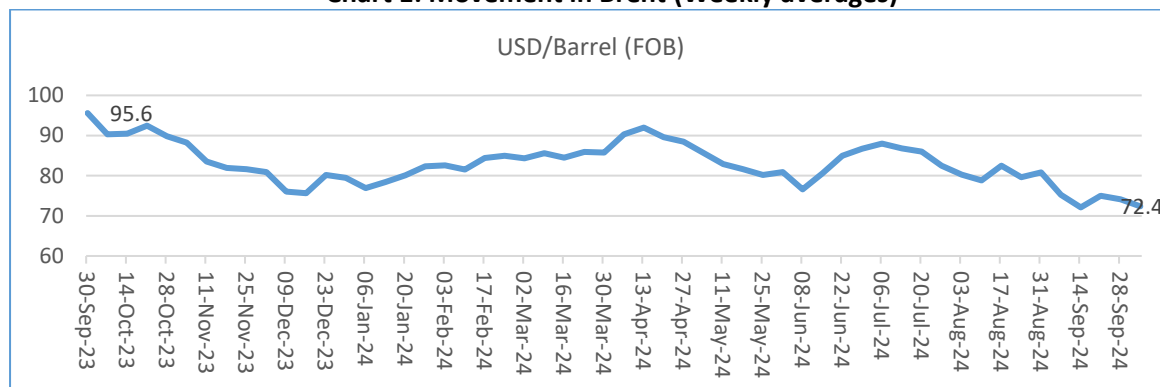


The West Asia Imbrogio: One year later

One year after October 7, 2023, when the Israel-Hamas (Palestine) battle started, it has spread with other groups like Hezbollah of Lebanon and Houthi from Yemen getting involved. The latest attack by Iran on Israel has led to conjectures on what would be the latter's reaction which has spooked markets all over. The world seems less safe since. It appears to be following the path of the Russia-Ukraine conflict with no end in sight. The global economy has shown some resilience or indifference as the tendency has been to carry on as normal after the initial disruption, which has tended to be temporary. What are the economic issues that would need to be watched?

The single point indicator of a war impact in West Asia has been the movement in the price of crude oil. Here the picture has not been perverse as can be seen in the chart below where the crude oil price has been mapped on weekly average basis from September 30, 2023 onwards. For the week ending 5th October 2024, Brent was at \$ 72.4/bbl. However, on a daily basis it touched \$ 80 mark on 7th October 2024. Hence one needs to observe how the price moves in the next couple of days which will be guided by the developments on the political front in this region. The past shows that the global markets have been resilient to this conflict with not much volatility in Brent price. There has been a downward movement subsequently till end September 2024. The present rise may or may not be temporary, and the future trajectory will be subject to conjecture.

Chart 1: Movement in Brent (Weekly averages)



Source: CMIE

The next question is how important is Iran, which is the latest subject in the conflict. Any escalation in the conflict can upset the supply dynamics. In this context, the table below gives the shares of various countries in total oil production in 2023. Out of the daily production of nearly 102 barrels, USA was the leader with share of 22%. Saudi Arabia and Russia come in the second and third places. Iran, has the ninth position and accounts for around 4% of production. Prima facie it does appear that the disruption that can be caused by such supplies being cutoff will have an impact and can still spook prices upwards. One of the comforting factors here is that USA is largely self-sufficient and hence would not be exerting demand side pressure. The China factor will be important because it is the second largest consumer with around \$ 15 mn bbl/day. Any recovery in the economy which is likely

due to the stimulus announced recently can up the demand for oil and put pressure on the market price. This is why the situation needs to be monitored closely. While the world has been moving more towards EVs and renewables, which has obviated demand for oil based products, the way ahead is much longer.

Table 1: Oil production in 2023 (mn bbl a day and share in total)

Country	Million barrels per day	Share of world total
United States	21.91	22%
Saudi Arabia	11.13	11%
Russia	10.75	11%
Canada	5.76	6%
China	5.26	5%
Iraq	4.42	4%
Brazil	4.28	4%
United Arab Emirates	4.16	4%
Iran	3.99	4%
Kuwait	2.91	3%
Total top 10	74.59	73%
World total	101.81	

Source: US Energy Information Services (2023)

In this context, it would be interesting to see how India’s import matrix stands for oil. In the first 5 months of the year, Russia was the largest source for oil with nearly 37% being sourced from this country followed by Iraq and Saudi Arabia. Iran is not a significant supplier of oil and to that extent the direct impact would be limited.

Table 2: Import of crude oil by India in FY25 (5 months)

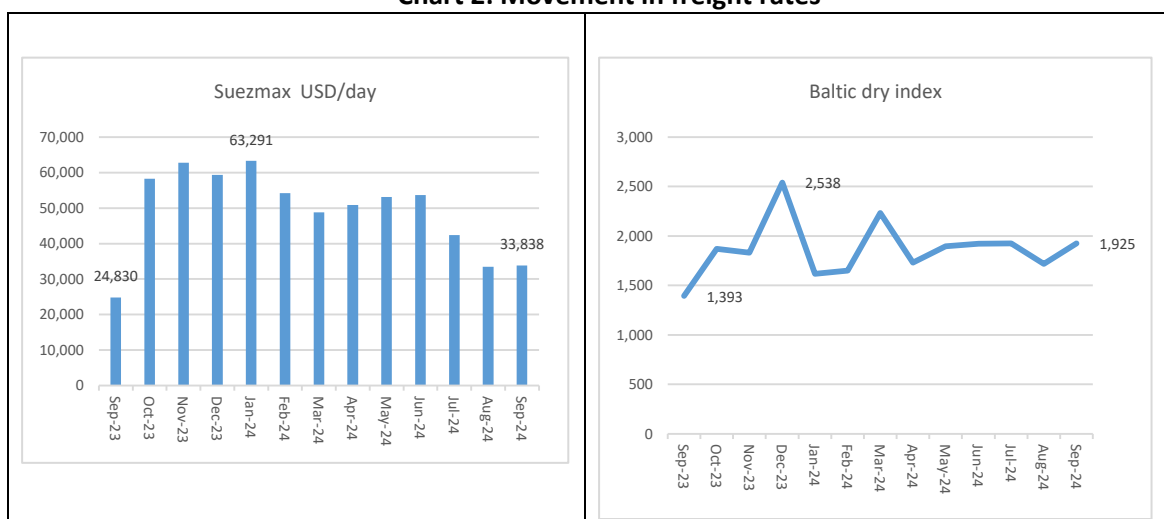
Country	Share in total (%)
Russia	37.4
Iraq	19.4
Saudi Arabia	12.1
UAE	8.4
Nigeria	2.6
Angola	2.6
Kuwait	2.8

Source: CMIE

While the direct impact of supply of crude oil at the global scale may be something that can be made up by other producers, a concern is more on the shipping routes that may have to be altered for transporting goods in general. The shipping routes through the Persian Gulf, Red Sea, Strait of Hormuz and Suez Canal would carry an accompanying risk depending on the level of escalation and

involvement of countries in the battle. This would mean taking alternative routes which in turn can push up transportation costs. In this context, two price indicators have been depicted in the Chart below. The first is the Suezmax freight rate which is the rate per day for the largest ship that can cross the Suez Canal while the second is the Baltic dry index. The purpose is to examine and see how these freight rates moved over the year ever since the Hamas raid last year. As can be seen the immediate impact was sharp, but the rates did moderate subsequently but have remained at a higher level than that in September 2023. The Suezmax increased by 36% while the Baltic Dry index by 38%. Therefore the possibility of freight rates increasing is very much on the table in case of further escalation of the crisis and this is something which will affect global trade making it more expensive. Global inflation is a real threat on this score.

Chart 2: Movement in freight rates



Source: CMIE

Concluding remarks

Therefore, the impact of the war can be significant in terms of price of oil as well as freight rates even though the direct trade relation is minimal. The oil price can affect inflation, trade balance as well as government revenue if the rise is permanent. A price in the range of \$ 80-85 should be absorbed well as was the case in the past.

The table below provides an indication of the variables that can be impacted by these developments. Inflation would depend on how the final prices play out in the CPI basket. The impact on WPI would be direct as this is absorbed by the system. The imports numbers would be driven by the price changes. However, the higher prices can have a mixed impact on the government finances depending on the tax structures. The final pricing will play out in terms of affecting the finances of the OMCs. Therefore, there will be a varied impact in case the crisis escalates and leads to higher prices of oil on a permanent basis.

Table 3: The contours of impact of higher oil prices

	Share
Crude oil share in WPI	1.95%
Mineral oils in WPI	7.95%
Fuel in CPI	1.82%
Fuel for conveyance in CPI	2.39%
Crude oil and fuel products in Imports in FY24	26.6%
Taxes received by centre in FY24	Rs 3.50 lkh crore
Dividend/income tax paid by OMCs in FY24	Rs 0.82 lkh cr
Taxes received by states and UTs in FY24	Rs 3.19 lkh cr

Source: CMIE, PPAC, Ministry of Commerce

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