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Economic Implications of the USA–Iran Conflict on India: Evidence from Oil Price Shocks, Trade Dynamics and Financial Market Responses

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ABSTRACT

The conflict between the United States and Iran has become one of the most important geopolitical issues influencing the global economy. Due to its strategic location in the Middle East and its impact on international energy markets, any escalation in tensions between these two countries has far-reaching economic consequences for both developed and developing nations. India, being one of the world's largest importers of crude oil and a rapidly growing economy integrated with global trade and financial systems, is particularly sensitive to such geopolitical developments.

This study examines the economic implications of the USA–Iran conflict on India, with special emphasis on energy security, trade balance, inflation, exchange rate movements, and financial market performance. The research is based on secondary data collected from various sources, including reports published by the Reserve Bank of India (RBI), the Ministry of Petroleum and Natural Gas, the International Monetary Fund (IMF), the World Bank, and the Ministry of Commerce and Industry. The study analyzes how disruptions in oil supply, sanctions, and uncertainties in the Middle East influence India's macroeconomic environment.

The findings indicate that geopolitical tensions between the United States and Iran significantly affect global crude oil prices, leading to an increase in India's import bill and putting pressure on the country's trade balance and current account position. Rising fuel prices contribute to inflationary pressures, while increased demand for foreign exchange affects the value of the Indian rupee. The study also finds that periods of heightened conflict create uncertainty in financial markets, resulting in fluctuations in stock prices and investor sentiment.

The paper concludes that although India has taken several measures to strengthen its economic resilience, including the development of strategic petroleum reserves and diversification of energy sources, sustained geopolitical instability in the region continues to pose significant risks. Therefore, greater emphasis on energy diversification, renewable energy development, and strategic economic planning is essential to reduce India's vulnerability to external shocks.

Keywords: USA–Iran Conflict, Indian Economy, Crude Oil Prices, Inflation, Trade Balance, Financial Markets, Energy Security.

INTRODUCTION

The global economy is closely interconnected with geopolitical developments, particularly in West Asia, a region that plays a critical role in the world's energy supply. The Middle East possesses a substantial share of global oil reserves and serves as a strategic hub for international maritime trade. Consequently, political instability and military tensions in the region often have far-reaching economic consequences for countries across the world.

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Among the major geopolitical issues affecting global markets, the long-standing conflict between the United States and Iran remains one of the most significant.

The relationship between the United States and Iran has been characterized by political disagreements, economic sanctions, diplomatic confrontations, and occasional military tensions since the Iranian Revolution of 1979.

These developments have frequently influenced global crude oil markets, investor confidence, and international trade flows. For countries that depend heavily on imported energy resources, such geopolitical tensions create substantial economic uncertainty.

India is particularly vulnerable to developments in the Middle East because of its growing energy requirements and dependence on imported crude oil. As one of the world's fastest-growing major economies, India's industrial growth, transportation sector, and overall economic activities rely heavily on a stable supply of energy.

Since domestic crude oil production is insufficient to meet rising demand, India imports a significant portion of its petroleum requirements from international markets, with West Asian countries remaining important suppliers.

Any escalation in tensions between the United States and Iran can disrupt energy markets and create volatility in crude oil prices. Such disruptions have direct implications for India by increasing import costs and widening the trade deficit.

Higher oil prices can also contribute to inflationary pressures, affect the value of the Indian rupee, and increase the burden on both consumers and businesses. Furthermore, uncertainty in global financial markets may influence foreign investment flows and lead to fluctuations in Indian stock markets.

The economic impact of the USA–Iran conflict extends beyond the energy sector. Rising fuel prices affect transportation, manufacturing, agriculture, and various service industries, thereby influencing the overall cost structure of the economy.

At the macroeconomic level, these developments may affect economic growth, fiscal management, monetary policy decisions, and external-sector stability. Consequently, understanding the channels through which geopolitical tensions influence the Indian economy has become increasingly important for policymakers, researchers, and business leaders.

The transmission mechanism of the conflict can be understood through a series of interconnected economic effects. Geopolitical tensions often lead to increases in crude oil prices, which subsequently affect inflation, trade balances, exchange rates, and financial markets. These developments ultimately influence economic growth and investor confidence. Therefore, the USA–Iran conflict serves as an important case for examining the relationship between geopolitical risk and economic performance in an emerging economy like India.

Against this backdrop, the present study seeks to analyze the economic implications of the USA–Iran conflict on India, with particular emphasis on energy security, trade performance, inflationary trends, exchange-rate movements, and financial-market behavior. The study aims to provide a comprehensive understanding of the challenges posed by geopolitical instability and to suggest policy measures that can enhance India's economic resilience in an increasingly uncertain global environment.

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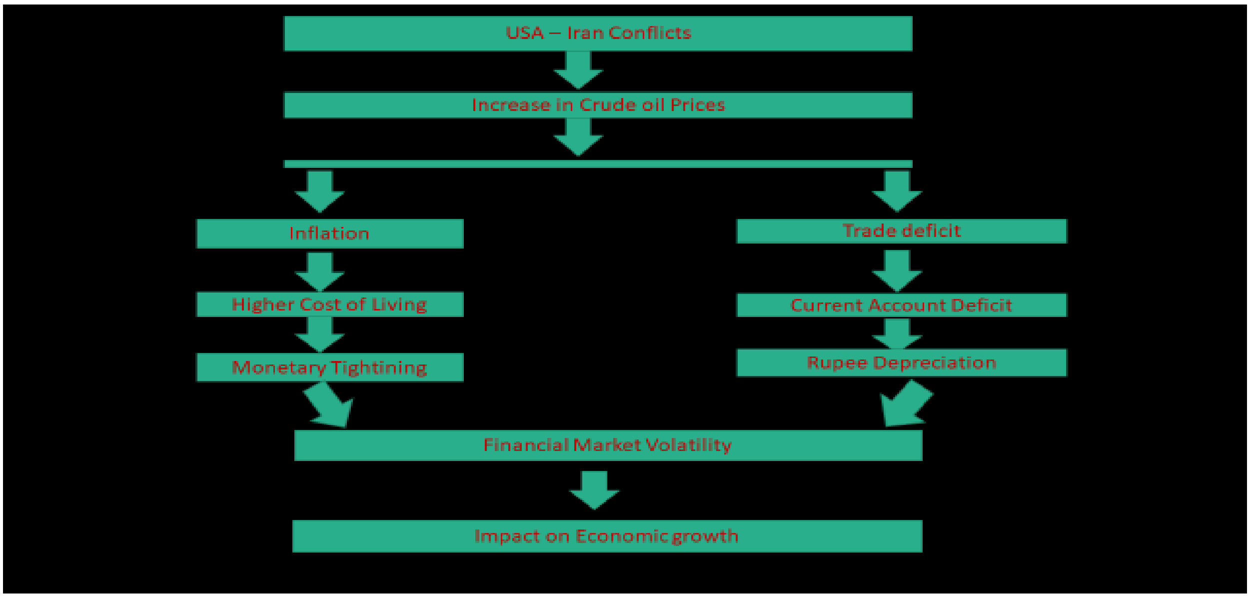
Chart 1: Impact on Economic growth



REVIEW OF LITERATURE

Several researchers have examined the relationship between geopolitical conflicts, oil price fluctuations, and macroeconomic performance. The existing literature suggests that geopolitical tensions in oil-producing regions significantly influence economic growth, inflation, trade balances, and financial stability across both developed and developing economies.

Hamilton (2003, 2009) was among the pioneering scholars to establish a strong relationship between oil price shocks and global economic downturns. His studies revealed that most post-World War II recessions in advanced economies were preceded by substantial increases in oil prices. He argued that energy demand tends to be relatively inelastic in the short run, making economies highly vulnerable to sudden disruptions in oil supply caused by geopolitical events.

In the Indian context, Bhattacharya and Bhattacharyya (2014) examined the impact of international crude oil prices on domestic inflation. Their findings indicated that increases in global oil prices are transmitted to the Indian economy through higher transportation and production costs, leading to inflationary pressures. The study found a significant relationship between crude oil prices and both the Wholesale Price Index (WPI) and Consumer Price Index (CPI).

Asati et al. (2020) analyzed the macroeconomic consequences of oil price shocks on India and observed that rising crude oil prices adversely affect economic growth and external-sector stability. Their study highlighted that sustained increases in oil prices tend to widen the current account deficit, weaken the domestic currency, and increase inflationary pressures.

Recent studies on economic sanctions and geopolitical conflicts have emphasized the changing dynamics of global energy trade. Researchers note that India's reduction in direct oil imports from Iran and its increasing dependence on alternative suppliers have improved compliance with international sanctions but have also increased exposure to broader regional disruptions. These studies collectively suggest that geopolitical instability in the Middle East continues to pose significant challenges to India's economic and energy security.

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This paper builds on the existing literature by directly focusing on the structural transmission mechanisms, integrating empirical observations up through the disruptions of 2026 to evaluate India's modern macroeconomic vulnerabilities.

RESEARCH METHODOLOGY

The present study adopts a descriptive and analytical research design to examine the economic implications of the USA–Iran conflict on India. Since the study focuses on macroeconomic variables and geopolitical developments, it primarily relies on secondary data collected from reliable national and international sources. The analysis covers a five-year period to understand the changing nature of the conflict and its impact on key sectors of the Indian economy.

The data used in this study have been obtained from various government and institutional publications. Information relating to crude oil imports, domestic production, and oil price trends has been collected from the Ministry of Petroleum and Natural Gas (MoPNG) and the Petroleum Planning and Analysis Cell (PPAC). Data on the current account deficit, balance of payments, foreign exchange reserves, and exchange rates have been sourced from the Reserve Bank of India's Database on Indian Economy. Trade statistics, including exports, imports, and trade balances, have been gathered from the Ministry of Commerce and Industry. In addition, reports and databases of the International Monetary Fund (IMF) and the World Bank have been consulted to obtain information on global commodity prices, inflation trends, and economic growth indicators.

The study considers the USA–Iran conflict as the independent variable, represented through major geopolitical developments such as sanctions, military tensions, and disruptions in oil supply routes. The dependent variables include crude oil prices, current account deficit, inflation, exchange rate movements, and foreign portfolio investment flows.

To analyze the relationship between these variables, the study employs trend analysis, comparative analysis, and interpretation of secondary data. The findings are presented through tables, charts, and graphical illustrations to identify patterns and assess the extent to which geopolitical tensions influence India's economic performance and financial stability.

Channels of Transmission and Impact Analysis

The economic impact of the USA–Iran conflict on India is transmitted through multiple channels, with the energy sector being the most significant. India is heavily dependent on imported crude oil to meet its growing energy requirements. Any escalation in tensions between the United States and Iran creates uncertainty in global oil markets and leads to an increase in crude oil prices. Since a substantial portion of the world's oil trade passes through the Strait of Hormuz, disruptions in this region can directly affect India's energy security and increase its import costs.

Higher crude oil prices have a direct impact on India's trade balance and current account deficit. As oil imports constitute a major share of the country's import bill, rising prices increase the value of imports even when the quantity imported remains unchanged. This widens the trade deficit and puts pressure on the balance of payments. Consequently, the country may need to rely more on foreign capital inflows and foreign exchange reserves to manage external imbalances.

Another important consequence is inflation. Rising fuel prices increase transportation and logistics costs, which are eventually passed on to consumers through higher prices of goods and services. In addition, industries that

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depend on petroleum products as raw materials, such as chemicals, plastics, and fertilizers, face higher production costs. These developments contribute to inflationary pressures and may compel the Reserve Bank of India to adopt tighter monetary policies. The conflict also affects exchange rates and financial markets. Increased demand for US dollars to pay for costly oil imports, combined with the withdrawal of foreign investments from emerging markets during periods of uncertainty, often leads to depreciation of the Indian rupee.

Financial markets react negatively to geopolitical tensions, resulting in stock market volatility and reduced investor confidence. Overall, prolonged conflict between the USA and Iran can adversely affect India's economic growth, macroeconomic stability, and financial performance.

Table 1: India's Crude Oil Import Dependency

Year	Domestic Production (MMT)	Crude Oil Imports (MMT)	Import Dependency (%)
2021-22	29.7	212.2	85.5
2022-23	29.2	232.7	87.3
2023-24	28.4	234.3	88.0
2024-25	28.0	242.5	89.0
2025-26	27.5	250.0	90.0

Source: Ministry of Petroleum and Natural Gas. (2025). *Indian Petroleum and Natural Gas Statistics*. Government of India, New Delhi.

Table 2: Crude oil prices and Inflation

Year	Indian Basket Crude Oil (US$/Barrel)	CPI Inflation (%)
2021-22	79	5.5
2022-23	96	6.7
2023-24	83	5.4
2024-25	78	4.9
2025-26*	95	5.8

Source: Ministry of Statistics and Programme Implementation. (2025). *Consumer Price Index Reports*. Government of India.

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Table 3: Trade Balance and Current Account Deficit

Year	Exports (US$ Billion)	Imports (US$ Billion)	Trade Deficit (US$ Billion)	CAD (% of GDP)
2021-22	422	613	-191	1.2
2022-23	451	714	-263	2.0
2023-24	437	678	-241	1.1
2024-25	448	692	-244	1.3
2025-26	455	720	-265	1.8

Source: Reserve Bank of India. (2025). *Handbook of Statistics on the Indian Economy*.

Table 4: Exchange Rate Movement

Year	Average INR/USD Exchange Rate
2021	74.57
2022	81.35
2023	81.94
2024	84.83
2025	88.72
2026*	Fluctuating between 90 and 96

Note: For the year 2026 Exchange rate taken from present market

Source: Reserve Bank of India. (2025). *Database on Indian Economy (DBIE)*.

Table 5: Foreign Portfolio Investment and Stock Market Performance

Year	FPI Net Inflows (₹ Crore)	Nifty 50 Annual Return (%)
2021-22	93,000	24.1

2022-23	-37,000	4.3
2023-24	1,68,000	20.0
2024-25	2,05,000	11.5
2025-26	1,15,000	8.2

Source: SEBI. (2025). *Annual Report*.

Chart 2: Financial Market Reaction after the US–Iran Conflict

Source: Author's compilation based on Reuters, Economic Times, and Times of India reports (2026)

Strategic and Bilateral Implications

The USA–Iran conflict has significant implications not only for India's economy but also for its foreign policy and regional trade relations. For many years, Iran was one of India's major suppliers of crude oil and offered several trade advantages, including flexible payment mechanisms, extended credit facilities, and reduced transportation costs. These arrangements helped India meet its growing energy requirements while conserving foreign exchange reserves.

However, the re-imposition of economic sanctions on Iran by the United States forced India to substantially reduce its direct oil imports from the country. To avoid financial and diplomatic complications, India shifted its crude oil purchases to alternative suppliers such as Saudi Arabia, Iraq, and Russia. While this strategy helped maintain energy security, it also reduced the flexibility and diversity of India's import sources.

The sanctions have also affected bilateral trade between India and Iran. Several Indian exports, including Basmati rice, tea, sugar, and engineering goods, have experienced a decline due to payment restrictions and banking challenges. As a result, overall trade volumes between the two countries have decreased, affecting businesses that traditionally relied on the Iranian market.

At the strategic level, the conflict has created challenges for important connectivity projects such as the Chabahar Port and the International North-South Transport Corridor (INSTC). Chabahar Port is particularly important for

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India because it provides direct access to Afghanistan and Central Asian markets while bypassing Pakistan. Despite geopolitical tensions, India has continued to support the development of this project due to its strategic significance.

Similarly, the INSTC aims to improve trade connectivity between India, Iran, Central Asia, and Russia. However, sanctions and financial restrictions have slowed infrastructure development and investment flows. Therefore, while India continues to pursue strategic cooperation with Iran, the ongoing USA–Iran conflict remains a major challenge to expanding bilateral trade, regional connectivity, and long-term economic partnerships.

FINDINGS AND POLICY RECOMMENDATIONS

Major Findings

- India's high dependence on imported crude oil makes its economy highly vulnerable to geopolitical tensions in West Asia.
- Escalation of the USA–Iran conflict leads to a rise in global crude oil prices, increasing India's import bill.
- Higher oil prices widen the trade deficit and Current Account Deficit (CAD).
- Increased demand for US dollars to pay for oil imports causes depreciation of the Indian Rupee.
- Rising fuel and transportation costs contribute to higher inflation in the domestic economy.
- Inflationary pressures may force the Reserve Bank of India (RBI) to adopt tighter monetary policies.
- Geopolitical uncertainty negatively affects investor confidence and creates volatility in financial markets.
- Foreign Portfolio Investors (FPIs) may withdraw investments from Indian markets during periods of heightened conflict.
- Economic sanctions on Iran have reduced bilateral trade opportunities between India and Iran.
- Strategic projects such as Chabahar Port and the International North-South Transport Corridor (INSTC) face operational and financial challenges due to geopolitical uncertainties.

Policy Recommendations

- Expand India's Strategic Petroleum Reserves (SPR) to ensure energy security during supply disruptions.
- Diversify crude oil import sources to reduce excessive dependence on any particular region.
- Strengthen investments in renewable energy sources such as solar, wind, green hydrogen, and biofuels.
- Promote electric vehicles (EVs) and energy-efficient technologies to reduce crude oil consumption.
- Develop alternative international payment and trade settlement mechanisms to reduce dependence on traditional financial networks.
- Enhance the use of the Indian Rupee in international trade transactions.
- Strengthen foreign exchange reserves to manage external economic shocks effectively.
- Continue strategic investments in Chabahar Port and the INSTC to improve regional connectivity.
- Encourage public and private sector participation in energy infrastructure development.
- Maintain a balanced foreign policy approach to safeguard India's economic and strategic interests.
- Strengthen cooperation with major energy-producing countries to ensure stable and diversified energy supplies.
- Improve risk management frameworks to protect the economy from future geopolitical and energy-related disruptions.

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Limitations

While the study provides useful insights into the economic implications of the USA–Iran conflict on India, certain limitations should be acknowledged.

- Descriptive Nature of Analysis: The study primarily adopts a descriptive approach and does not employ advanced econometric techniques to establish causal relationships or estimate the magnitude of economic impacts. Consequently, the findings should be interpreted as indicative rather than conclusive.
- Limited Time Horizon: The analysis covers the period from 2021–22 to 2025–26, which represents a relatively short time frame. Such a limited period may not adequately capture long-term structural changes and makes it difficult to distinguish temporary cyclical fluctuations from enduring economic trends.
- Use of Aggregate Annual Data: The study relies mainly on annual macroeconomic data. As a result, short-term variations and intra-year dynamics, such as sudden spikes in crude oil prices following specific geopolitical developments, may not be fully reflected in the analysis.
- Influence of Confounding Factors: The study does not isolate the exclusive impact of the USA–Iran conflict on India's economy. Other concurrent global and domestic factors, including the Russia–Ukraine conflict, changes in international monetary policy, global supply chain disruptions, and domestic demand conditions, may also have influenced the observed economic outcomes.
- Financial Market Assessment Constraints: The analysis of financial market reactions is based largely on secondary sources and news reports rather than a rigorous event-study methodology. Therefore, the assessment of market responses should be viewed as exploratory in nature.
- Absence of Counterfactual Analysis: The study does not develop a counterfactual scenario to estimate how India's economic performance might have evolved in the absence of the USA–Iran conflict. Consequently, the precise contribution of the conflict to observed economic changes cannot be quantified.

Despite these limitations, the study offers a valuable overview of the channels through which geopolitical tensions can influence India's economy and provides a foundation for future research employing more sophisticated analytical techniques and longer datasets.

CONCLUSION

The USA–Iran conflict continues to be an important geopolitical issue with significant implications for the Indian economy. As India depends heavily on imported crude oil to meet its energy requirements, any disruption in the Middle East can have a direct impact on the country's economic stability. Rising geopolitical tensions often lead to higher crude oil prices, which increase import costs, widen the trade deficit, and create inflationary pressures. These developments also affect the value of the Indian rupee and contribute to volatility in financial markets.

The study highlights that India's economic vulnerability to external shocks is closely linked to its dependence on imported energy. Geopolitical conflicts in oil-producing regions not only affect energy security but also influence trade, investment flows, and overall economic growth. The analysis shows that fluctuations in global oil prices can quickly transmit to the domestic economy through higher transportation costs, increased production expenses, and changes in consumer prices.

To reduce these risks, India must adopt a long-term strategy focused on strengthening economic resilience. Expanding strategic petroleum reserves, diversifying energy import sources, and promoting renewable energy development are important steps toward enhancing energy security. In addition, strengthening alternative trade

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and payment mechanisms and improving regional connectivity through projects such as Chabahar Port and the International North-South Transport Corridor can help reduce the impact of future geopolitical disruptions.

In conclusion, while geopolitical tensions between the United States and Iran remain beyond India's direct control, their economic consequences can be effectively managed through sound policy measures and strategic planning. By reducing its dependence on external energy sources and strengthening its economic fundamentals, India can better safeguard its growth prospects and maintain stability in an increasingly uncertain global environment.

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