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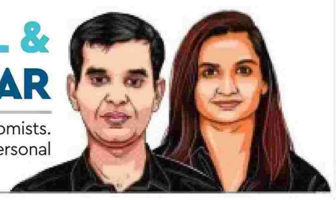
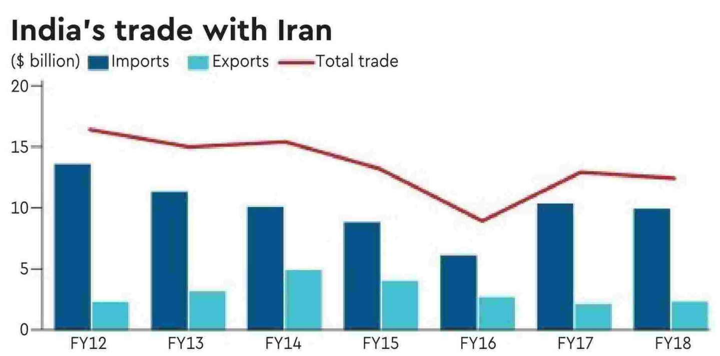
Authors are corporate economists. Views are personal



Will India get impacted by US-Iran tussle?

While the India-Iran trade is likely to remain unaffected, India must keep a close watch on the recent geopolitical developments and conduct its diplomacy accordingly



Source: Ministry of Commerce & Industry

LAST WEEK, THE United States (US) pulled out of the Iran deal—the Joint Comprehensive Plan of Action (JCPOA), which was signed in 2015 to ensure that Iran's nuclear programme will be exclusively peaceful. The International Atomic Energy Agency (IAEA) verified that Iran had implemented its key nuclear-related measures described in the JCPOA. As a result of Iran, in a verifiable manner, meeting its nuclear commitments, the US and the European Union (EU) lifted nuclear-related sanctions on that country, as described in the JCPOA.

With the US pulling out of the deal and imposing sanctions on Iran, the US will reinstate curbs on Iran's purchase or acquisition of US dollars, as well as any global trading in Iran's gold, coal, steel, cars, currency and debt, plus imports of Iranian carpets into the US. In addition, the US will bring back sanctions on Iran's oil exports, shipping, port operators, central bank dealings, insurance and the rest of its energy sector. The US has also prohibited dealings of Boeing and Airbus in aircraft and aircraft parts. Estimates suggest that the sanctions previously imposed by the United Nations (UN), the US and the EU cost the country more than $160 billion in oil revenue from 2012 to 2016 alone. With the lifting of the sanctions, Iran gained access to more than $100 billion in assets frozen overseas, and was able to resume selling oil on international markets and using the global financial system for trade. So, what is the likely impact of this on India?

India's trade with Iran stands at around $12 billion, and deficit with Iran stands at around $8 billion (5% of India's total merchandise deficit). In 2017-18, India imported around 256 million tonnes of crude oil and its derived products worth $101 billion. Imports from Iran made up around 10% of this ($10 billion)—it is India's third largest oil supplier after Saudi Arabia and Iraq. India and China are the largest importers of Iranian oil—accounting for 1.4mbpd of imports from Iran, which is about a third of the country's total production. Other major imports from Iran include fertilisers and organic & inorganic chemicals—India imported around $4.5 billion of fertilisers during 2017-18, and Iran ($0.5 billion) ranks amongst top three in India's supplier of imported fertilisers. India's exports to Iran mainly comprise of food items, organic chemicals and iron & steel. India may now resort to looking for waivers from the US or going back to using a mix of barter, rupee and gold to settle payments. Imposition of US sanctions might also adversely affect the development of Chabahar Port, which provides access to Afghanistan and Central Asia, bypassing Pakistan.

> **Oil and fertilisers are key strategic import items, and India should try to diversify its trading partners to shield itself from any adverse consequences**

Trade between India and Iran is unlikely to suffer on account of re-imposition of US sanctions—these have been in place for long and India has maintained good trade relations with Iran. In fact, trade in the years following the implementation of the JCPOA in January 2016 has been lower than in the sanction years. Re-imposition of the sanctions might actually give India better bargaining power when trading with Iran.

The most critical impact in India will be via oil prices—which rose in response to the US withdrawing from the JCPOA. There are fears that the sanctions will further tighten the already squeezed oil market. Saudi Arabia has said that it will alone not seek to increase its oil output to make up for Iran's loss, but will consult all the other OPEC (Organisation of the Petroleum Exporting Countries) members and Russia. According to the US Energy Information Administration (EIA) estimates, Iran's crude oil output stood at 3.8mbpd in 2017—making up around 4% of global crude production. Estimates suggest that 500kbpd to 1mbpd of oil supply from Iran could be impacted because of the sanctions. Further risk to oil price stems from the falling Venezuelan oil output, tension between Saudi Arabia and Houthi rebels in Yemen, and slow recovery in US shale. Some downside to oil prices is possible in case Iran pulls out of the OPEC output deal and increases its output.

The Reserve Bank of India (RBI) estimates that every $10 rise in global crude oil price adversely affects inflation by 30bps and growth by 10bps. Brent crude oil price is up almost 16% since the start of 2018. While oil prices are a supply-side factor, RBI will need to pay attention to it due to the second round impact of oil prices on overall inflation. The impact of higher global oil prices is hard to bypass unless India refuses to align the retail prices of fuels in line with global oil prices. The same, however, is not advisable since the consumers will fail to adjust their consumption to higher prices and will contribute to the ballooning trade deficit.

India's oil trade deficit stood at $66 billion in 2017-18. This accounted for almost 40% of India's merchandise trade deficit. Higher trade deficit will have an adverse impact on currency and will contribute to higher imported inflation. At the same time, RBI might have to draw-down on its reserves to support the currency and stabilise the market.

Higher global oil prices will lead to higher inflation across countries. Higher inflation might prompt central banks of developed economies, particularly the US, to follow a monetary policy tighter than expected before. This can have a negative spillover on capital flows into emerging markets, including India.

While the India-Iran trade is likely to remain unaffected, India must keep a close watch on the recent geopolitical developments and conduct its diplomacy accordingly. Oil and fertilisers are key strategic import items, and India should try to diversify its trading partners to shield itself from any adverse consequences. Situations in India's key oil partners—Saudi Arabia, Iraq and Iran—remain fragile. China accounts for almost 20% of our urea imports and 30% for overall fertiliser imports. Relationship with China, too, is always under a doubt. Things are moving fast on North Korea's front—trade with North Korea was only $132 million during 2016-17 and fell further in 2017-18. This could be a threat as well as an opportunity.