India amid the West Asia conflict

Caught in a squeeze

Economic Update ▸ West Asia Crisis ▸ March 24, 2026

Elevated risks of wider energy supply disruptions from a prolonged Iran conflict prompt a reset of India's macro realities. We shift our baseline FY27E forecast around a more realistic, yet manageable, Brent average of USD80/bbl, with higher pressure in 1Q. Accordingly, we trim FY27E GDP growth by 0.4pp to 6.6% and raise inflation and CAD/GDP to 4.3% and 1.7%, respectively. A more adverse terms-of-trade shock, with Brent above USD100/bbl, could push CAD/GDP beyond 2.5% and drive a BoP deficit of ~USD85bn. The eventual growth, inflation, and fiscal hit will largely hinge on how a sustained crude shock is distributed between OMCs, the government, and end consumers. With OMC under-recoveries (GRM-adjusted) already exceeding ~Rs3trn at current prices, the burden is likely to fall disproportionately on the government, implying a minimum fiscal cost of ~0.5% of GDP. The RBI is likely to allow calibrated INR depreciation while keeping a check on rates through market interventions. The trade-offs are not easy, nonetheless. USD/INR is set to reach 96, while the 10Y yield could drift higher and touch 6.95%.

Revising macro forecasts as geopolitical risk premium keeps oil market hot

The West Asia conflict is entering a more precarious phase, despite recent news around potential de-escalation. Recent attacks on energy infrastructure have heightened the risk of broader and persistent supply disruptions. India faces an adverse terms-of-trade shock from rising energy prices, with ~45%/55% of crude oil/gas imports from the region and limited domestic strategic reserves. Besides, a protracted conflict implies a broader supply shock, global stagflationary tail risks and heightened volatility, impacting India's exports, remittances (~40% from ME) and capital flows. Early signs of strain in domestic gas supply are visible, while short-term inelastic oil demand constitutes a direct macro shock. We revise our baseline macro forecasts, basis Brent averaging ~USD80/bbl, up 15% from earlier. We reckon that while oil and natural gas prices have edged higher, they remain well below levels that would typically reflect a shock of this scale and duration. Brent at USD80-85/bbl will be mostly manageable, while the macro impact will be more acute and non-linear if prices average north of USD100/bbl. With the revised oil forecast, we lower baseline FY27E real GDP growth by 0.4pp to 6.6%, and raise headline inflation and CAD/GDP by 0.3pp to 4.3% and by 0.4pp to 1.7%, respectively. Our dynamic scenario analysis suggests that with average Brent at USD100/bbl for FY27E, CAD/GDP could widen to >2.4% while the BoP deficit could worsen to >USD85bn.

Burden sharing, uneven distributional effects and associated trade-offs

The eventual growth, inflation, and fiscal hit will largely depend on how the crude price shock —if sustained—is distributed between OMCs, the government, and end consumers (households and firms). OMCs' price shock absorption, while entailing a smaller pass-through to retail inflation, effectively also carries a mild fiscal cost, as it reduces the dividend/corporate taxes transferred to the government. Our estimates suggest at the current Brent prices, retail pump prices of diesel and petrol need to rise by 43% and 19%, respectively, for OMCs to earn normalized gross marketing margins. OMCs' annualized deficit on auto fuels at current prices are tracking a massive Rs3.0trn (adjusted for super-normal gross refining margin gains). Our model simulation suggests that at current oil prices, the government will need to cut excise taxes by ~Rs19.5/ltr avg blended for diesel and petrol and absorb extra subsidy on LPG (estimated Rs1trn) to fully bear the OMC losses. This could entail a fiscal cost of nearly 1.1% of GDP. The best fit in our view, in a sustained pain scenario, is equal pass-through among all economic agents, which still effectively imposes the highest cost on the government. However, this could imply inflation hit to be sub-35bps, and OMC burden falling to 0.35% of GDP. However, the effective fiscal hit of ~0.5% of GDP would crowd out other policy spending.

RBI's battle unlikely to be easy: FX and rates trade-offs

There is no simple playbook for a monetary policy response to energy price shock. Amid benign inflation, the pre-war policy focus was on monetary policy transmission—especially in the bond market—via ample liquidity that kept overnight rates below the policy rate. While direct oil pass-through remains limited under managed pump prices, second-round effects via inflation expectations, growth shocks, and tighter financial conditions now shape the RBI's trade-offs. The bar for any conventional rate hike remains high in the face of a supply shock; however, it needs to be seen if the RBI remains comfortable injecting abundant liquidity and sub-repo overnight rates. With INR under steady strain despite consistent FX intervention (largely via forwards), the associated liquidity drain is being deferred, while rates have been kept in check through the RBI's bond purchases. A sharp policy response in the form of interest rate defense—raising overnight rates to curb FX arbitrage—appears unlikely at this stage. USD/INR now looks poised to touch 96, while the 10-year yield may edge higher and touch 6.95%.

Key highlights:

- Baseline FY27 growth/inflation revised lower/higher to 6.6%/4.3%
- FY27E CAD/GDP at 1.7%, with possible hit to 2.4% with Brent at USD100/bbl
- Effective fiscal hit of ~0.5% of GDP amid burden-sharing of oil shock with OMCs and end-consumers
- Sharp interest rate defence by the RBI unlikely as of now
- USD/INR to hit 96; 10Y headed to 6.95%

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Protracted war now requires macro resets

Iran conflict: The end is not in sight

The Iran conflict, with sustained Israel-US strikes and sporadic Iranian reprisals, is increasingly looking less short-lived than markets had initially assumed, with considerable potential spillovers across the region, and into the global economy and markets. Despite recent news around de-escalation, we believe the Strait of Hormuz (SoH) will remain relatively choked for the foreseeable future. Continued West Asia tensions raise risks of global supply chains and shipping disruptions, higher global freight and insurance costs, even without a full blockade. While the military balance remains highly asymmetric and the intensity of Iran's missile and drone responses has moderated somewhat, the ultimate endgame for the Iranian state remains uncertain. Iran's military abilities have been degraded but not destroyed completely, with the key risk now lying in continued disruptions to energy flows through the SoH, through which ~20% of global oil and gas consumption flows.

Moreover, Iran has also continued attacking GCC neighbors, striking not just energy infrastructure but also civilian infrastructure, despite the overwhelming military advantage held by the US and Israel. Meanwhile, Trump faces his own set of constraints, notably the inflationary implications of higher oil prices and weak domestic political support for an extended conflict, especially with midterm elections approaching later this year.

The new Iranian leadership shows no signs of retreat, and while economic and political pressures will eventually weigh on both sides, we are increasingly of the opinion that Iran that will be the key determinant of the conflict's end—though it is not yet close to that juncture, even as a prolonged conflict risks internal fractures within Iran.

Exhibit 1: SoH accounts for 27% of seaborne oil trade and 20% of global consumption origin

Oil and petroleum flow through SoH (mbd)	2021	2022	2023	2024	1QCY25
Crude oil/condensates	14	16	16	14	14
Petroleum products	5	6	6	6	6
Total flows through SoH	19	22	21	20	20
Global seaborne oil trade	73	74	76	76	76
SoH share (%)	**27**	**29**	**28**	**27**	**26**
Global POL consumption	97	100	102	103	102
SoH share in global consumption (%)	**20**	**22**	**21**	**20**	**20**

Source: US EIA, Emkay Research

Exhibit 2: SoH also accounts for ~20% of global LNG trade

LNG flow via SoH (mmt)	2021	2022	2023	2024	1QCY25
Qatar	79	80	79	77	81
UAE	6	5	5	6	5
SoH (Qatar + UAE)	**84**	**85**	**84**	**83**	**86**
Global LNG trade	372	402	401	411	437
SoH share (%)	**23**	**21**	**21**	**20**	**20**

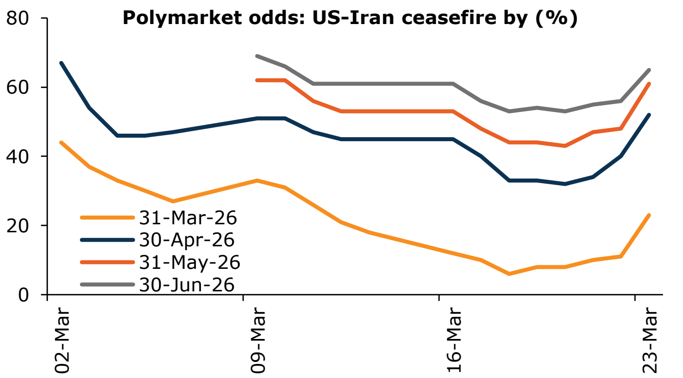
Source: Bloomberg, Emkay Research

Exhibit 3: Nearly 90% of SoH oil shipments go to Asia, with 15% to India

Country-wise oil imports via SoH (mbd)	2021	2022	2023	2024	1QCY25
China	4.2	4.5	5.0	4.8	5.4
India	2.3	2.4	2.0	1.9	2.1
South Korea	1.4	1.7	1.7	1.7	1.7
Japan	1.8	1.9	1.7	1.5	1.6
Europe	0.5	0.9	1.0	0.7	0.5
US	0.6	0.7	0.5	0.5	0.4
Other Asia	2.1	2.2	2.1	2.1	2.0
Others	1.5	1.6	1.6	1.1	0.6
Total	**14.4**	**15.9**	**15.6**	**14.3**	**14.2**
Asia share (%)	**82**	**80**	**80**	**84**	**90**
India share (%)	**16**	**15**	**13**	**13**	**15**

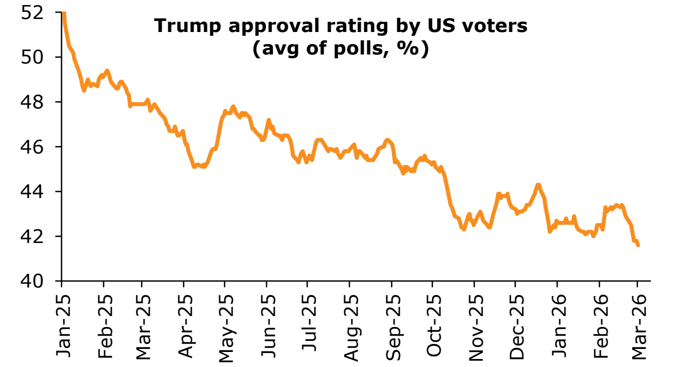
Source: US EIA, Emkay Research

Exhibit 4: Prediction markets still consider a ceasefire by Apr-end to be a toss-up, despite recent de-escalation news



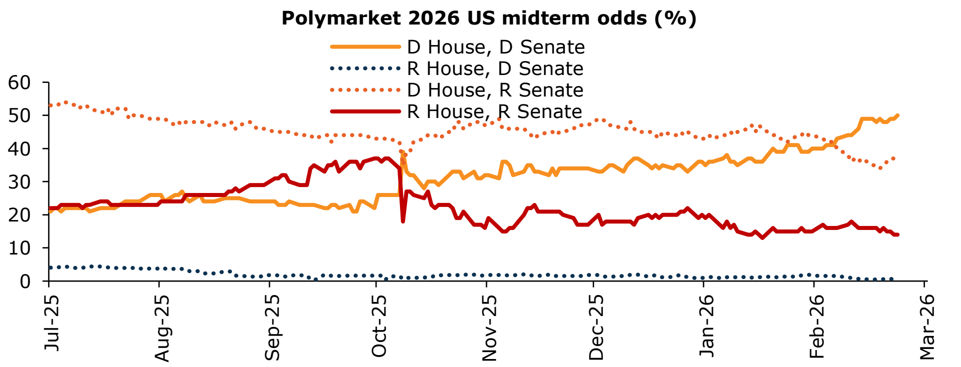
Source: Bloomberg, Emkay Research

Exhibit 5: Trump's approval rating has dipped because of the extended conflict



Source: Bloomberg, Emkay Research

Exhibit 6: Betting odds increasingly predict a Democrat clean sweep in the midterms



Source: Bloomberg, Emkay Research

Market pricing still not fully reflecting an extended conflict

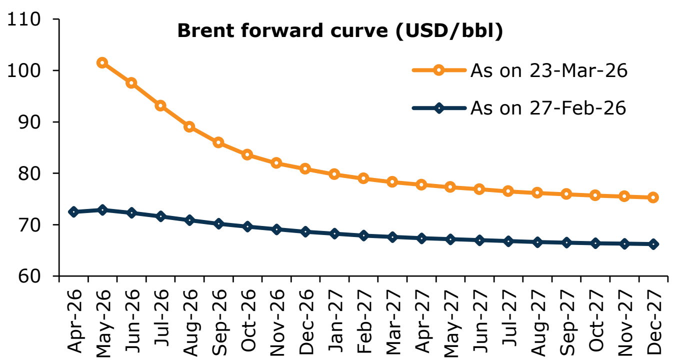
As fears around this critical chokepoint of SoH grow, oil price scenarios of USD120–150/bbl, which seemed implausible just weeks ago, are now within the market's risk envelope. Even then, markets are not yet really pricing in an extended conflict. While the Brent futures curve has risen since the start of the conflict, there remains possibility of repricing, as supply shocks may mean >USD100/bbl sustaining and crossing USD120-150/bbl if Hormuz remains closed for several more weeks. Rerouting away from SoH for players like Saudi and UAE solves only a fraction of GCC energy exports, while pipelines and tankers moved via alternate routes could potentially be targeted by Iran. Separately, for gas, suppliers like Qatar have virtually no other option but use the SoH.

Meanwhile, supply outside the ME is unlikely to close the gap. Strategic reserve releases by IEA are insufficient in volume, while sanctions relief on Russia largely reshapes pricing and trade destinations rather than boosting production. The potential supply shock is simply too large—sustained losses from the region would overwhelm all available alternatives.

To be sure, oil prices have soared more than 40% since the war began 3 weeks ago and are up nearly ~70% CYTD. But they remain below the peak seen after the start of the Russia-Ukraine conflict in 2022. During that period, crude oil prices averaged ~USD95/bbl in FY23, with Brent above USD100/bbl from the start of the conflict in late-February, until August.

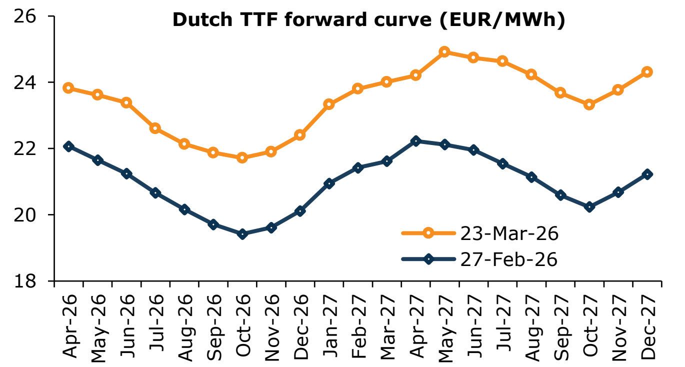
Oil demand meanwhile is, on average, highly inelastic in the short run (*as low as -0.05-0.2 aggregate*) because most end uses have few immediate substitutes—factory boilers rely on fuel oil, aircraft require jet fuel, and most cars still run on gasoline. **Under such conditions, a large price adjustment may be necessary to rebalance physical supply and demand following a system shock.**

Exhibit 7: While the Brent forward curve has dropped on de-escalation news, it still signals >USD80/bbl for the rest of CY26



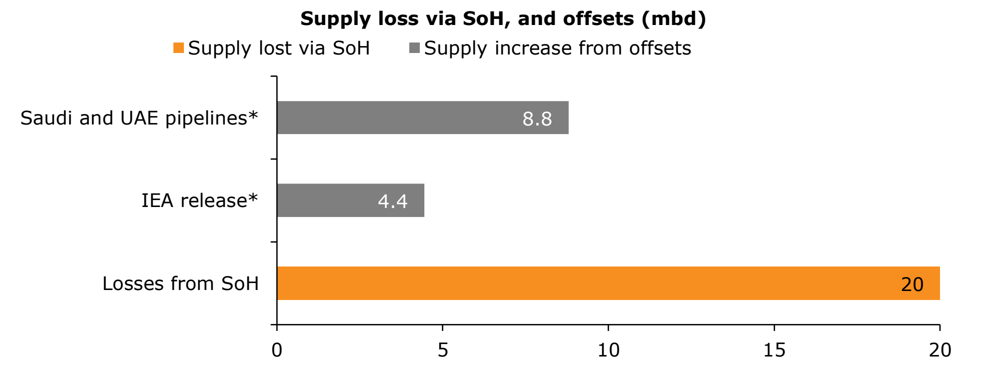
Source: Bloomberg, Emkay Research

Exhibit 8: Similarly, gas futures still expect prices to remain at least ~50% higher by Dec-27 compared to pre-war



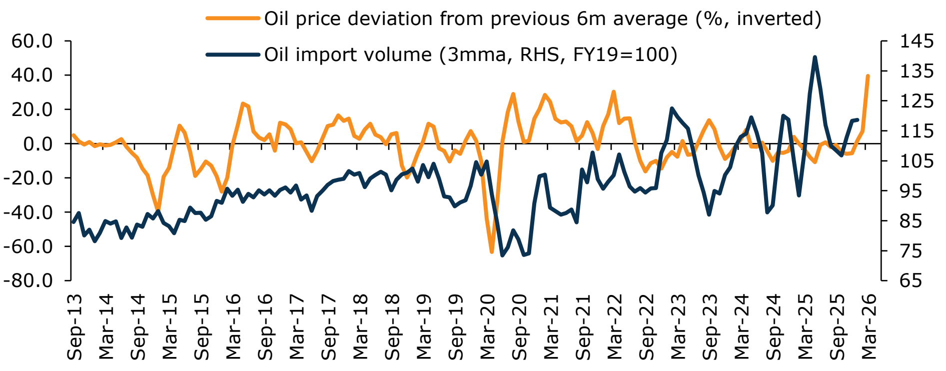
Source: Bloomberg, Emkay Research

Exhibit 9: Alternatives to SoH only partially offset the supply hit



*Source: Bloomberg, Emkay Research. *IEA release of 400mbd over three months assumed; Saudi and UAE pipeline full capacity assumed*

Exhibit 10: India's oil import demand is relatively inelastic, especially at higher prices

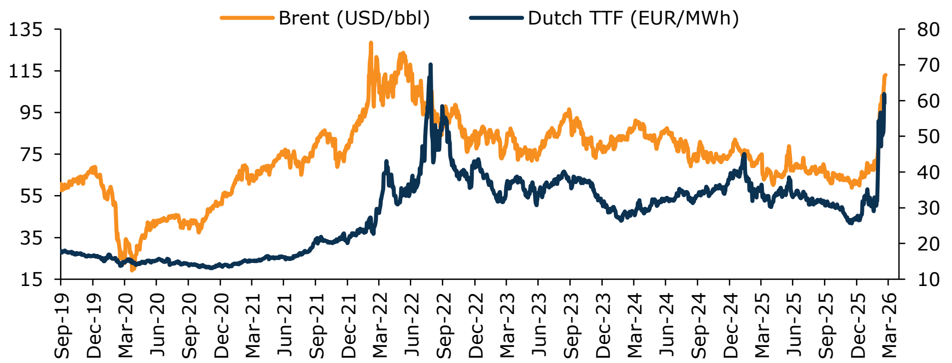


Source: Bloomberg, Emkay Research

Global cross-commodity price hit visible…

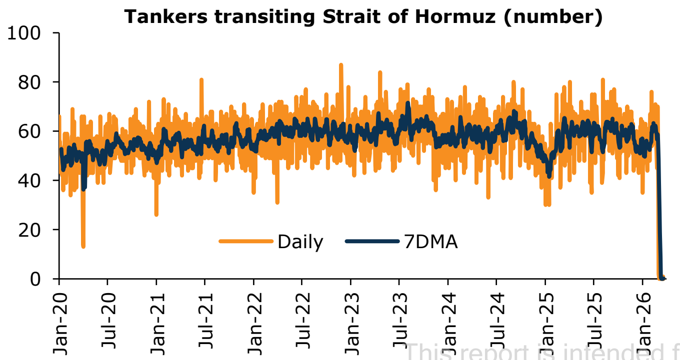
The crude oil supply is estimated to have been reduced by nearly 7mbd, a disruption which is likely to increase. OPEC+ spare capacity of ~4.6mbd (with the likes of Saudi Arabia, UAE, and Kuwait) is largely inaccessible at present, given SoH closure. The closure has restricted a broader range of trade as well, pushing up prices for natural gas, fertilizers, and select metals. Roughly 50% of the world's seaborne trade in sulphur, a key ingredient in fertilizer for agricultural goods and sulfuric acid used in the production of a range of industrial supplies—including semiconductors, passes through the Strait. The price of urea—the world's most widely used nitrogen fertilizer—has risen 60% since the war began. Helium (used in chip production, semiconductor fabs, aerospace, etc) prices have surged amid supply shock and lack of substitution (Qatar produces nearly 1/3rd of helium globally), and this is likely to add to the existing chip supply crunch.

Exhibit 11: Brent is up ~56% since the start of the crisis, while gas prices have risen ~85%



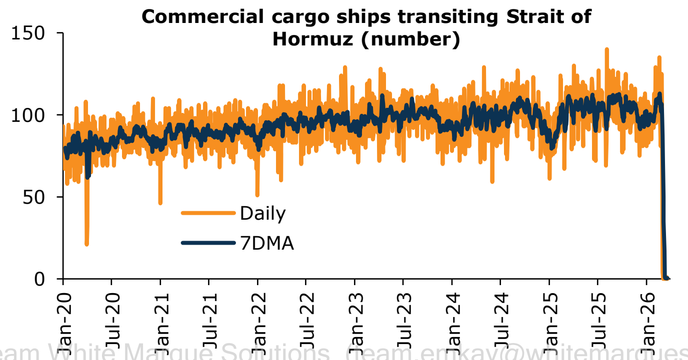
Source: Bloomberg, Emkay Research

Exhibit 12: Tanker traffic via SoH has collapsed completely…



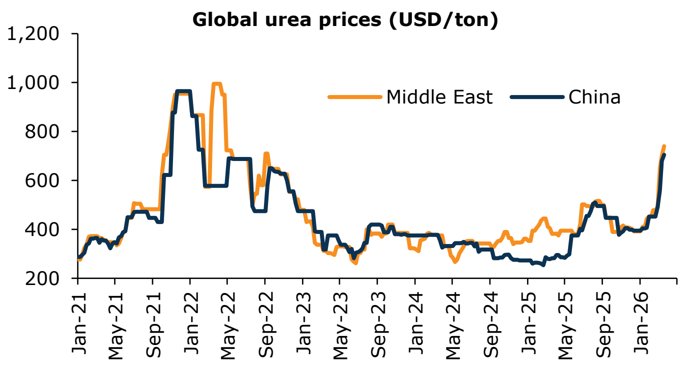
Source: Bloomberg, Emkay Research

Exhibit 13: …as has all commercial cargo traffic



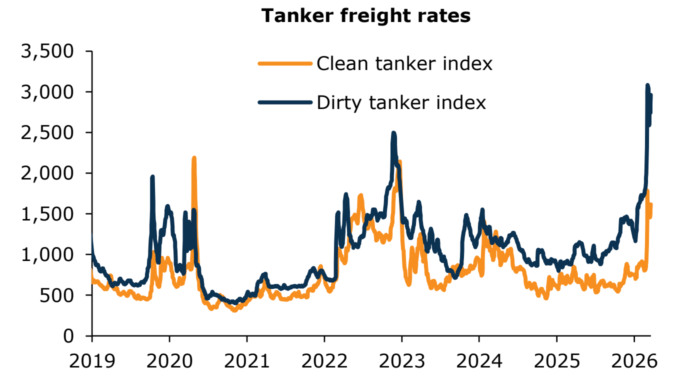
Source: Bloomberg, Emkay Research

Exhibit 14: Global urea prices have risen 40-50% since the start of the crisis…



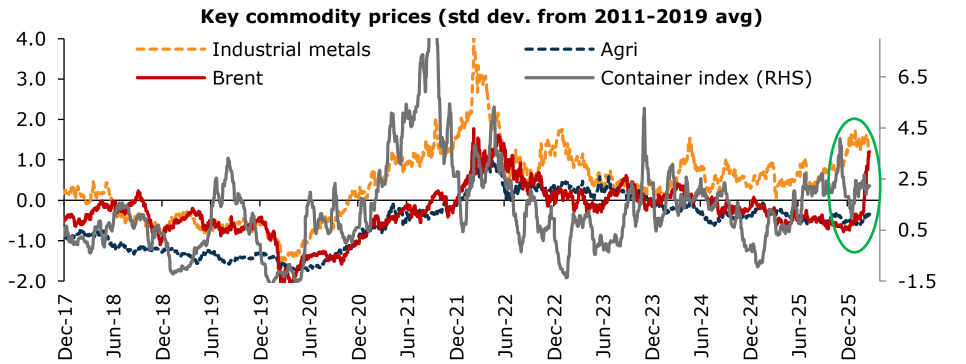
Source: Bloomberg, Emkay Research

Exhibit 15: …while tanker freight rates have shot up by ~80%



Source: Bloomberg, Emkay Research

Exhibit 16: While prices have risen over the last few weeks, the increase is much lower (so far) than during the post-Covid supply shock



Source: Bloomberg, Emkay Research

… with post-conflict supply normalization taking time

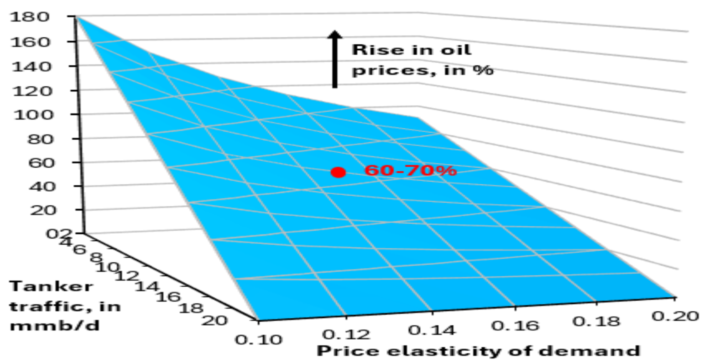
Even if the crisis ends soon, restoring energy supply via SoH to pre-crisis levels will take weeks amid operational and logistical constraints. While clearing the backlog of stranded vessels will take only a few days, closed oil and gas production facilities will require weeks or longer to return to full capacity, while there will also be a lag in terms of available vessels to ferry the products. Thus, the supply shock and macro impact will be materially felt in 1QFY27 (along with the impact of higher prices). The longer the crisis drags on, the larger and more material the impact on 1QFY27 and beyond. There is also a fear that the oil market risk premium may be elevated long after the conflict ends.

As mentioned earlier, both demand and supply for energy are inelastic in the short term: households and manufacturers have no readily available alternative for heating and powering production, and it takes several years to build the infrastructure necessary to extract more. As a result, prices are sensitive to changes in supply.

The economics of the supply shock

The effective closure of the SoH takes ~20% of global crude and LNG supply off the global market. Academic and historical studies suggest that a 1% drop in global oil supply raises the price by 3-8% (depending on various price elasticities ranging from 0.05-0.20). Taking 5% price rise as a mid-point (assuming 0.2 price elasticity of oil demand), a 20% drop in global oil supply due to the closure of the SoH should double the oil price from USD60/bbl at the end of 2025 to USD120/bbl—a level (briefly) seen already in March this year.

Exhibit 17: Research suggests that oil prices should double given the quantum of supply that is now offline



Source: Robin J Brooks' Substack (IIF), Emkay Research

The protracted disruption to global energy supply from the Iran conflict has undermined our assumption that oil prices would hover between USD65-70/bbl for the foreseeable future (our baseline case for FY27E macro forecasts). However, it is crucial not to get too hung up on the daily oil price fluctuations because they do not move the needle materially on our baseline forecast—the monthly and quarterly averages are more important for macro variables forecasts. If Middle East tensions persist, elevated oil prices would lead to broader supply shock, directly transmit into higher input costs, and macro stability could deteriorate. While we are no geopolitical experts, we understand that the probability of an extended crisis has increased, implying that the baseline case of Brent at USD65-70/bbl needs a meaningful revisit before undertaking further scenario analysis.

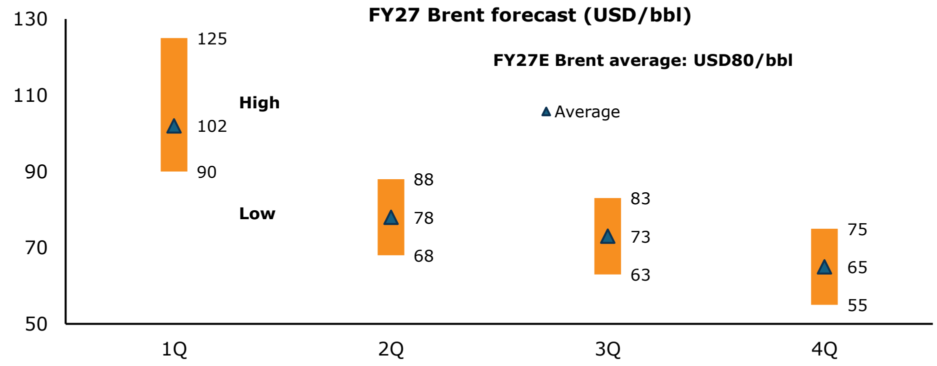
We still do not rule out Brent spiking at USD125/bbl for a brief period, before easing to converge to our pre-conflict baseline of sub-75 levels by end-CY26. This could potentially shift the baseline itself to close to USD80/bbl from USD65-70/bbl in our pre-conflict case for FY27E. However, crude oil prices at USD80-D85bbl will be mostly manageable, while the macro impact will be most acute if prices average north of USD100/bbl. For now, our Energy team prefers to stick to Brent averaging USD70/bbl as their base case for FY27E, preferring to wait until end-March once they get more directional clarity, before making formal forecast changes.

Revising baseline forecasts for FY27E

However, for our revised macro forecasts, we have shifted our baseline average Brent to USD80/bbl from USD70/bbl pre-war, even though we do not know the quantum of uncertainty. We assume the war impact peaks with Brent at USD125/bbl, averaging USD100-102/bbl, and rest ofFY27 averages USD70-72/bbl.

In our new baseline, we estimate an effective fiscal cost of ~0.5% of GDP to absorb oil and fertilizer price pass-through, after partial burden-sharing with the OMCs (and consumers). With this fiscal assumption, we lower our FY27E real GDP growth forecast by 0.4pp to 6.6% and raise headline CPI inflation forecast by 0.3pp to 4.3%. We also revise FY27E CAD/GDP by 0.4pp to 1.7%.

Exhibit 18: We expect Brent prices to remain elevated throughout 1QFY27E, before gradually reducing throughout the rest of the year



Source: Emkay Research estimates

Gauging the macro impact and scenarios in detail

As much as static scenario analysis may be imperfect, it still provides a useful sense of the ceiling and floor of the macroeconomic shock. Importantly, the current episode is no longer merely a price shock but a material supply shock, with spillovers across multiple channels. With gas supplies being curtailed to industries, firms are increasingly resorting to production cuts or price hikes to manage the disruption. While the hospitality sector has been the first to face domestic gas shortages, production curtailments across major industries—such as autos, chemicals, food and beverages, metals, and fertilizers—are likely in the weeks ahead as energy shortages intensify.

While it will take time to gauge the magnitude of the shock and its macroeconomic impact, we understand the impact of a lingering war could soon translate from being an economic issue to being a material risk to macro-financial stability. The longer the conflict drags on, the greater the risk that energy sector disruptions generate a nonlinear hit to growth, operating through prices, quantity constraints, and sentiment and financial channels. The only comfort lies in a stronger starting point, which equips us with buffers to navigate macro adjustments.

Exhibit 19: The stress scenario shows the longer the conflict drags on, the greater the nonlinear hit to growth, via higher prices, quantity constraints, sentiments and financial and external channels

	Baseline (Pre war)	Realistic Baseline (Post war)	Medium Shock	Large Shock	Immense Shock
Brent (US$bbl)	***70***	***80***	***90***	***100***	***130***
CAD/GDP (%)*	-1.3	-1.7	-1.9	-2.4	-3.7
Changes in CAD vs Pre war baseline (% of GDP)		***-0.4***	***-0.6***	***-1.1***	***-2.4***
BoP (US$bn)*	-15	-39	-63	-85	-138
Changes in BoP vs Pre war baseline (US$bn)		***-24***	***-48***	***-70***	***-123***
GDP growth (%)***	7.0	6.6	6.4	6.0	5.4
Changes in GDP vs Pre war baseline (% pts)		***-0.4***	***-0.7***	***-1.0***	***-1.7***
CPI inflation (%)**	4.1	4.3	4.5	4.6	5.2
Changes in CPI vs Pre war baseline (% pts)		***0.2***	***0.4***	***0.5***	***1.1***

Source: Emkay Research estimates

Note(s):

**CAD and BoP estimates assume dynamic analysis, with fall in non-oil export and import demand, remittances and capital flows*

***CPI inflation assumes 30% burden sharing via pump pass through of petroleum-related products (rest to be absorbed by OMCs and Govt)*

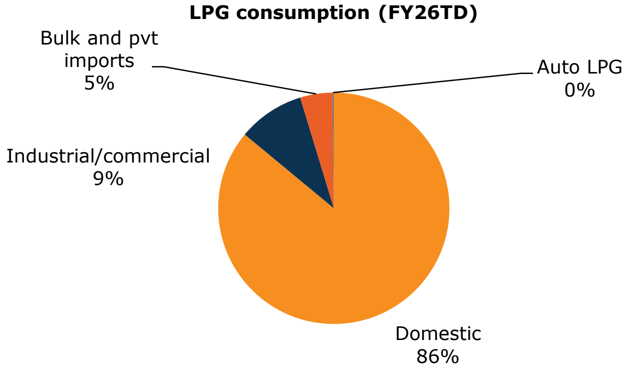
****GDP growth impact could be amplified owing to supply shock cross-sectoral hit*

Exhibit 20: Several industries are already facing lower gas supply in order to prioritize domestic consumption

Sector	Share of total consumption (%)	Volume curtailed (%)
Power	12	100
CGD	23	7
Refineries	8	35
Tea	0	20
Industrial	1	20
Manufacturing	2	20
Fertilizer	29	30
Petrochemicals	6	100
Others	19	20
Total	**100**	**31**

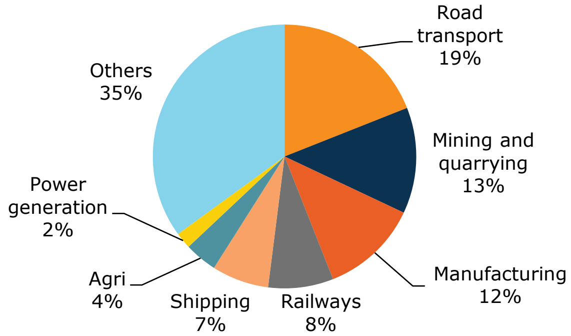
Source: PPAC, MoPNG, Emkay Research

Exhibit 21: ~86% of LPG is used for household consumption



Source: PPAC, Emkay Research

Exhibit 22: Diesel usage is more widespread across industries



Source: PPAC, Emkay Research

The external terms-of-trade (ToT) impact

Higher oil prices represent a negative terms-of-trade shock for India, which is starting to percolate to domestic macros. This will come via four transmission channels: direct being the crude and gas price shock, export hit to GCC destination, remittance hit from GCCs, financial channels via risk aversion-led capital flows and lastly, through extended global pain and demand destruction impacting both our non-oil exports and imports.

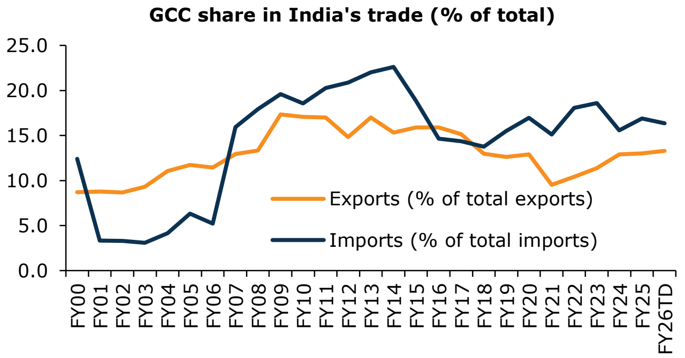
The importance of Middle East—direct external hit for India

India's dependency on imported crude oil is ~90% of its consumption, and India procures a sizeable part of its oil/gas from the Middle East, which comes through SoH. Hence, there is both an oil price and supply risk. Separately, the Middle East accounts for ~13% of India's goods exports, supplies ~16% of goods imports (led by ~40%/~55% of crude oil/gas imports), and contributes ~38-40% of remittances (~3.4% of GDP) and ~9% of gross inward FDI. Our key exports to the Middle East include engineering goods, agricultural products, and refined petroleum products, while our non-oil key imports are fertilizers, rough diamonds, polyethylene, and sulphur, among others.

With India reducing Russian crude imports in Jan-26 to <20% share from peak of >40% in mid-summer of CY25, oil imports from SoH also increased to about 53% in Jan-2026 (41% in 9MFY26). Amid prolonged shutdown, it will be difficult for India to get alternate supplies. Limited strategic reserves (9-10 days for oil and none for gas at the start of the crisis) and operational inventories nearing 45 days are not enough to support beyond a few days ahead. However, Indian refiners are reported to have increased Russian crude imports by 50% from February levels.

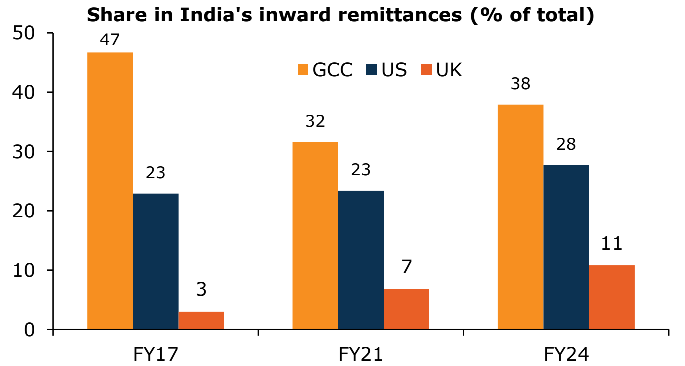
With about 55% of LNG supplies disrupted (28-29% of consumption), a curtailment of gas to industries is already visible, with the government invoking the Essential Commodities Act, prioritizing household cooking gas over industrial use. While the hospitality sector has been the first in the firing line of gas shortages domestically, we are likely to see production cuts across major industries due to energy shortages (auto, chemicals, F&B, metals, fertilizers) in the weeks to come.

Exhibit 23: GCC accounts for ~16%/~13% of India's imports/exports



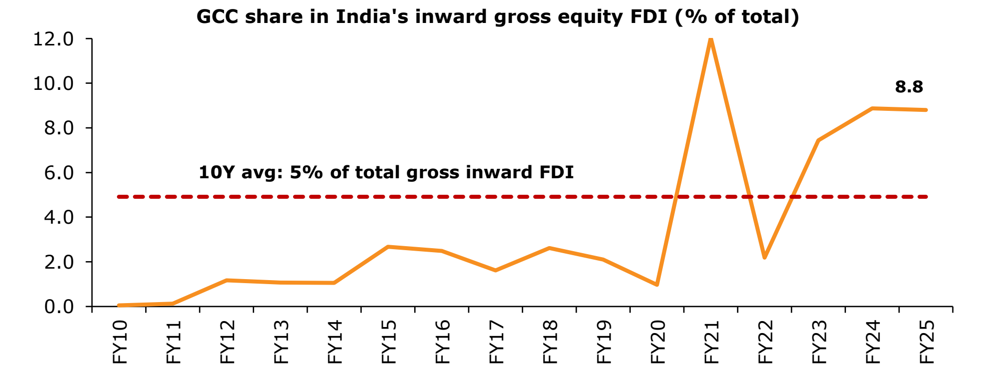
Source: CEIC, Emkay Research

Exhibit 24: While the GCC share of inward remittances has declined vs pre-Covid, it remains the highest contributor



Source: RBI, Emkay Research

Exhibit 25: GCC share in inward FDI has been rising compared to pre-Covid levels (with the UAE making up nearly all of the flows)



Source: Ministry of Commerce, Emkay Research

Exhibit 26: Nearly half of India's crude oil imports comes from the Gulf

India crude oil imports	FY22	FY23	FY24	FY25	10MFY26
Total (mbd)	**4.4**	**4.8**	**4.6**	**4.9**	**5.4**
of which:					
Russia	0.8	1.0	1.7	1.8	1.7
Iraq	1.0	1.0	1.0	1.0	1.0
Saudi Arabia	0.7	0.8	0.7	0.7	0.7
UAE	0.4	0.4	0.3	0.4	0.6
US	0.3	0.3	0.2	0.2	0.4
Kuwait	0.2	0.2	0.1	0.1	0.2
Others	0.9	1.0	0.7	0.7	0.8
SoH (Iraq+Saudi+UAE+Kuwait)	***2.3***	***2.5***	***2.1***	***2.2***	***2.5***
SoH share (%)	**53**	**52**	**45**	**45**	**46**

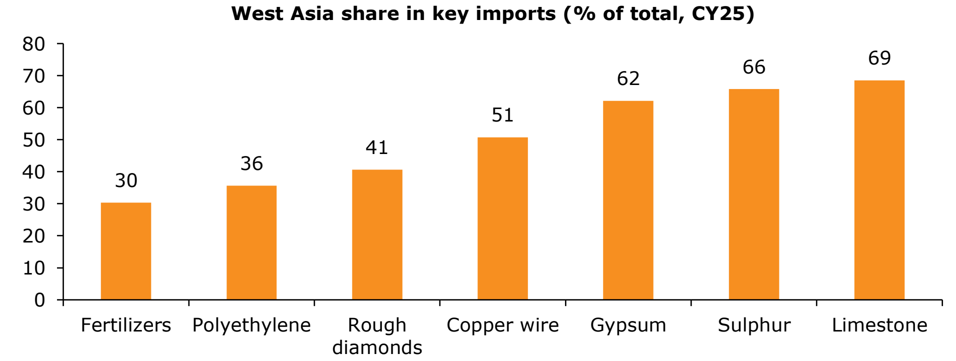
Source: Ministry of Commerce, Emkay Research

Exhibit 27: Qatar makes up ~45% of India's LNG imports, with total Gulf exposure at ~55%

India LNG imports (mmt)	FY21	FY22	FY23	FY24	FY25	10MFY26
Qatar	9.9	10.1	10.7	10.9	11.2	10.0
US	2.9	3.7	2.7	3.3	5.3	2.9
UAE	3.2	3.2	2.7	3.1	3.5	2.4
Angola	1.9	1	0.4	1.2	1.7	1.9
Nigeria	2.2	1.8	0.5	1.1	1.2	1.9
Others	4.9	3.7	2.9	4.4	4.2	3.3
Total	25	23.5	19.9	24	27.1	22.3
Share in India's LNG imports (%)						
Qatar	40	43	54	45	41	45
US	12	16	14	14	20	13
UAE	13	14	14	13	13	11
Angola	8	4	2	5	6	9
Nigeria	9	8	3	5	4	8
Others	20	16	15	18	15	15
Total	100	100	100	100	100	100
SoH share (Qatar + UAE)	**52**	**57**	**67**	**58**	**54**	**55**

Source: CEIC, Emkay Research

Exhibit 28: West Asia has a large share in India's imports of several key commodities ex-POL

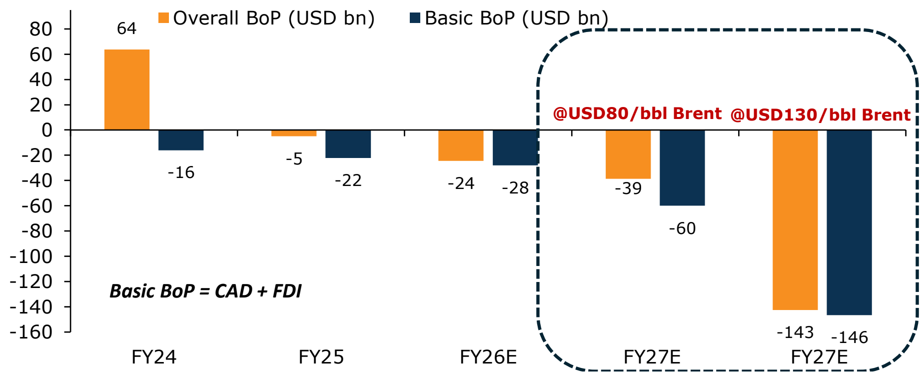


Source: GTRI, Emkay Research

CAD and BoP hit: Immense shock could hit CAD/GDP to as high as 3.7%

- On a static basis, every USD10/bbl increase in crude prices is likely to widen the CAD/GDP by ~0.45%. However, economic variables and foreign capital flows are rarely static in dynamic stress situations. The impact on the current account would be significantly larger if remittances from the ME to India also come under pressure, while global/domestic demand slows. Besides, risk aversion would significantly influence the direction of foreign flows and gold demand/prices (a key hit to CAD this year)—although easing gold prices in this uncertainty cycle could actually act as a mild buffer.
- A sub-USD90/bbl case for crude appears manageable, through a combination of letting INR absorb the shock and using FX reserves effectively to prevent any disruptive adjustment. In contrast, if crude were to go much above that, the pressure would begin to rise sharply. With our new baseline Brent at USD80/bbl, we are tracking FY27E CAD/GDP at 1.7% (vs 1.3% earlier), while BoP is now tracking at ~USD39bn (vs USD15bn earlier).
- Our dynamic scenario analysis at average Brent at USD100/bbl for FY27E implies that CAD/GDP could widen to >2.4%, while BoP deficit could worsen to >USD85bn.
- The immense shock scenario, where Brent stays above USD100/130/bbl, could see CAD rising as high as 3.7% of GDP, almost 2.5ppts higher than the pre-war forecast. The BoP deficit hit in the worst-case scenario could be as bad as ~USD145bn—nearly 23% of FX reserves adjusted for the net short forward position.

Exhibit 29: FY27E could see BoP deficit rising to USD39bn in a stable Brent scenario, while a shock with Brent at USD130/bbl would widen this sharply to ~USD145bn



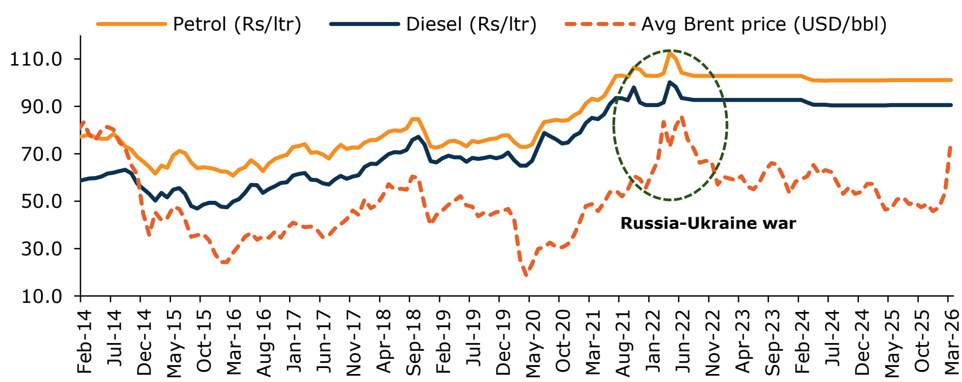
Source: CEIC, Emkay Research estimates

Burden sharing to determine growth, fiscal and inflation hit

The eventual fiscal and inflationary impact will hinge on how the burden is shared between the balance sheets of oil marketing companies (OMCs), government (via a cut in oil duties and increase in subsidies), and end-consumers (via price hikes). Price absorption by OMCs would also effectively constitute a fiscal cost, as it erodes the dividends these companies would otherwise transfer to the government. Conversely, if OMCs were to incur sustained losses, they would likely be compensated by the government in some form, ultimately shifting the burden back onto public finances and also impeding the Centre's spending ability.

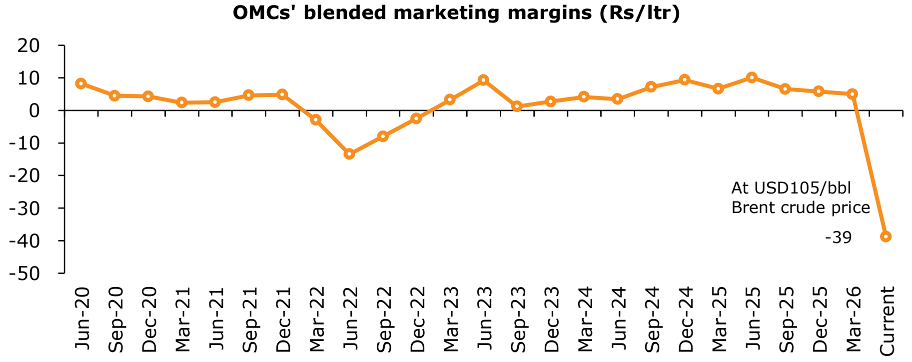
Retail prices for petrol and diesel have not changed since mid-2024, with OMCs absorbing both upward and downward movement in crude prices. In the current crisis, other than reduced supplies, commodity prices and logistic costs (freight, insurance) are being pushed higher. With higher feedstock costs and frozen retail prices, OMCs' margins are already compressing. However, the policy response has been more focused on energy supply management. **Our energy team highlights that in the case of a short-lived crisis, OMCs remain relatively cushioned**, with earnings from other business segments helping offset fuel marketing losses, reducing the likelihood of the government taking the hit on its books at this point. Furthermore, upcoming state elections could mean retail pump prices staying unchanged in the near term. Notably, **every Rs1/ltr cut in excise duties by the Centre implies an annualized fiscal hit of ~Rs155bn.**

Exhibit 30: Domestic pump prices have remained stable post-2022



Source: CEIC, Emkay Research

Exhibit 31: OMCs are staring at a huge margin hit at current crude oil prices



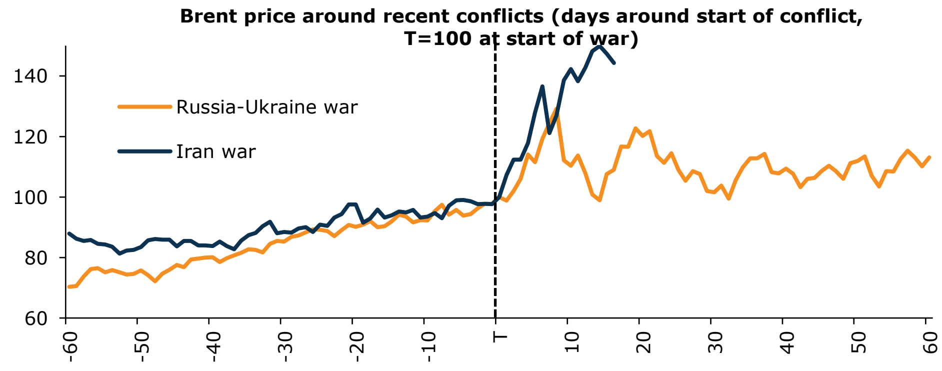
Source: Company data, Emkay Research

Russia-Ukraine war (2022)

Not a perfect template for the current crisis but still an important reference for macro variables

- During the escalation of the Russia–Ukraine conflict, Brent crude prices remained above USD100/bbl for ~100 days (from end-Feb-22 to Aug-22), while they were already trending higher since Dec-21 on anticipation of a war.
- By end-Feb-22, the Indian crude basket also moved above USD100/bbl (unlike the current state, where Indian crude basket is trading at a premium of ~USD30/bbl vs crude). Domestic retail petrol and diesel prices began rising between late-March 2022 and April 2022, increasing by about 10% (roughly Rs10/ltr). To cushion the impact on consumers, the Centre reduced excise duty by Rs8/ltr on petrol and Rs6/ltr on diesel.
- For the full fiscal year 2022-23, the Indian crude basket averaged ~USD90/bbl, while average Brent crude prices were USD95/bbl. Retail petrol and diesel prices were higher by ~3% on average in FY23. Subsidized LPG prices rose by ~21%, while aviation turbine fuel (ATF) prices increased by ~60% on average.
- The fiscal impact was reflected in revenue foregone due to the excise duty cuts (annualized loss of ~Rs1trn, effective ~Rs850bn for FY23—implemented from May-22), along with higher outlays on fertilizer subsidies (nearly double of BE) and additional LPG subsidies (~Rs61bn).
- The govt briefly introduced a "**windfall tax**" on domestic crude oil production in 2022 to offset some of the fiscal pain. It also imposed export levies of Rs6/ltr on petrol and ATF, and Rs13/ltr on high-speed diesel, while directing companies to allocate roughly half of their output to the domestic market. The windfall tax on domestic crude production was subsequently rolled back.

Exhibit 32: The move in Brent prices this time has been far higher than that seen after the start of the Russia-Ukraine conflict



Source: Bloomberg, Emkay Research

OMCs bearing the burden currently: First leg of pain absorption

With pump prices largely frozen in practice now, any burden of crude price hike initially is borne by OMCs and later by the government via excise tax cuts, to offset part of the losses borne by OMCs. **Roughly 35%/39% of retail pump diesel/petrol prices comprise the Centre's excise** (charged per liter), cess and states VAT (ad valorem tax, ranging 17-24% as a percentage price of petrol/diesel, inclusive of excise duties and dealer commissions), of which the Centre's excise and cess would be nearly 20%.

OMCs typically run under-recoveries when crude oil prices rise, while periods of lower crude prices allow them to rebuild margins. Recent softer crude prices had supported healthy marketing margins; however, with crude prices rising again, margins have compressed to their lowest levels since mid-2022. This reflects the degree to which OMCs are currently absorbing higher costs to shield consumers from a full pass-through to retail prices.

For every USD1/bbl increase in Brent, we estimate an impact of ~Rs0.52/ltr on diesel and ~Rs0.55/ltr on petrol retail prices. With retail pump prices largely frozen, the Centre tends to step in when OMCs losses get unsustainable with excise cuts, with states also stepping in some cases with VAT cuts, as seen in Nov-2021 (by Rs5/10 ltr on petrol/diesel) and May 2022 (by Rs8/6 ltr on petrol/diesel).

Our estimates suggest that at current Brent prices, retail pump prices of diesel and petrol need to rise by 42% and 18%, respectively, for OMCs to earn normalized gross marketing margins. Consequently, **annualized deficit on auto fuels at current level of prices are tracking a massive Rs4.4trn.** However, adjusted for supernormal GRM gains, the annualized deficit of OMCs is tracking ~Rs3trn or so. Meanwhile, annualized deficit on cooking fuels at current level of prices, adjusted for subsidies, is currently tracking <Rs700bn.

Exhibit 33: OMCs require Rs 19/ltr increase in blended retail prices to earn normative margins

Calculation of marketing margins on auto fuels based on current prices (Rs/liter)

Based on current global prices (Brent $100/bbl)	Diesel	Petrol
C&F price - current (US$/bbl)	140.0	110.0
Exchange rate - current (Rs/US$)	93.5	93.5
Refinery transfer price of BS-IV equivalent (Rs/litre)	83.5	65.3
Price charged to dealer (excluding duties)	54.0	53.1
Gross marketing margins	(29.5)	(12.2)
Specific excise duty	17.8	21.9
Dealer commission	3.0	4.4
VAT/cess in Delhi	12.8	15.4
Retail selling price in Delhi (current)	87.7	94.8
Normative calculation		
Normalized gross marketing margins	3.0	3.0
Required increase in retail price	37.9	18.2
Required increase in retail price (%)	**43.3**	**19.2**

Source: PPAC, Emkay Research estimates (Energy team)

Exhibit 34: OMCs are bearing nearly Rs 3tn+of annualised deficit at current prices

Annualized deficit on auto fuels at current level of prices (Rs bn)

	Diesel	Petrol	Total
Consumption (mn tons) - only PSUs	83	38	121
Consumption (bn liters)	100	54	154
Required increase in retail price, excluding state VAT (Rs/	32.5	15.2	26.5
Annualized deficit (Rs bn)	3,264	816	4,081
Deficit adjusted for supernormal GRM gains	2,416	604	3,020

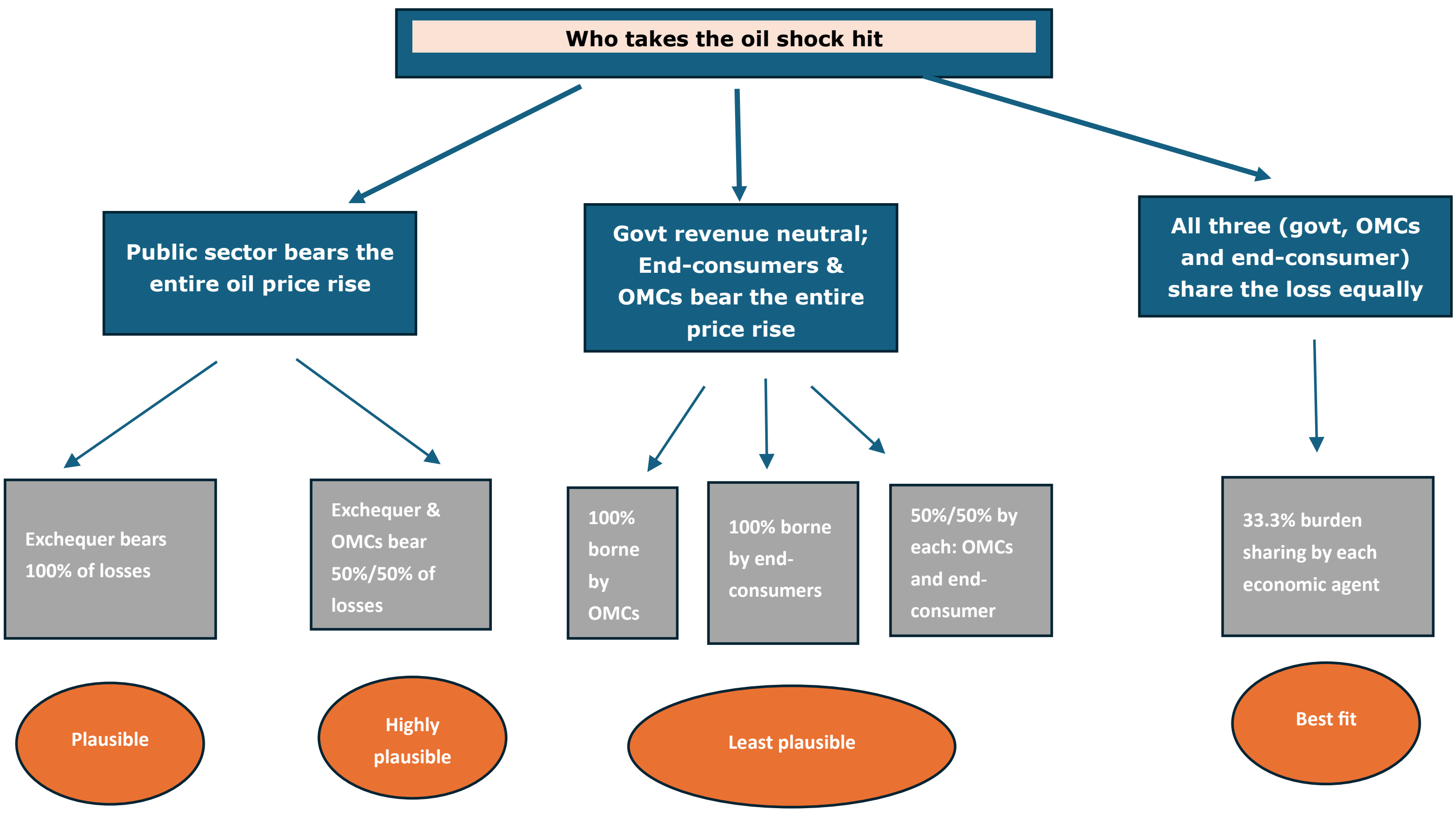
Cooking fuel losses at current prices Brent (US$/bbl) @100	
LPG Cracks (US$/mt)	(30)
Desired Price (Rs bn)/cylinder	1,387
Delhi Retail Selling Price (Rs bn)/cylinder	913
Unit Under-recovery (Rs bn)/cylinder	474
Domestic Vol (mmt)	30
Total Losses	1001
Subsidy provision: DBT provision for LPG, incl. one time grant for LP(	-
Deficit on LPG (Rs bn)	**1,001**

Source: PPAC, Emkay Research estimates (Energy team)

Burden sharing among economic agents

We assess the current situation and try to gauge the eventual fiscal and inflationary impact which will hinge on how the burden is shared between the balance sheets of oil marketing companies (OMCs), the government (via a cut in oil duties and increase in subsidies), and end consumers (via price hikes).

We assume three scenarios on how this burden would be shared between economic agents.



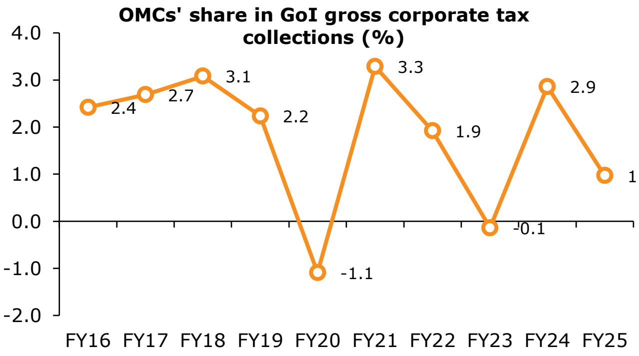
Trading inflation risk for fiscal cost

What remains uncertain is how much of the expected under-recoveries, if sustained, will ultimately be absorbed by OMCs and how much will be passed on to households and firms. **Any price absorption by OMCs should effectively also be viewed as a fiscal cost**, as it erodes the dividends these companies would otherwise transfer to the government as revenue. Conversely, if OMCs were to incur persistent losses, they would likely be compensated by the government in some form (we assume via excise cuts, but it could be via subsidies as well), eventually shifting the burden back onto the fiscal accounts.

Separately, **the greater the share of the oil shock absorbed by the government or OMCs, the smaller the pass-through to retail CPI inflation**.

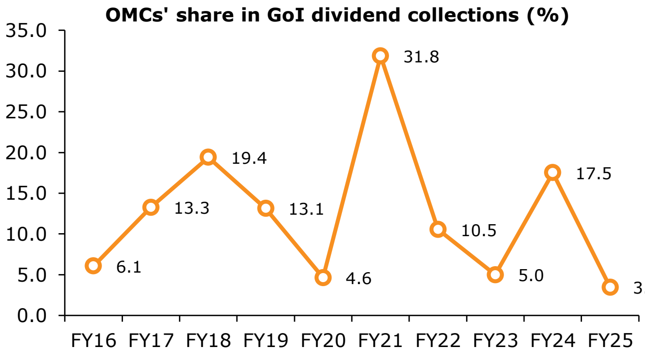
However, we believe the **best fit in a protracted supply shock situation is near-equal distributional burden sharing by economic agents**, with OMCs bearing the first leg of pain, followed by the government and eventually the end consumer.

Exhibit 35: OMCs have rarely exceeded 3% as a share of the govt's corporate tax revenue



Source: Company data, Union budget documents, Emkay Research

Exhibit 36: However, they have been a significant contributor to dividends received, albeit dividends are extremely volatile



Source: Company data, Union budget documents, Emkay Research

The model simulation of cost sharing

As mentioned, our calculation of marketing margins on auto fuels based on current prices (Rs/ltr) reveal that OMCs require another Rs36.8/ltr and Rs17.3/ltr increase in retail prices of diesel and petrol respectively to earn normative margins. This implies that annualized deficit on auto fuels at current level of Brent prices (USD100/bl) and USD/INR exchange rate could be a whopping Rs3trn (adjusted for supernormal GRM gains). Meanwhile, annualized deficit on cooking fuels is tracking nearly Rs700bn, assuming current global/local prices and exchange rate.

1. **Assuming the central government bears full OMC losses at Brent USD100/bbl:** the revenue loss to the government could shoot up to 1.0% of GDP. This will require the government to cut excise taxes by ~Rs19.5/ltr avg blended for diesel and petrol and absorb losses via extra subsidy on LPG (Rs1trn).
2. **Assuming the central govt bears half of OMC losses at Brent USD100/bbl:** The direct revenue loss could reduce to 0.5% of GDP; however, second-order fiscal cost in the form of lower OMC dividends, and lower corporate taxes implies that this could intensify to as high as 0.6% of GDP. The OMCs' burden, however, reduces to ~Rs2trn. We assume no windfall taxes or export levy in this scenario.
3. **Consumers and OMCs are unlikely to bear the price rise or losses alone:** The case of end-consumer bearing the full loss via pass-through to pump prices is likely to be highly unpopular, and the direct fuel price hike hit would lead to nearly 100bps of inflation increase. Meanwhile, if oil companies bear the full pain of nearly Rs4trn, they become super-loss making, which is not a feasible scenario. Equal burden sharing by these two agents would still hit fiscal indirectly to the extent of 0.1-0.2% of GDP.
4. **Equal pass-through among all economic agents:** This seems to be the best fit, and more feasible, if the supply shock is long drawn. The exchequer still bears the maximum hit in this scenario, owing to second order impact via lower OMC dividends and taxes, implying the fiscal slippage could be ~0.4% of GDP. OMCs' direct burden reduces to ~Rs1.3trn while consumers bear 30-35bps higher inflation.

Exhibit 37: The best fit scenario of burden sharing implies fiscal hit could be contained under 0.4% of GDP

Macro Scenarios *(Assuming Crude remains @ USD100/bbl in FY27)*	Who takes the hit?	How?	Impact (in Rs bn unless mentioned otherwise)				
			Oil cos burden	Corporate tax hit	Dividend hit	Direct revenue loss for govt	CPI impact (bps)
1 - Public Sector bears the entire oil price rise	100% Central govt	By cutting Excise (Rs. 19.4/ltr avg. blended for Diesel and Petrol) and absorbing extra subsidy (~Rs 1000 bn) - Not plausible	-	-	-	4,021	-
	50% Central govt & 50% Oil cos	By cutting Excise (Rs. 19.4/2 = Rs 9.7 ltr avg.) and absorbing extra subsidy (Rs 350 bn)	2,010	176	157	2,010	-
2 - Govt Revenue Neutral - Consumers & OMCs bears the entire price rise	100% Oil cos	Leads to zero profits for oil cos (not plausible)	4,021	176	157	-	-
	100% Consumer, Oil cos and central govt do not bear any cost	Unpopular	-	-	-	-	100
	50% Consumer, 50% Oil cos, No Central govt	Direct Pass-through, with no excise cut	2,010	176	157	-	49
3 - All share equally (Best Fit)	33.3% Consumers, 33.3% Oil cos., 33.3% Central govt	Equal direct pass-through	1,340	176	157	1,340	33

Source: Emkay estimates; Calculations shared on request; Note: tax hit and dividend hit are indirect fiscal costs

Growth and inflation impact: Distributional burden sharing and the second order hit

- Burden sharing has varied implications for growth, both from the point of view of domestic demand and role of state. The impact on GDP is generally assessed primarily through the private and government consumption channel, where higher inflation leads to an erosion of real incomes and weaker consumer spending or lower ability to do effective fiscal spending, leading to smaller growth multipliers.
- **Growth is affected through several channels**—first, weaker consumption as household purchasing power declines; second, reduced government spending to adhere to fiscal deficit targets amid higher oil-related subsidies (including higher fertilizers as well); and third, softer investment as elevated input costs compresses corporate margins and profitability.
- The negative impact of higher energy prices on the economy is expected to be mitigated in large part by government subsidies, so to that extent, the drag from an inflation shock on domestic demand ex-govt. may remain less severe in the first leg.
- Even so, manufacturers are unlikely to be spared from the headwinds of shortages of petroleum products/derivatives—indispensable as intermediates—and supply chain disruptions. If this leads to broad-based production adjustments, the effects could spill over into corporate profits and domestic demand and eventually feed into further disincentives to invest. More so, an uncertain global backdrop will also potentially undermine animal spirits and investment intentions.
- Meanwhile, if the fiscal deficit target remains unchanged, any **oil shock absorbed through fiscal policy—directly or indirectly—would crowd out other categories of public spending on a one-for-one basis**. In contrast, if the shock is allowed to pass through to CPI and reduces household real incomes, the adjustment in consumption is likely to be more gradual relative to the sharper contraction typically associated with fiscal compression.

The RBI's policy choices are unlikely to be easy

With the current situation persisting longer than anticipated, India's challenge could quickly evolve from a current account problem into a capital account one. In such an environment, global idiosyncrasies may constrain the RBI's ability to stabilize INR through FX intervention, complicating the policy trade-offs ahead.

Financial stability, therefore, will no longer play second fiddle policy reaction function that is primarily inflation-targeting, and may well emerge as the primary focus for the RBI. Anyway, **we think the bar for any conventional rate hike remains high**. It would require a sustained supply shock that drives headline CPI well above target on a persistent basis, with energy price pressures spilling over into core inflation and, importantly, into inflation expectations.

FX is the biggest variable to watch…

With financial stability taking a front seat, FX would the biggest variable to watch. INR has been on the receiving end since the middle of CY25, bearing the brunt of India's relative loss of export competitiveness vs EM Asia amid higher US tariffs. The policy response to tariffs has been largely that of restrained FX defense, without trying to fiercely change the direction of the currency.

Despite that, i) INR has been the worst performing EM in CY25 and CY26TD, ii) FPI outflows have been higher than Asian peers in CY25 and CY26TD at USD12bn and USD10bn respectively, and iii) the RBI's estimated spot and forward intervention has been to the tune of USD55-60bn and USD20-30bn, respectively, in FY26, with forward position tracking net >USD100bn+ as of now.

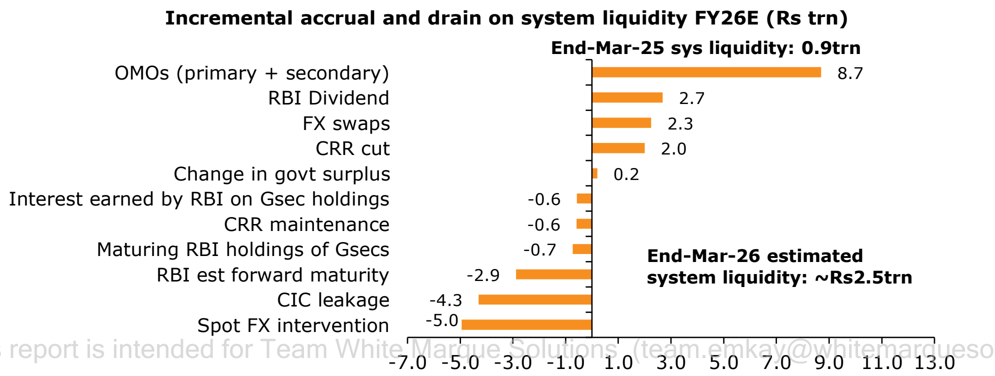
…with system liquidity drain likely in ahead amid heavy forward position

Sustained and sizeable unsterilized spot FX intervention ahead would directly drain domestic liquidity and push up money market rates. At the same time, further expanding the RBI's heavy net short forward position by intervening in forward markets will also come at a cost. Reports suggest the net short forward position of the RBI appears to have shot up to >USD100bn by mid-March-26 after having fallen to the lows of -USD53bn in summer of 2025.

This will come to bite system liquidity with a lag, and pressure the spot INR with higher USD demand as contract maturity nears. We note past build-up of a heavy net dollar short position has also weighed both on FX and FI in FY26, with durable liquidity remaining under pressure due to FX intervention. This was largely offset by OMOs, CRR cuts and FX swaps, amounting to nearly Rs14trn, with OMOs absorbing ~80% of net Gsec supply, while keeping overnight rates low.

In the present Iran war scenario, the RBI has again chosen to support rates over FX, with consistent OMOs and keeping real rates stable, while letting INR act as an automatic shock stabiliser. We expect FX-led liquidity drag to continue in FY27E, largely in 1H, implying continued sterilization by the RBI via OMOs and FX swaps.

Exhibit 38: RBI OMOs have been the primary liquidity support in FY26E



Source: CEIC, Emkay Research estimates

Drawing the line between FX tolerance and defense

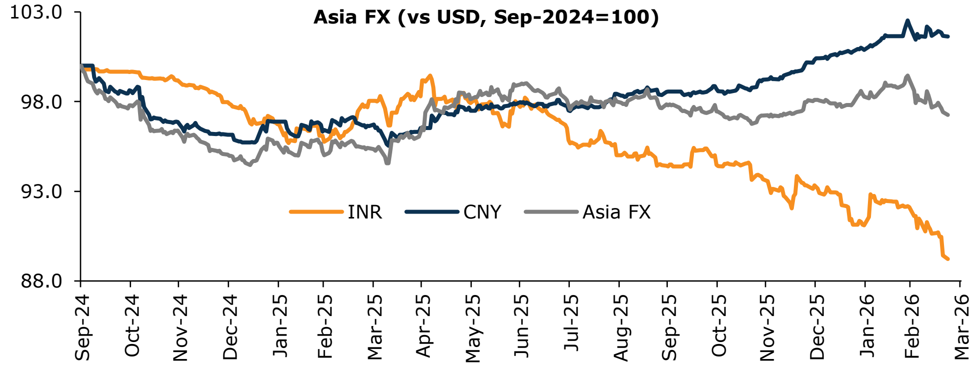
The RBI's policy reaction must be wider, focused on macro financial stability factors, and assertive, keeping currency management a key determinant especially in times of crisis.

However, sustained and sizeable FX intervention comes with a cost. And therein lies the real dilemma for an EM central banker like the RBI: where exactly does a central bank draw the line between FX tolerance and defence? Yet, letting the INR freely absorb the shock is not an option in times of stress, when speculative dominance in FX markets can quickly put the currency on a slippery slope, one that we can ill-afford.

As a result, when crisis concerns resurface, any lag in policy response will stand out and could manifest as upward pressure on long-term yields (fear of fiscal funding) and/or downward pressure on the currency. Both FX and rates markets transmit directly to the real economy, and missteps in either can amplify external as well as domestic vulnerabilities, complicating macro and financial stability objectives.

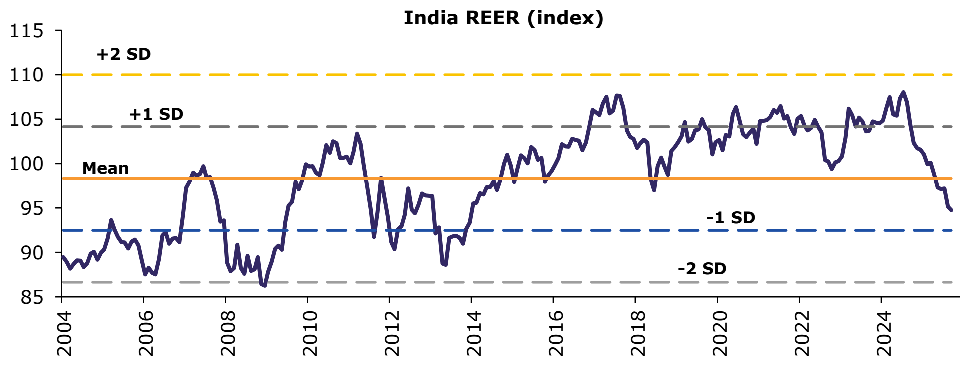
Non-assertive communication may not be the best bet when EMFX gets attacked by speculators. However, we are not expecting a harsh policy response of interest rate defense of summer of 2013 as of now, aimed at raising the overnight rates and curbing onshore-offshore arbitrage by FX speculators. That said, we believe a protracted crisis could mean USD/INR could reach 96, while 10Y yield could edge higher towards 6.95%.

Exhibit 39: INR's pain vs Asia pain has continued in CY26, with a sharp fall post-Iran crisis



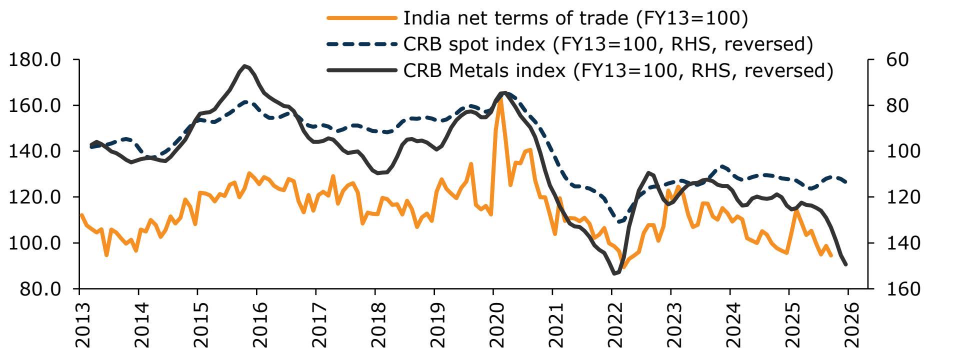
Source: Bloomberg, Emkay Research; Asia FX includes China

Exhibit 40: INR REER now looks undervalued after the sharp recent depreciation



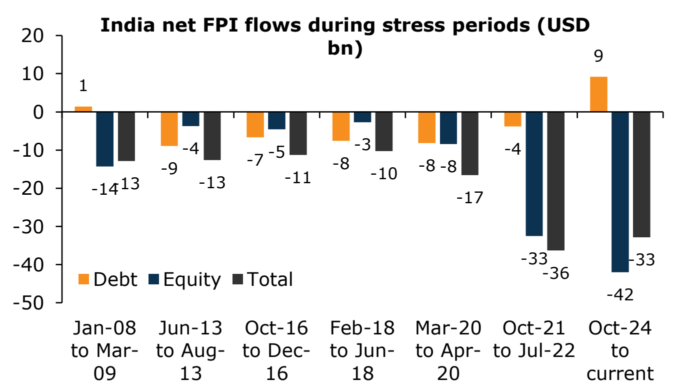
Source: Bloomberg, Emkay Research

Exhibit 41: India's Terms of Trade (ToT) is not favorable for INR strength



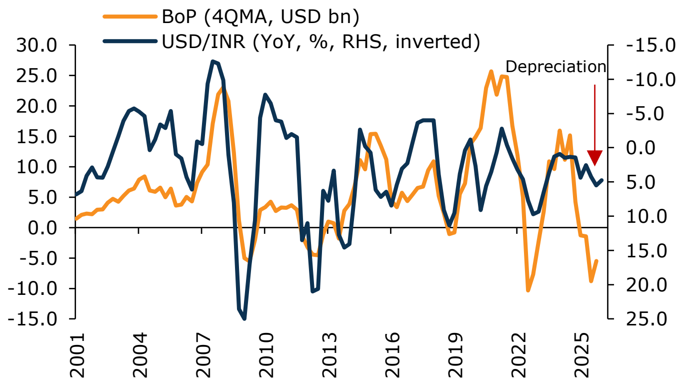
Source: DGCIS, CEIC, Emkay Research; ToT defines the ratio of a country's export prices to its import prices

Exhibit 42: India has seen the highest outflows since Oct-24 compared to prior stress periods



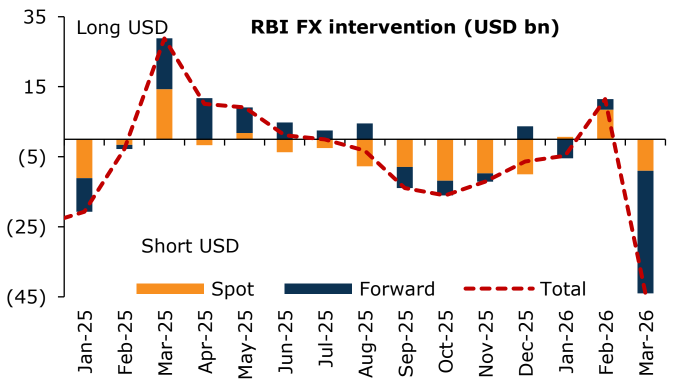
Source: Bloomberg, Emkay Research

Exhibit 43: Persistent BoP deficits to put further pressure on the currency



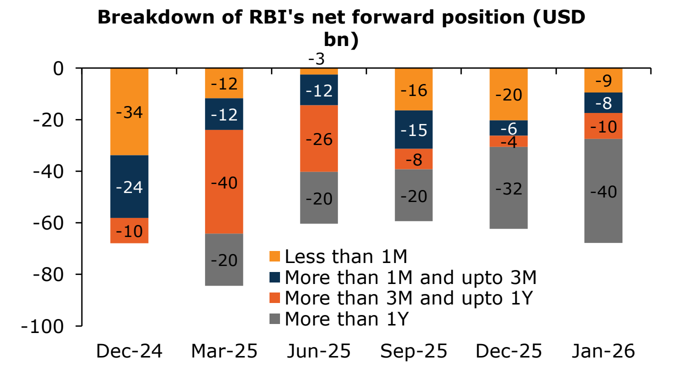
Source: Bloomberg, Emkay Research

Exhibit 44: Mar-26 may see nearly USD50bn of RBI FX intervention



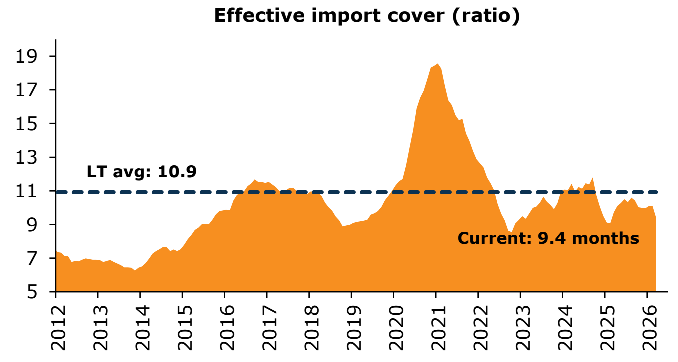
Source: Bloomberg, Emkay Research; Feb/Mar-26 is estimated

Exhibit 45: RBI's net forward position has elongated in recent months, with >1Y maturity now amounting to ~60% of total



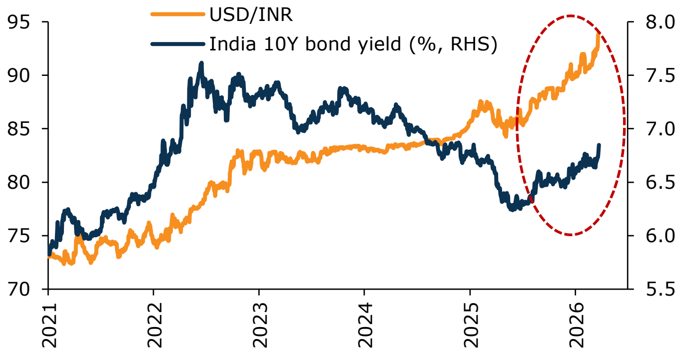
Source: CEIC, Emkay Research

Exhibit 46: India's effective import cover has dropped to less than 10 months



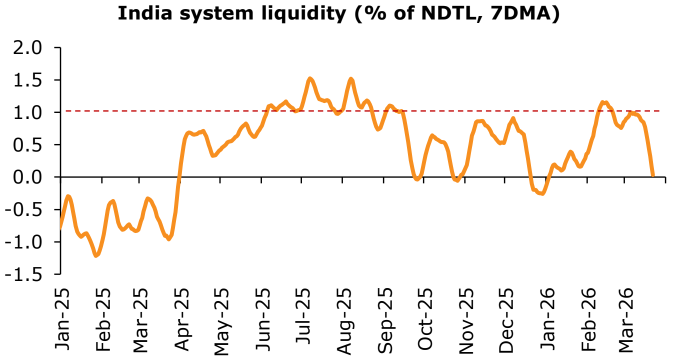
Source: CEIC, Emkay Research. Effective import cover is calculated using FCA instead of total FX reserves, adjusted for forward position

Exhibit 47: INR and 10Y yields moving in tandem, but the bond yield rise has been managed by the RBI so far



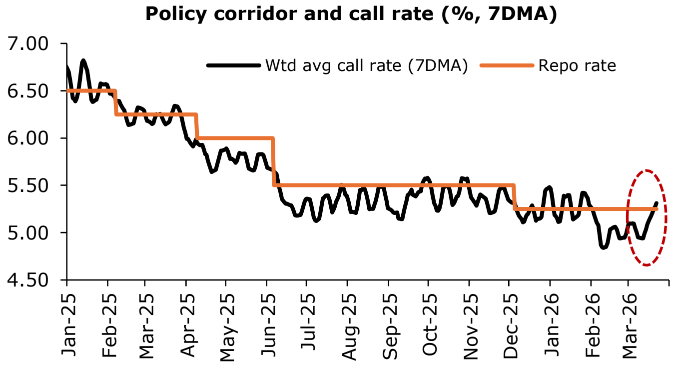
Source: Bloomberg, Emkay Research

Exhibit 48: System liquidity has fallen sharply in recent weeks due to seasonal factors as well as RBI FX intervention



Source: CEIC, Emkay Research

Exhibit 49: Call rate has stayed below repo for most of the year but has been recently inching higher on lower liquidity



Source: CEIC, Emkay Research

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