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News: Israel – Iran conflict and its implications

- The conflict between Israel and Iran has entered a volatile phase, raising concerns across various sectors, particularly trade and economics. As tensions escalate, the implications for India, an emerging player in the global market are becoming increasingly significant.



Reasons for the Iran-Israel Conflict

- **Formation of Israel (1948):** The creation of Israel led to the Arab-Israeli War. Although Iran opposed Israel's formation and voted against the Partition Plan in 1947, it recognized Israel in 1950 under the Pahlavi regime (last Iranian royal

dynasty), fostering friendly relations characterised by economic and military ties.

- Despite formal ties, segments of Iranian society remained sympathetic to the Palestinian cause. The Iranian Revolution in 1979 marked a turning point, ending Pahlavi rule and leading to the deterioration of Israel-Iran relations.
- **Religious and Ideological Differences:** Iran, governed by Shia Islam, and Israel, a predominantly Jewish state, has fundamental religious and ideological differences that fuel mutual suspicion and animosity.
- **Post-1979 Revolution Relations:** The Islamic Republic severed diplomatic ties with Israel, labelling it “Little Satan”.
- Shia clerics in Iran view the Old City of Jerusalem as a holy site and oppose its Israeli control. After the revolution, Iran promoted the idea of a Palestinian state and branded Israel an "illegal" entity.
- **Israeli-Palestinian Conflict:** Iran supports Palestinian causes, backing groups like Hamas and Hezbollah, which Israel designates as terrorist organisations. Iran's calls for the destruction of Israel exacerbate tensions.
- **Nuclear Program:** Israel perceives Iran's nuclear ambitions as an existential threat, fearing potential nuclear weapons development.
- Israel has criticised the Iran nuclear deal (Joint Comprehensive Plan of Action) and undertaken covert operations to disrupt Iran's nuclear activities.

- **Proxy Conflicts:** The Iran-Israel conflict has seen significant proxy warfare involving several groups. Iran supports Hezbollah in Lebanon, which frequently engages in fights with Israel, and the Houthis in Yemen, who have targeted Israeli shipping in the Red Sea.
- Additionally, Iranian-backed Shia militias in Iraq have been retaliating against US forces while also resisting Israeli actions in the region.
- These proxy conflicts enable Iran and Israel to wage indirect warfare, complicating regional stability and raising the risk of direct confrontations amid increasing tensions.
- **Regional Power Dynamics:** The competition between Iran and its allies versus Israel and its allies contributes to ongoing tensions and conflicts in the region.

Implications of the Israel-Iran Conflict on India

- **Disruption of Trade Routes:** The conflict has heightened the risk of disruptions along key shipping routes crucial for India's trade with Europe, the US, Africa, and West Asia.
- The Red Sea and Suez Canal routes are particularly vital, as they facilitate the movement of goods worth over USD 400 billion annually.
- The instability threatens not just shipping lanes but also the overall security of maritime trade.

- **Economic Impact on Exports:** The escalation of conflict has already begun to affect Indian exports. For instance, exports fell by 9% in August 2024, primarily due to a substantial 38% decline in petroleum product exports caused by the Red Sea crisis.
- These exports accounted for a significant portion of India's trade, with Europe receiving 21% of total petroleum product exports.
- The tea industry is particularly vulnerable. With Iran being one of the largest importers of Indian tea (India's exports reaching 4.91 million kg in early 2024), concerns about the impact of conflict on shipments have arisen.
- **Rising Shipping Costs:** As shipping routes become longer due to conflict-related diversions, costs have increased by 15-20%.
- This surge in shipping rates has strained the profit margins of Indian exporters, especially those dealing in low-end engineering products, textiles, and garments, which are highly sensitive to freight costs.
- Exporters have reported that rising logistics costs could negatively impact their overall profitability, forcing them to reconsider pricing strategies and operational efficiencies.
- **India-Middle East-Europe Economic Corridor (IMEC):** The IMEC, during India's G20 presidency to create an efficient trade route connecting India, the

Gulf, and Europe, aims to reduce dependency on the Suez Canal while also countering China's Belt and Road Initiative.

- However, the ongoing conflict threatens the progress and viability of this corridor, impacting bilateral trade between India and its partners as well as regional economic dynamics.
- **Impact on Crude Oil Prices:** The ongoing conflict has led to a spike in global crude oil prices, with Brent crude nearing USD 75 a barrel. As Iran is a major oil producer, any military escalation could disrupt oil supplies, further pushing prices upward.
- Higher oil prices may hinder central banks from cutting interest rates, as increased inflation can complicate economic recovery efforts.
- **Effects on Indian Markets:** India relies heavily on oil imports (more than 80% of its oil needs coming from abroad), making it vulnerable to price fluctuations. A sustained rise in oil prices may lead investors to shift focus from Indian equities to safer assets like bonds or gold.
- The Indian stock market has already felt the impact, with major indices like the Sensex and Nifty opening lower amid fears of a prolonged conflict.
- **Gold as a Safe Havens:** Gold prices have reached new highs, fueled by geopolitical tensions and shifts in investment strategies.

- In times of uncertainty, investors often flock to gold as a safe haven, which could further elevate its price.
- **Logistics Challenges:** Indian exporters are currently navigating a "wait and watch" situation. Some exporters are urging the government to invest in developing a reputable Indian shipping line to mitigate the reliance on foreign shipping companies, which often impose high transport charges.

Status of India's Trade with Israel and Iran

India- Israel Trade

- **Significant Growth:** India-Israel trade has doubled over the last five years, growing from approximately USD 5.56 billion in 2018-19 to USD 10.7 billion in 2022-23.
- In FY 2023-24, the bilateral trade was USD 6.53 billion (excluding defence) witnessing a decline due to regional security situation and trade route disruption.
- India is Israel's second-largest trading partner in Asia. During FY 2022-23, Israel was India's 32nd biggest trading partner.
- **Key Exports:** The primary exports from India to Israel include diesel, diamonds, aviation turbine fuel, and Basmati rice, with diesel and diamonds alone accounting for 78% of total exports in 2022-23.

- **Imports:** India primarily imports space equipment, diamonds, potassium chloride, and mechanical appliances from Israel.

India-Iran Trade

- **Declining Trade Volumes:** In contrast to the robust trade with Israel, India's trade with Iran has seen a contraction over the past five years, with bilateral trade amounting to just USD 2.33 billion in 2022-23.
- In FY 2023-24, the bilateral trade Iran reached USD 1.52 billion during the first 10 months (April-January).
- **Trade Surplus:** In 2022-23, India enjoyed a trade surplus of approximately USD 1 billion, exporting USD 1.66 billion worth of goods to Iran, primarily agricultural products, while importing USD 0.67 billion.
- **Major Indian exports to Iran:** Basmati rice, tea, sugar, fresh fruits, drugs/pharmaceuticals, soft drinks-other than sharbat, kernels H.P.S, boneless bovine meat, pulses etc.
- **Major Indian imports from Iran:** Saturated methanol, petroleum bitumen, apples, liquified propane, dry dates, inorganic/organic chemicals, almonds, etc.

Global Implications of the Israel-Iran Conflict

- **Energy Supply and Pricing Dynamics:** Iran, a member of Organization of the Petroleum Exporting Countries (OPEC), produces approximately 3.2 million barrels per day (bpd), constituting about 3% of global output.
- Despite facing U.S. sanctions, Iranian oil exports have surged, primarily due to demand from China. The country's strategic importance in the global oil market cannot be overstated.
- **OPEC's Spare Capacity:** OPEC+ possesses significant spare oil production capacity, with estimates suggesting that Saudi Arabia could increase output by up to 3 million barrels per day and the UAE by about 1.4 million.
- This capacity provides a buffer against potential Iranian supply disruptions, but the situation remains delicate.
- **Long-term Energy Security:** The increasing diversity of global oil supply, particularly due to rising US production, has provided a degree of insulation from price shocks associated with conflicts in the Middle East.
- The US produces approximately 13% of global crude oil and nearly 20% of total liquid production, which helps stabilise the market amid uncertainties.
- **Potential for Escalation:** Israel has not yet launched attacks on Iranian oil facilities, but the possibility remains. If Israel were to strike key installations,

such as the Kharg Island oil port, it could provoke a significant military response from Iran.

- Historically, conflicts have escalated quickly in this region, leading to unintended consequences for global supply chains.
- **Geopolitical Considerations:** The US is likely to exert pressure on Israel to avoid major military escalation, aiming to maintain regional stability and prevent a broader conflict.
- This reflects a nuanced approach to foreign policy that seeks to balance support for Israel with global economic interests.
- Other global players, especially China, which has significant energy ties with Iran, will be closely observing developments.
- The outcome of this conflict may influence international energy strategies and alliances, potentially reshaping the geopolitical landscape.
- **Humanitarian Crises:** A wider conflict could lead to significant refugee flows, impacting Mediterranean countries like Italy and Greece, and straining international humanitarian resources.

Possible Solutions to De-escalate the Iran-Israel Conflict

- **Immediate Ceasefire Agreement:** Urging both Iran and Israel to agree to an immediate ceasefire can serve as a foundational step toward reducing tensions and facilitating dialogue.
- Global powers, particularly the United States and China, should leverage their **diplomatic influence** to press for a ceasefire and promote negotiations between the conflicting parties.
- **Regional Collaboration:** Engaging Gulf Arab states in discussions can provide a more comprehensive approach to de-escalation, addressing shared concerns about Iran's influence in the region.
- **Humanitarian Aid and Support:** Increasing humanitarian assistance to affected regions can alleviate suffering and foster goodwill, potentially easing hostilities.
- **International Organisations:** Engaging organisations like the United Nations to mediate discussions and facilitate conflict resolution efforts can provide neutral ground for negotiations.
- **Long-term Peace Initiatives:** Regional powers should collaborate to establish a comprehensive security framework that includes confidence-building measures; arms control agreements, and peaceful conflict resolution mechanisms.

- Addressing underlying issues such as historical grievances, territorial disputes, and religious extremism will foster a conducive environment for lasting peace.