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THE IRAN-ISRAEL TENSION: OIL PRICE IMPLICATIONS FOR INDIA

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Introduction

Iran's first direct attack using missiles and drones against Israel on 13th April'24 has ignited new tension between the two states and increased the probability of further escalations. According to media reports, Israel has attacked back as a retaliation the Isfahan province in Iran with drone and missile strikes.

Whether Iran would close the Straits of Hormuz, is an open question, but the issue is quite complex. The Strait serves as a fundamental international shipping lane, enabling the transportation of a significant portion of the world's oil and gas supply. Given its global strategic significance, any attempt to block this could have serious international repercussions.

As of now, it seems that Iran's purpose is to 'warn' Israel (and not cause any provocation) about no further harm from Israel towards Iran. To that extent, the tension is bilaterally limited. Nevertheless, any significant retaliatory action by Israel might escalate the matter and in an extreme case, the worst possible scenario cannot be ruled out. On the other hand, it could take initially the form of a bilateral war between Iran and Israel, but even if in such a scenario, the global repercussion impact could be severe.

Iran had huge oil revenue over the past year, exporting roughly $43 billion worth of crude oil excluding discounts, which is slightly less than fifty per cent compared to last year. According to Reuters and other media reports, there is little interest as of now from the Biden administration to impose any sanction, since a G7 communique one day after the April 13 attack kept quiet on oil sanctions on Iran. Nonetheless the White House has declared new sanctions on Iranian drone and missile capability.

Oil Market Worries

So far, the oil price reaction remains benign, though initially after the Iranian attack on Israel, both Brent and West Texas Intermediate (WTI) have shown upward trends. However, the supply side factors remain favourable as OPEC+ retains ample production capability, easing concerns about possible troubles.

The major issue is about any potential full or partial blockage to the Strait of Hormuz, where around 13 million barrels per day (b/d) of oil supplies (and additional refined products) flow through this waterway, including almost 1.5 million b/d of Iran's own exports. While a few million b/d of supply from Saudi Arabia and the UAE could be switched, more than half of those barrels could be stopped from global markets in the absence of the access to the Strait.

Implications for India:

One major issue highlighted by a leading brokerage institution is that while for oil, alternative sources besides the 'Red Sea' exists, but for liquified natural gas (LNG) alternatives routes are not available. India's major import of oil and LNG comes from the Strait of Hormuz through UAE, Qatar, Saudi and Iraq.

Initially, there was a decline of Asian Paints, IOC, Apollo Tyres, HPCL, IndiGo & BPCL shares due to the conflict. According to media news, among the tyre companies, TVS Srichakra tanked more than 6 per cent to Rs 4008.65, whereas Balkrishna Industries tumbled about 3 per cent to Rs 2266.35. Other tyre companies including CEAT, Apollo Tyres, Goodyear India and JK Tyres declined.

In the Paint category stocks, Berger Paints India, Kamdhenu Ventures, Indigo Paints, Sirca Paints and Asian Paints have seen moderation. Other paint stocks including Akzo Nobel, Kansai Nerolac and Shalimar Paints have also traded in red.

Escalation of the conflict could complicate matter further, disrupting the entire supply chain mechanisms. Potential increase in oil prices could aggravate the inflationary spiral. Oil dependant industries would be impacted, moreover, high fertiliser, seed and transport costs might increase food price inflation further. One positive is that despite lower discounts, India remains a significant importer of Russian oil. In case of further escalation, possibly India needs to negotiate further with Russia and related other countries regarding LNG and oil imports to safeguard its interests.