

# The Geopolitical Crucible: Assessing the Macroeconomic Implications of a US-Israel-Iran Conflict on the Indian Economy

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## Abstract

This paper looks at the potential economic impacts on India if a military conflict breaks out or grows larger among the United States, Israel, and Iran. Because India relies heavily on the Middle East for oil, shipping routes, and money sent home by workers, any major trouble in the Persian Gulf directly affects its economy. By looking at how the economy is structured, this paper analyzes the main channels of impact—mostly volatile oil prices, supply chain delays in the Bab-el-Mandeb and Strait of Hormuz, rising inflation, and investors pulling their money out. It uses these factors to predict how the conflict would affect India's fiscal deficit, GDP growth, and central bank interest rate decisions.

**Keywords:** Geopolitics, Indian economy, GDP, Fiscal deficit.

## 1. Introduction

The geopolitical landscape in Western Asia (the Middle East) is a major factor in keeping India's economy stable. A direct or proxy war that pits the United States and Israel against Iran would shock the entire global economy. For India, which is the world's third-largest user of crude oil, these dangers are deeply built into its economic system rather than being minor issues. India imports more than 85% of the crude oil it needs, and a lot of it travels through risky maritime choke points. Because of this, a full-scale regional war would cause a severe drop in supply. This paper breaks down the exact pathways through which such a conflict would disrupt India's budget planning, everyday consumer spending, and trade balances with other countries.

## 2. Objectives of the Study

To fully understand the economic damage a major Middle Eastern war could cause to a large, growing economy, this study focuses on these core goals:

- To identify and map the exact pathways through which a US-Israel-Iran war spreads into India's domestic economy.
- To measure how much India's main economic indicators—specifically GDP growth, Consumer Price Index (CPI) inflation, and the Current Account Deficit (CAD)—change when oil supplies face a shock.
- To analyze how disruptions at key shipping bottlenecks (the Strait of Hormuz and Bab-el-Mandeb) affect India's import-export trade and factory supply chains.

- To check the vulnerability of India's external financial buffers, including foreign portfolio investments (FPI), the value of the Indian Rupee (INR), and money sent home by workers living in the Gulf Cooperation Council (GCC) countries.
- To look at India's institutional defense strategies, like its emergency oil reserves and central bank actions in the currency market, and offer ideas on how to lower these risks.

### 3. Literature Review

The link between political risks and economic performance in growing markets is well-studied by economists.

#### 3.1 Geopolitical Shocks and Oil Price Volatility

Early research by Hamilton (1983) proved that sharp oil price increases caused by political trouble in the Middle East have historically been strong signs of upcoming economic recessions. Kilian (2009) built on this by breaking oil shocks down into three types: supply shortages, overall demand increases, and panic buying. In a war involving the US, Israel, and Iran, prices would spike due to a mix of immediate panic buying and actual physical blockages of oil because the Strait of Hormuz is highly vulnerable.

#### 3.2 Emerging Market Vulnerabilities: The Indian Context

Focusing on India, studies by the Reserve Bank of India (RBI) regularly point out how deeply rooted the country's oil dependency is. Peer and Bhattacharyya (2022) found that unexpected oil shocks badly hurt India's trade terms, forcing the currency to lose value and widening the current account deficit. Because India's short-term demand for oil cannot easily be cut down, price hikes act like an unfair tax on everyday consumers, shrinking their spending money and lowering overall demand for goods.

#### 3.3 Maritime Trade and Global Value Chains

Modern studies look closely at how vulnerable sea shipping is. Today's factory supply chains rely on parts arriving exactly when needed. Research by banks after the Red Sea disruptions of 2024–2025 showed that security threats in the Bab-el-Mandeb pass high costs onto Asian exporters through expensive shipping container rates and higher insurance premiums. A larger war involving Iran would spread this danger to the Strait of Hormuz, threatening not just container ships but the global flow of oil and gas.

#### 3.4 Capital Flight and "Risk-Off" Sentiment

Calvo et al. (1993) wrote about how foreign investments can suddenly stop and leave a growing economy during times of global panic. When political risks spike, international investors move their money into safe havens like US Government Bonds and Gold. Past research shows that even economically healthy growing nations see their currencies lose significant value during these panicked phases, no matter how far away they live from the actual war zone.

### 4. Research Methodology

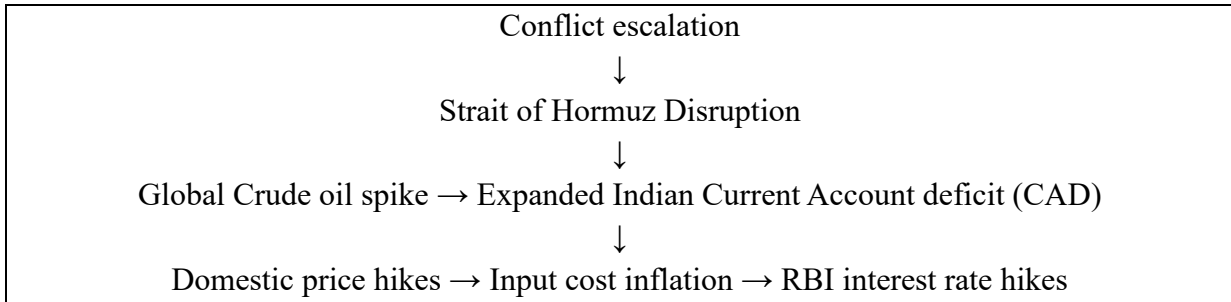
This study uses a structural, scenario-based analysis method based on logical economic relationships, using existing public economic data and historical formulas that measure how different financial factors react to one another.

### 5. Key Transmission Channels to the Indian Economy

#### 5.1 The Crude Oil Conundrum and Fiscal Slippage

The fastest and most aggressive way a Middle Eastern war hurts India's economy is through the price of crude oil. Any military response from Iran or threats to shipping lanes would directly hurt the 'Strait of

Hormuz’, which passes about 20% of the world's petroleum liquids.



**The Math of Indian Oil Dependency:** In the past, every \$10 increase per barrel in global crude oil prices expanded India’s Current Account Deficit (CAD) by about 0.5% of its GDP and raised retail inflation (CPI) by roughly 0.3% (30 basis points).

**Fiscal Deficit Pressures:** If global oil benchmarks like Brent crude jump past \$100–\$120 per barrel, the Indian government faces a tough choice: absorb the high cost by lowering fuel taxes (which cuts government revenue) or let consumers pay the high prices (which slows down everyday shopping and drives up inflation).

### 5.2 Maritime Trade and Supply Chain Disrupted

A war involving the US, Israel, and Iran would endanger shipping routes in both the Persian Gulf and the Red Sea corridor.

**The Red Sea / Bab-el-Mandeb Bottleneck:** India’s trade with Europe and the US East Coast depends heavily on the Red Sea route. Threats here force shipping companies to skip the Suez Canal completely and sail all the way around Africa's Cape of Good Hope instead.

**Economic Impact:** This detour adds 10 to 14 days to shipping times and causes freight costs and marine insurance fees to skyrocket. Indian exporters—especially those selling lower-profit, high-volume items like clothes, farm products, and engineering goods—face lower competitiveness and major inventory delays.

### 5.3 Capital Outflow and Currency Depreciation

War causes global investors to immediately look for safety. Foreign Portfolio Investors (FPIs) usually sell off assets in growing markets like India to move their money into safe places, mainly US Dollars, gold, and US Government Bonds.

**Rupee Vulnerability:** This large exit of investment capital, combined with a higher oil import bill, puts heavy downward pressure on the Indian Rupee (INR).

**Imported Inflation:** A weaker rupee, combined with already high global prices, causes imported inflation. This makes everything from imported electronic parts to farming fertilizers much more expensive for Indian businesses.

## 6. Macroeconomic Variables Analysis

The following table breaks down the expected direct impacts on India's economy:

Macroeconomic Metric	Anticipated Direct Impact	Core Driver
GDP Growth Rate	Downward Pressure (-0.5% to -1.0%)	Lower profit margins for companies, weaker everyday consumer spending, and delayed private business investments

CPI Inflation	Upward Spike (+1.0% to +1.5%)	Higher shipping and transport costs, widespread supply chain delays, and more expensive imported materials
Current Account Deficit	Widening Trend	A much larger total import bill because India cannot easily cut down its crude oil use
Monetary Policy (RBI)	Hawkish / Tightening	The Reserve Bank of India is forced to keep interest rates high or raise them further to protect the value of the currency and control inflation

### 7. The Human and Remittance Factor

The Gulf Cooperation Council (GCC) nations are home to over 8.5 million Indian workers. While Iran itself does not employ many Indian citizens, a wider war involving the US and Israel would inevitably disrupt neighboring GCC economies like the UAE, Saudi Arabia, and Qatar.

**Remittance Shock:** India is the world's top country for receiving remittances, bringing in over \$100 billion a year, and nearly half of that money comes from the Gulf. A widespread war that hurts the security or economies of the Gulf region could slow down these money inflows, which hurts consumer spending in India's rural and semi-urban areas.

**Evacuation Logistics:** Any large regional crisis creates a massive humanitarian and rescue challenge for the Indian government. Finding the resources to safely bring home millions of citizens places a heavy financial strain on state budgets.

### 8. Strategic Mitigation and Silver Linings

Even though the overall impact is clearly negative, India has built up strong economic defenses that it did not have in past decades:

**Strategic Petroleum Reserves (SPR):** India keeps underground emergency oil reserves that can cover about 9.5 days of its crude needs. While this is not a long-term solution, it gives the country a temporary shield against sudden supply stops.

**Diversified Energy Sourcing:** Over the last few years, India has shifted where it buys energy, importing more discounted crude oil from alternative sources (like Russia) to protect itself from Middle Eastern price spikes.

**Robust Foreign Exchange Reserves:** With its foreign currency reserves sitting at historically high levels, the RBI has plenty of power to step into the currency markets and stop a panicked, speculative crash of the rupee.

### 9. Conclusion

A US-Israel-Iran war would create a harsh external economic environment for India's growth momentum. The main damage pathways are structural: an expensive oil bill that worsens the budget gap, continuous imported inflation that limits what the central bank can do to help, and blocked sea routes that hurt Indian exporters. To handle such a crisis, Indian leaders must use smart trade diplomacy, use their foreign

currency reserves carefully to keep the rupee steady, and move faster toward domestic energy alternatives to break free from fossil fuel risks. Ultimately, while India's solid economic foundations offer good defence, a long war in Western Asia would inevitably slow down its planned GDP growth path.

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