



## Macroeconomic Theme: Macroeconomic Implications of War

## Implications of War in West Asia

### Highlights:

- ✓ *The conflict in West Asia has created significant volatility in oil prices and Brent London based Future Crude oil prices spiked towards USD 115 per barrel.*
- ✓ *Indian Rupee remains under pressure as it has now crossed a record low of 95 to a dollar and so do the G-sec bond yields as they hover around the 7 per cent level on current account and fiscal fears.*
- ✓ *We estimate a net revenue loss of ~₹ 1.0 lakh crore for the exchequer post the special additional excise duty cut and the levy of the export duty on diesel and Aviation Turbine Fuel (ATF) for full year contingent to continued support warranted if war continues.*

The full-scale war in west Asia threatens to upend the calculations of RBI, with crude oil breaching USD 115 per barrel. The near-term effects might not be pronounced as average crude oil price for baseline projections for FY2025-26 is USD 70 per barrel and is not likely to be breached in this financial year. However, going ahead a sustained elevation in crude oil prices is likely to not only have a negative effect on growth if the crisis is sustained but also on inflation which is more worrisome as supply shocks are already witnessing a chain reaction with crude oil, liquified petroleum gas (LPG) and fertilizers witnessing price pressures and supply shortages. Since the Russia-Ukraine war India has seen relatively moderate or tolerable oil prices averaging USD 75-78 per barrel.

The evolving conflict in west Asia has added an element of uncertainty to the existing external headwinds for India. Crude oil has been pushed up to USD 115 per barrel. While in the near term this poses no significant risk, prices sustained at higher levels have adverse effects on both growth and inflation. The current commodity stress has followed the ebb and flow of the tariff war imposed by the US administration the end of which is still unknown. The geopolitical conflict has once again brought the USD/INR under duress, with the Indian rupee now likely to breach ₹ 96-97 in the near term and the possibility of much wider current account levels than were anticipated during the year. In times such as these a sharper focus remains on external flows which narrow down to financial or capital flows as capital flows have been crucial in financing the BoP deficits.

**The annual consumption of Crude Oil in India:** As per the Petroleum Planning and Analysis Cell (PPAC) the major shares of consumption in Petroleum, Oil and Lubricants (POL) products in India are in Diesel with a share of 38.7 per cent during the period April-February 2026, as diesel is widely used for industrial as well as transportation purposes across the country. The consumption trends for various POL and Natural Gas (NG) are indicative of a growing economy.

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Since the demand for decontrolled products is naturally estimated to increase in the next financial year, sustained elevation in prices of crude oil remains a potent upside risk for growth and inflation. In addition, Indian imports constitute what is known as the Indian Crude Oil basket with the Dubai crude traded above the USD 130 per barrel which is a much higher price as compared to the Brent Crude oil and is more detrimental for India's import bill.

**Table 1 : Consumption Estimates for Petroleum Products**

All Figures in Thousand Metric Tons (TMT)

	2025-26 (RE)	2026-27		
<b>(A) Sensitive Products</b>				
LPG	33702	34692	14%	14%
SKO	449	469	0.2%	0.2%
<b>Sub-Total</b>	<b>34151</b>	<b>35161</b>	<b>14.0%</b>	<b>14.4%</b>
<b>(B) Major Decontrolled Products</b>				
Petrol/Motor Spirit (MS)	42534	44877	17.4%	18.4%
Naptha	11699	12667	4.8%	5.2%
High Speed Diesel	94087	96399	38.6%	39.5%
ATF	9131	9744	3.7%	4.0%
LDO	1006	966	0.4%	0.4%
Lubes	4921	4781	2.0%	2.0%
FO/LSHS	6142	5830	2.5%	2.4%
Bitumen	9094	8856	3.7%	3.6%
<b>Sub-Total</b>	<b>178614</b>	<b>184120</b>	<b>73.2%</b>	<b>75.5%</b>
<b>(C) Other Minor Decontrolled Products</b>				
Pet Coke	20962	20794	8.6%	8.5%
Others	10277	10715	4.2%	4.4%
<b>Sub-Total</b>	<b>31239</b>	<b>31509</b>	<b>12.8%</b>	<b>12.9%</b>
<b>All Products</b>	<b>244004</b>	<b>250790</b>		

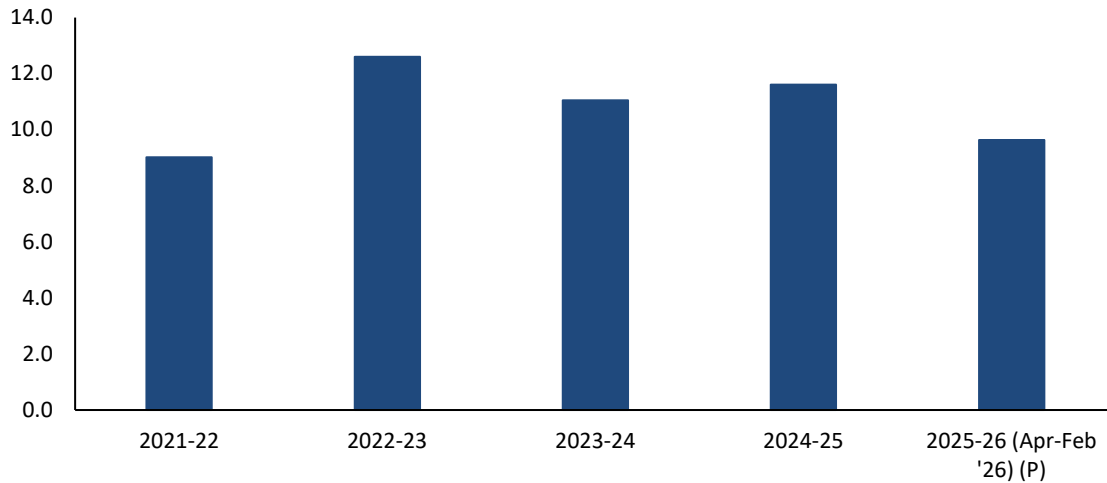
Source: Petroleum Planning & Analysis Cell (PPAC)

**India's Imports and Exports of Crude Oil:** Indian imports of crude oil amount to ₹ 10-12 lakh crore on average going by the data given by PPAC. India also re-exports much of the crude oil post refining the crude oil and that is to be reckoned again as a major export for the country. The central government cut the excise duty on petrol and diesel by ₹ 10 per liter each, giving the oil marketing companies much relief as the under-recovery on petrol and diesel was close to ₹ 24 per liter on petrol and ₹30 per liter on diesel and the oil marketing companies might find relief to the extent of the excise duty cut on petrol and diesel. While this excise duty cut will put a string on the exchequer of approximately ₹1.5 lakh crore as per our estimates, the offsetting export duty on export of refined crude oil will lead to an additional revenues for the government to the tune of ₹ 50,000-60,000



crore and hence the overall shortfall in revenue is likely to be round ₹90,000-1,00,000 crore overall in FY2026-27.

**Chart 1: Crude Oil Imports (₹ Lakh Crore)**



Source: PPAC

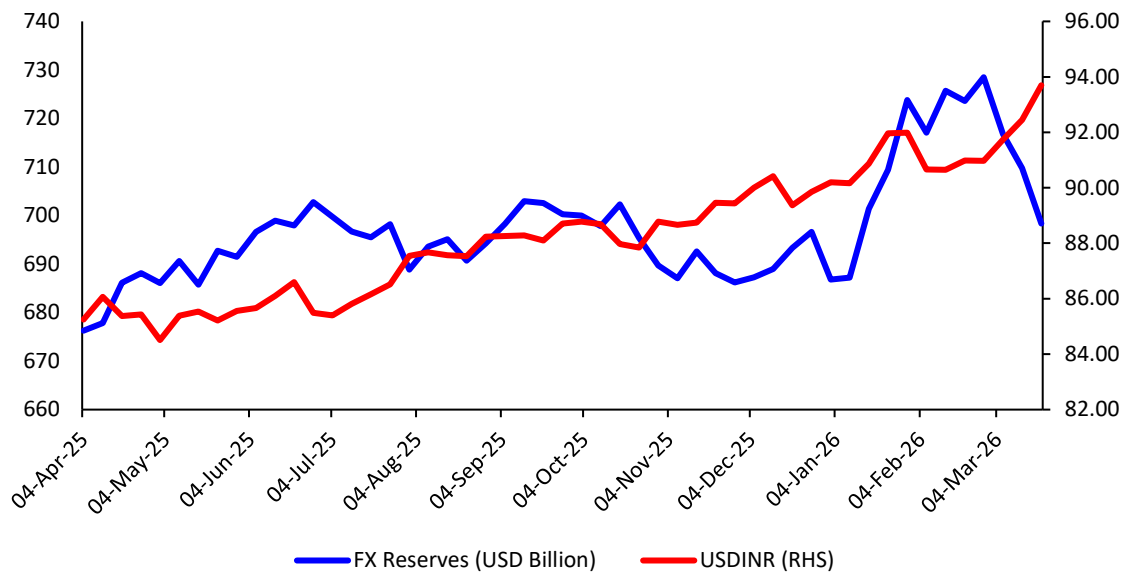
**The effects of oil price increases on the current account deficit:** The effects of oil price increases on the current account deficit are manifold, as not only it widens the trade deficit which beyond a point i.e. when crude is trading above USD 100 per barrel becomes unsustainable to finance even with robust software service exports plus strong remittance inflows (likely to be adversely affected due to west Asia conflict) and strong foreign capital flows are need to tide over the widening CAD. RBI estimates a USD 10 per barrel rise to widen the current account deficit 0.5 per cent of GDP as per RBI research done immediately post the Ukraine-Russian war which began in March 2022 and sent crude oil prices spiraling to USD 133 per barrel. However, the commodity prices then stabilized relatively quickly as supply chains were restored and additional oil supply from other nations was brought on the market. The current situation remains unique as the major supply link i.e. the Strait of Hormuz remains restricted. Although Indian ships have been allowed to exit the strait considering the friendly relations between Iran and India, the commodity markets globally have prices in the uncertainty with higher prices, especially of crude oil.

**The state of FX reserves:** Foreign exchange reserves are usually a central bank's war chest and are highlighted in debates on current account deficit as such. India has a sizable chest of FX reserves amounting to USD 698 Bn. This can be seen in context of the recent decline in FX reserves on the back of significant RBI intervention in the currency markets and revaluation changes as the rupee declined sharply since the conflict in West Asia



escalated. The FX reserves declined from a record high of USD 728 Bn even as RBI continued to smooth volatility in the currency markets. It is important to note that RBI also has a significant short position in the forward markets, which in effect alters the view on the dollar reserves.

**Chart 2: FX Reserves and USD/INR**



Source: RBI

**RBI's Regulatory Changes -NOP-INR cap:** The most recent move by the Indian central bank was to cap the net open position (NOP) in the Indian Rupee (INR) positions in the onshore deliverable market shall be maintained within USD 100 Mn at the end of each business day. This was a regulatory move to break the linkage between the onshore deliverable and offshore non-deliverable forward market which is a bigger market and is often seen as setting the trend and direction for the Indian rupee in the onshore markets.

The arbitrage between these two markets is now curbed, however the larger macroeconomic forces of higher crude oil prices, pressure on the trade deficit, continued capital outflows and demand for dollars in times of international crisis will keep the pressure on the Indian rupee as was seen after the announcement of the regulatory move the rupee briefly touched and cross a record high of ₹95 to a dollar. This move also signals a step up from market-based measures such as dollar interventions to regulatory measures to curb the volatility in the Indian rupee.

**The Fiscal Burden:** The special excise duty cut, and similar measures taken by the government to ease the pressure on the margins of oil marketing companies is likely to pose a fiscal strain on the exchequer to the tune of ₹ 0.9-1.1 lakh crore in FY2026-27. Even



this estimate has more upside risks as the conflict drags further. If the conflict drags on for a longer period, there might be a larger fiscal burden on the government which has already rolled out an ₹8.2 lakh crore of H1-FY2026-27 borrowings and in the medium term is likely to see bond yields stay sticky on the upside due to the demand supply dynamics. Hence, the government has little or no headroom on the borrowing front in the coming year. This would indicate some moderation in capital spending if warranted and the pressure on the fiscal balances remains unabated during the year. The fiscal calculation might waver with the current 4.3 per cent to 4.4 per cent for FY2026-27.

**Concluding Observations:** The conflict in West Aisa was unanticipated at the beginning of the year and more so in the previous year when RBI had calculated its growth inflation projections with Brent Crude at USD 70 per barrel. Apart from the effects on the current account and the fiscal balances, this sudden and significant rise in crude oil price will also have a moderating impact on headline growth and inflation for India. We expect the RBI to maintain the status quo in the April 2026 policy meeting and see through this spike more as transient rather than a persistent spike in oil prices, though this premise is predicated purely on how long the war drags on. While the rupee has depreciated to levels beyond ₹95 to a dollar, the 10-year benchmark bond has crossed the level of 7 per cent despite the significant open market operations (OMOs) conducted by the RBI indicating a deeper demand-supply disequilibrium in the fixed income space.

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