 22,339.05.
- Nifty had scaled all-time highs of 22,775.70 on Wednesday, April 10, 2024, while the BSE Sensex also hit its all-time high of 75,124.28 before it closed at 75,038.15- which was above the 75,000 mark for the first time in history.

BSE SENSEX (Historical)



Source: BSE

NIFTY 50 (Historical)

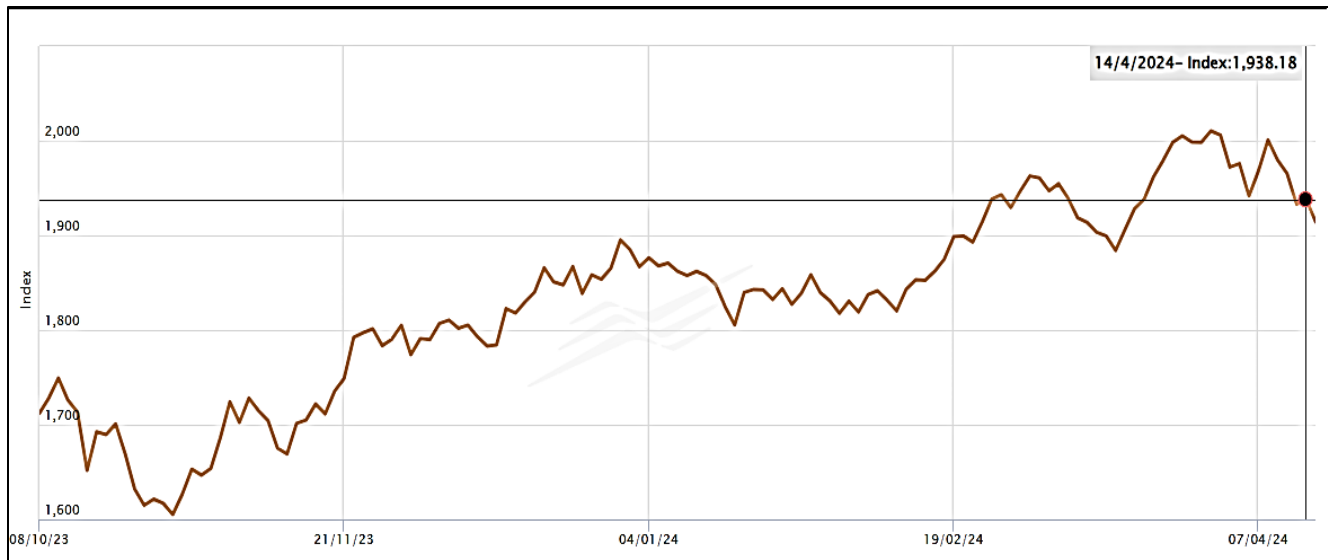


Source: Trading Economics

Short-term Impact

- The tensions between Iran and Israel are likely to push **air fares significantly higher** especially in Asia, Europe, and Middle-East. Iran and its neighbouring countries including Jordan, Iraq, Lebanon and Israel have imposed certain restrictions on their aircrafts operating in their airspaces. The travel time is also expected to increase by an hour with airlines avoiding the Iranian airspace and taking a longer route. This will entail higher fuel cost (approx. 9-15 per cent) thereby impacting the air fare by almost 25-30 per cent. It also poses concerns for navigational safety.
- The risk of an escalation of the conflict is expected to keep **crude oil prices extremely volatile** at least in the near-term. Crude prices are already prevailing close to USD 90/bbl, and with the new developments denting investor sentiments internationally, crude prices are expected to touch USD 100/bbl in the near-term.
- However, **Indian investors' sentiments are less likely to get affected** unless there is a further escalation in the conflict pushing the crude prices higher. With the tensions between Iran and Israel becoming visible from Thursday, April 10, 2024, in India FPIs sold shares around Rs. 8027 crore on Friday, April 12, 2024. However, DIIs bought shares worth Rs. 6341 crore-thereby limiting the losses.
- Further, despite the tensions between the two nations, **investor sentiments in Israel were not dented**. The Tel Aviv Stock Exchange's (TASE) benchmark TA-35 closed 0.27 per cent higher on Sunday, April 14, 2024.

TA-35 (Historical)



Source: TASE

- **Maritime and agricultural trade is also likely to be significantly impacted.** Iran is one of the largest destinations for India's exports of Basmati rice. War risk premiums are likely to rise for vessels operating in the affected area. War risk premiums have increased from USD 10,000 per vessel six months ago to USD 35,000 per vessel at present. Further, while India's oil imports from Russia have increased, the Arab states still constitute two-thirds of India's oil needs.

Commodity Composition of India's Trade with IRAN (Top 5 commodities)

| EXPORTS | % Share in Exports (2022-23) |
|---|------------------------------|
| Rice | 62.0% |
| Chemicals & related products | 10.5% |
| Sugar & molasses | 4.7% |
| Tea | 4.1% |
| Drugs, pharmaceuticals & fine chemicals | 3.6% |
| | |
| IMPORTS | % Share in Imports (2022-23) |
| Chemicals and related products | 41.4% |
| Petroleum products | 28.3% |
| Fresh fruits | 19.7% |
| Chemical material & products | 7.2% |
| Ores and minerals | 2.1% |

Source: CMIE

Commodity Composition of India's Trade with ISRAEL (Top 5 commodities)

| EXPORTS | % Share in Exports (2022-23) |
|---------------------------------------|------------------------------|
| Petroleum products | 65.4% |
| Gems & jewellery | 15.0% |
| Engineering goods | 4.9% |
| Chemicals & related products | 3.4% |
| Electronic goods | 2.9% |
| | |
| IMPORTS | % Share in Imports (2022-23) |
| Pearls precious & semiprecious stones | 32.8% |
| Chemicals and related products | 25.8% |
| Electronic goods | 20.3% |
| Fertilisers | 17.4% |
| Engineering goods | 12.0% |

Source: CMIE

- India's trade with Iran and Israel comprises mainly of petroleum, chemical and agricultural commodities. India also exports labour intensive commodities such as gems and jewellery, tea, electronic products, etc. to the two nations- which are expected to take a hit due to the ongoing strife.
- Additionally, fertilizers from Israel constitute a substantial portion of the imports from Israel into India. **Disruption in this will likely push domestic food prices up.**

Longer-term Impact

- The conflict has unfolded at a time when India has been performing well in all aspects. Inflation is cooling down, industrial production is gathering momentum, consumption demand is strengthening and rural prospects are upbeat.
- Inflation India's retail inflation reduced to 4.85 per cent in March 2024 owing to a moderation food prices. Core inflation moderated to 3.25 per cent. Inflation is ebbing and the steady decline in core inflation would have brought headline inflation down towards RBI's target of 4.0 per cent if not for the repetitive spikes in food inflation. However, the **trajectory of moderation in CPI may not persist if food price pressures remain volatile.**
- Higher oil prices are likely to keep inflation from cooling down and may also push it further up. This may lead to a delay in policy rate cuts or a shift in stance by the RBI- which are expected after August 2024.

- Israel has also threatened to close the Suez Canal which, if executed, will severely **impact international trade flows**. With 30 per cent of global container traffic and 12 per cent of global trade passing through the Suez Canal, its possible closure will lead to a re-routing of vessels through Africa's Cape of Good Hope equating to a roughly 30 per cent increase in transit times and an approximately 9 per cent reduction in effective global container shipping capacity. Taking the lengthy detour around the Cape of Good Hope will add around 3,500 nautical miles and 10-12 days sailing time to each trip. This will add to fuel costs (an additional USD 1 million), finding alternative ports of call, and adjustments to delivery timetables.
- India's CAD moderated from USD 11.4 billion (1.3 per cent of GDP) in Q2 FY'24 and remained considerably lower at USD 10.5 billion (1.2 per cent of GDP) in Q3 FY'24 compared to USD 16.8 billion (2.0 per cent of GDP) in Q3 FY'23. **Expectations of CAD moderating to 0.8-0.9 per cent of GDP going ahead may be derailed** due to tensions in West Asia.
- **Higher oil prices are expected to have a ripple effect in the medium to long term-** leading to a higher outgo of forex reserves, pushing up the Current Account Deficit (CAD) and a pass through to domestic prices- leading to higher inflation. The exchange rate is also affected and so are corporate earnings. All of these factors ultimately dent GDP growth.
- Nonetheless, **India's forex reserve position is comfortable** to brace the impact of higher crude prices. India's forex reserves grew by USD 2.98 billion to reach a new peak of USD 648.6 billion for the week ended April 5, 2024. Foreign currency assets increased by USD 549 million to USD 571.2 billion.

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