
An exploratory study on the impact of external world situations on the various macroeconomic indicators of the Indian economy

Prisha Goel

Sat Paul Mittal School, Ludhiana, Punjab

DOI: 10.46609/IJSSER.2025.v10i03.007 URL: <https://doi.org/10.46609/IJSSER.2025.v10i03.007>

Received: 4 March 2025 / Accepted: 17 March 2025 / Published: 26 March 2025

ABSTRACT

The impact of war anywhere around the world is extremely detrimental to all countries. The disruptions occur right from imported supplies to exports, balance of payment inflation levels, higher freight and airfare as well as the corresponding impact on tourism and levels of FDI and FPI. Amicable solutions through dialogue would help in restoring world finances.

Keywords: war tax, geopolitical disruptions, inflation, supply of energy, sanctions, Development, monetary policy, supply and demand, EU council, genocide, increased expenditure, lockdown, sustainable.

Research Question: An analysis would be attempted on the role of external disruptions on economic indicators in both developed and developing countries. How does various political disharmony like invasion and military warfare amongst nations impact macroeconomic indicators like inflation, FPI and FDI in India? Does this development have a bearing on domestic savings and investments? If so, how? What would be the impact on domestic monetary and fiscal policies? Does this lead to a rethinking on foreign policy decisions with respect to macroeconomic indicators? These and similar type of questions would be attempted to be addressed in the course of this paper.

1. Introduction

The decade that has begun from 2020 has been wrought with a complex set of challenges, both political and economic. The decade started with the onset of the

- covid pandemic,
- Ukraine Russia war,

- conflict between Israel and Palestine, Gaza -Israel, Israel-Hamas war, Israel -Lebanese conflict, Hezbollah-Israel conflict, 2024 Israel invasion of Lebanon, Iran -Israel proxy conflict
- Red Sea crisis
- the Haiti gang violence.

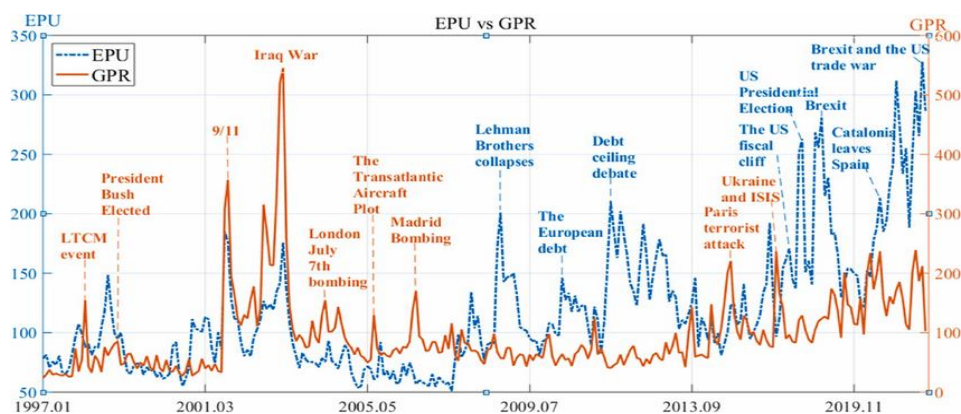
All these conflicts have had an adverse impact on hunger in the world, on families, communities, infrastructure and food systems. On the trade side increased restrictions due to tensions between countries can disrupt trade flows and cause supply chain problems even in third party countries. Restrictions can impact commodity prices and lead to shortages of key resources such as oil and gas affecting industrial production worldwide.

The geopolitical risks posed by tension, polarisation and conflicts within and between states inevitably impact economies both globally as well as the countries involved. The global economies like India are affected directly and indirectly through financial, trade and commodity price channels.

Geopolitics involves the impact of internal political affairs that influence both domestic and global financial markets. This means that governments can influence economic activity through various fiscal policies (taxes and spending) and other economic and strategic decisions based on different priorities depending on their political leanings.

The image in figure 1 indicates the political impact on currencies namely the euro and the British pound. One can see the fluctuation of the currency exchange impacted by political reasons both domestically and worldwide.

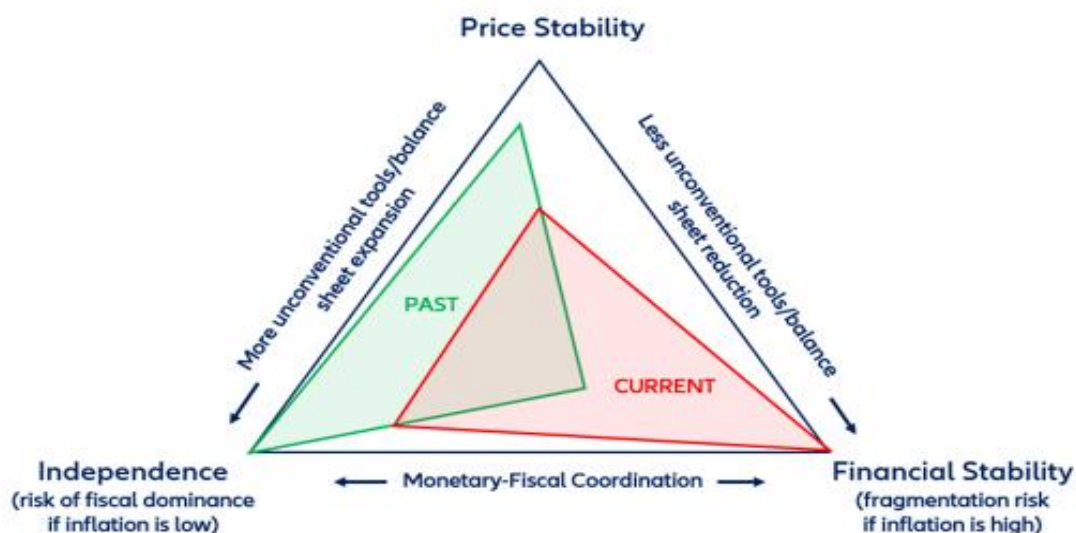
Figure 1 Representation of Geopolitical Interference



Source: researchgate.net

The impact occurs both through direct capital control, financial sanctions and indirectly through increased uncertainty, high risk premium or asset price surges. These tensions amongst major economies have intensified concerns about global economic and financial fragmentations. Financial fragmentation as a situation in which the financial cost is determined by events in external economies rather than on the underlying fundamentals of the country. This means that globalisation of the world has impacted finances and macroeconomic indicators of the countries.

Figure 2 An Example in the Euro zone of Impact of Financial Fragmentation



Source: <https://www.allianz-trade.com>

World disruptions result in impacting global production networks. These started to emerge in 2020 and are a reflection of imbalances between the supply and demand of certain goods. Strains in global production networks are commonly called supply bottle necks and are multifaceted. The current geopolitical disruptions which started with the Russian Ukraine war came straight after the process of recovery of economic activity after the covid 19 pandemic.

The impact of countries due to the spread of the pandemic have been unprecedented as they reflect a shift in demand and supply that is likely to have been triggered by the closing and reopening of economies as a response to monetary and fiscal stimulus adopted. Pandemic related measures severely restricted consumption opportunities especially in the services sector (travel, tourism and recreational activities).

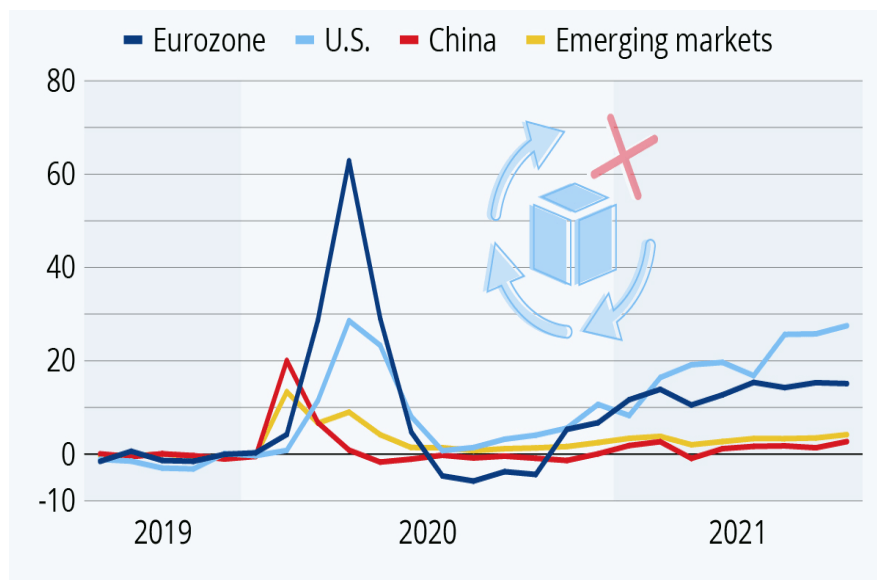
As the economies started moving towards normalcy a reduction in supplies started putting a drag on activity and trade at the global level. The specific impact of the Russian Ukraine war was in terms of:

- Difficulties in the logistics and transportation sector
- Semiconductor shortages
- Pandemic related restrictions on economic activity
- Labour shortages

2. Current Political Disruptions (World Scenario)

Global shipping of merchandise goods has been severely disrupted due to container misplacement and congestion not only due to the rapid recovery of the global economy after the covid 19 pandemic but also due to the immediate disruption caused by the Russian Ukraine crisis. This led to a rotation of consumption demand from services to goods resulting in high import volumes. These shortages were further accentuated due to localised and a simultaneous outbreak of covid 19. The reaction to the pandemic was staggered around the world as it erupted at different times at different places. Whenever there was a whiff of the pandemic in a particular city of a particular country the administration would react by posing a lockdown automatically resulting in a disruption of supply of goods.

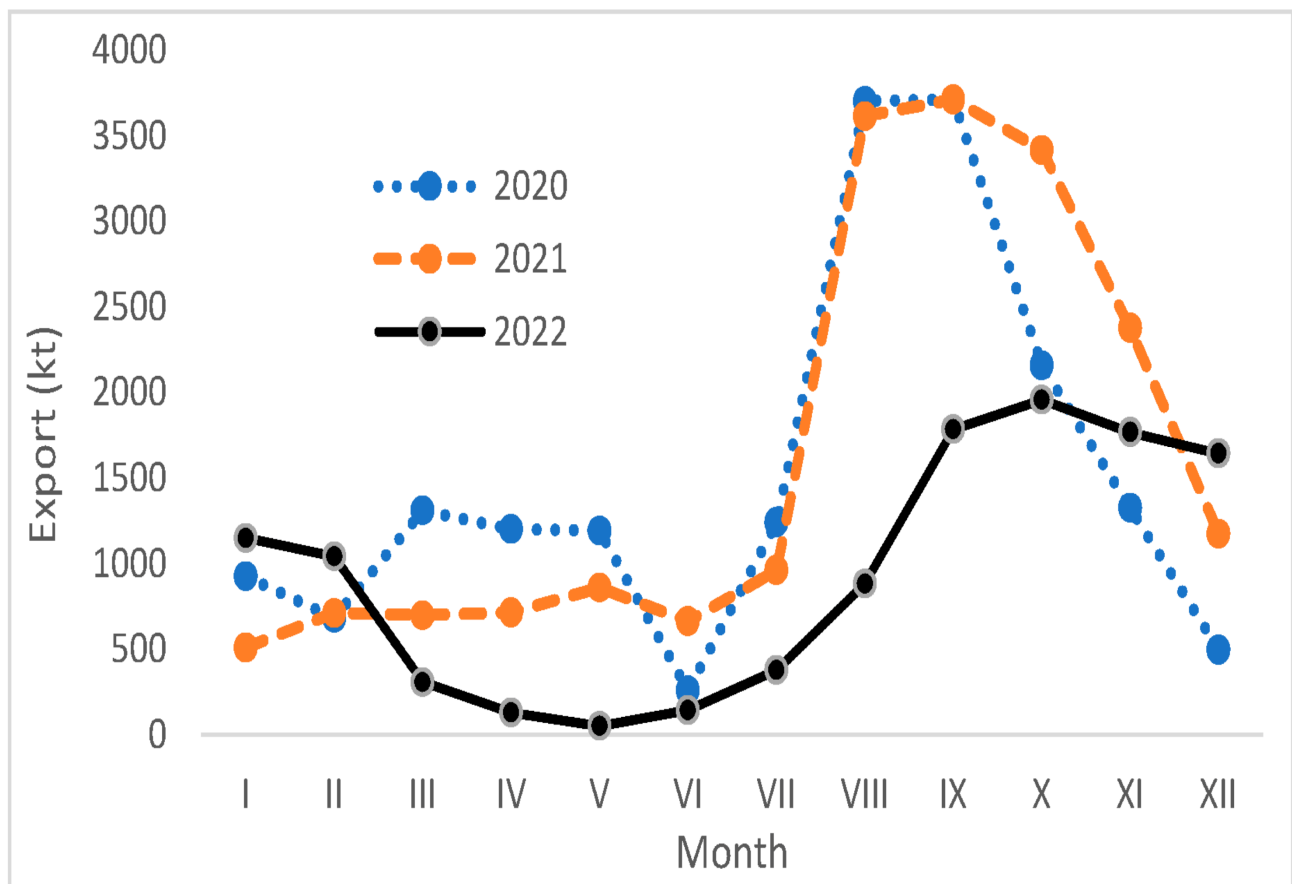
Figure 3 Visualisation of disruption due to pandemic



Source: Statista

Figure 3 clearly indicates the impact of the pandemic on supplies of commodities in the world. The world seems to be at an enviable position in 2019 before the pandemic set in. The dip can be noticed in subsequent years. If along with this the impact of disruption due to Russia Ukraine crises are added the impact is disastrous.

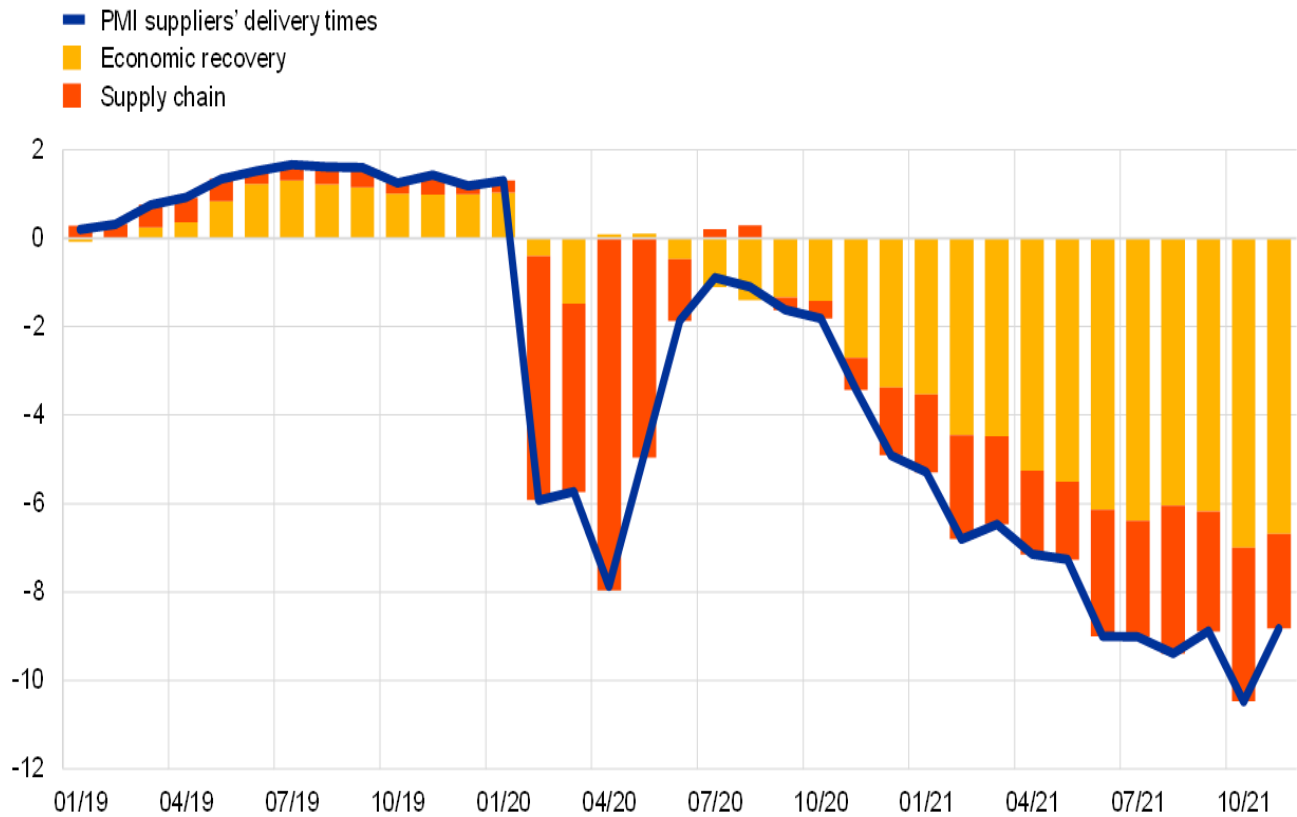
Figure 4: visual representation of agricultural food supply disruptions



Source: MDPI

World sources including the United Nations have stated that the covid 19 pandemic and the Ukraine Russia war straight after has led to a food crisis due to the fact that Russia and Ukraine are supplying 30 percent of wheat and barley to the world. The countries that they supply include the vulnerable ones which are already impoverished. Disruptions in supply would further aggravate the hunger situation in these economies, shortages of supply leading to an increase in prices of food items making it out of reach for developing economies. This further aggravated poverty, hunger and malnutrition in these economies.

Figure 5: graphic represent of negative recovery after pandemic and negative disruptions due to the war



Source: <https://www.ecb.europa.eu/>

2.1 IMPACT OF ISREALS CONFLICTS WITH HAMAS HEZBOLLAH SYRIA IRAN

The key aspects of conflict which has led to Isreal reacting militarily in October 2023 was with respect to

- The Gaza strip
- Status of Jerusalem
- Israeli settlements
- Borders
- Security

- Water rights
- The permit regime
- Palestinian movement of freedom

The conflict between Israel and Hamas has sparked regional tensions in the Middle East. Hezbollah fighters in Lebanon have engaged in cross border skirmishes. Yemen's Houthi rebels have shot missiles at Israel and commercial strips in the Red Sea. Iran backed groups have launched attacks on US military positions in Iraq and Syria.

These conflicts have led to Gaza being low on water and fuel. The war is likely to lead to a famine type situation in Gaza. A number of hospitals in the strip have been bombed and very few of them are functional leading to the possibility of epidemics coupled with civilian casualties.

This conflict has further affected civil aviation across multiple dimensions in the form of

- Restricted airspace
- Increased operational costs
- Risk to passenger safety
- Disruption to air traffic management

All the above disruptions have led to an increase in cost of raw materials as well as finished goods. This is not only in terms of disruption of supply but also in terms of freight costs while transporting both commodities and people.

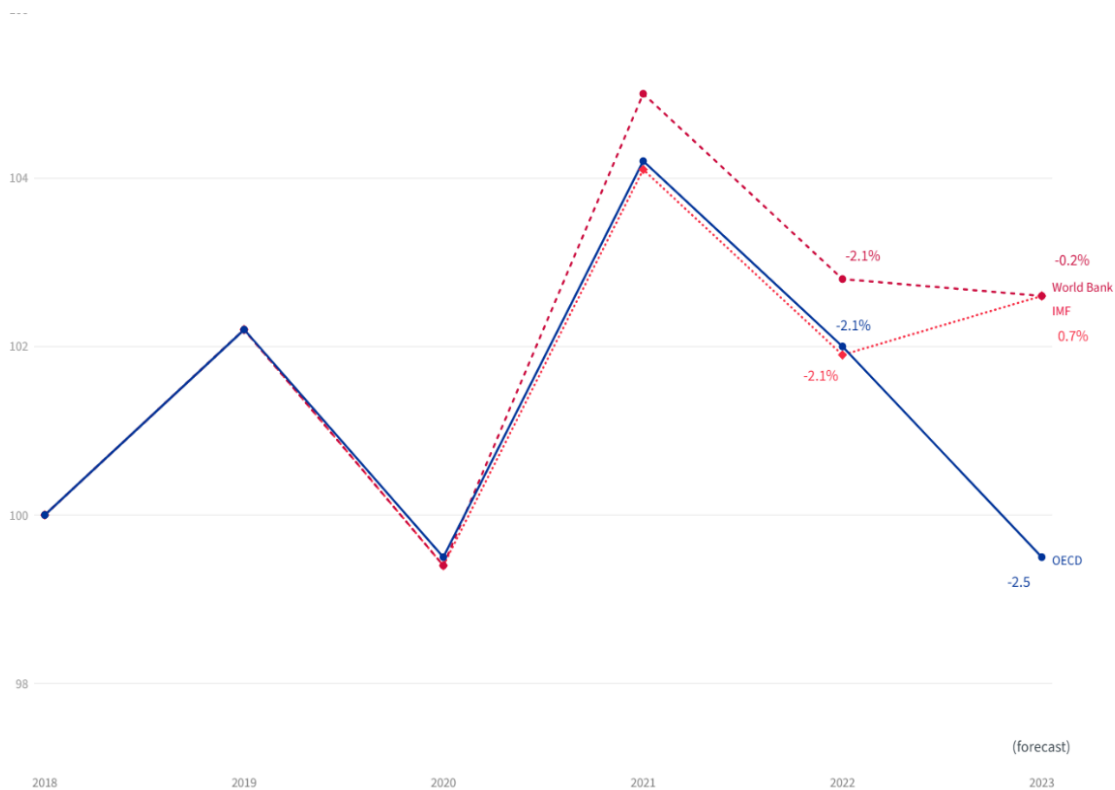
3. REACTION OF THE WORLD TO THE WARS THAT ARE TAKING PLACE

3.1 RUSSIA UKRAINE

The world condemned Russia's invasion into Ukraine as it led to Europe's largest refugee crisis since World War II with more than 8.2 million Ukrainians fleeing the country. This invasion received widespread international condemnation from governments and inter-governmental agencies resulting in new sanction being imposed on Russia. These sanctions have led to widespread economic effects on Russia and the world economies. They were primarily aimed to weaken Russia's ability to finance the war. According to the World Bank and International Monetary Fund (IMF) and the Organisation for Economic Cooperation and Development (OECD). The Russian GDP fell to a low of 2.1% per annum in 2022.

Figure 6: Impact of the sanctions on Russia’s GDP

(Base 100 in 2018)



Source: European Council

These sanctions have also led to a decline in Russia’s trade of goods and services. Its revenues from sale of fossil fuels have diminished significantly. Sanction imposed by the EU and its partners on Russia’s financial system reduces its ability to finance the war.

But this in turn has impacted other countries leading to disruptions in global supply chain, higher global commodity prices and slowdown in economic growth. The EU have faced the greatest economic crisis in terms of destabilization of the global energy markets.

The sanctions on Russia are multilateral but not global for e.g. Russia’s exports to Brazil, China, India and Turkey have increased by at least 50% since the war.

China has become Russia’s largest trade partner and both India and China have replaced the European union by Russia as a significant importer of energy.

3.2 ISRAEL GAZA

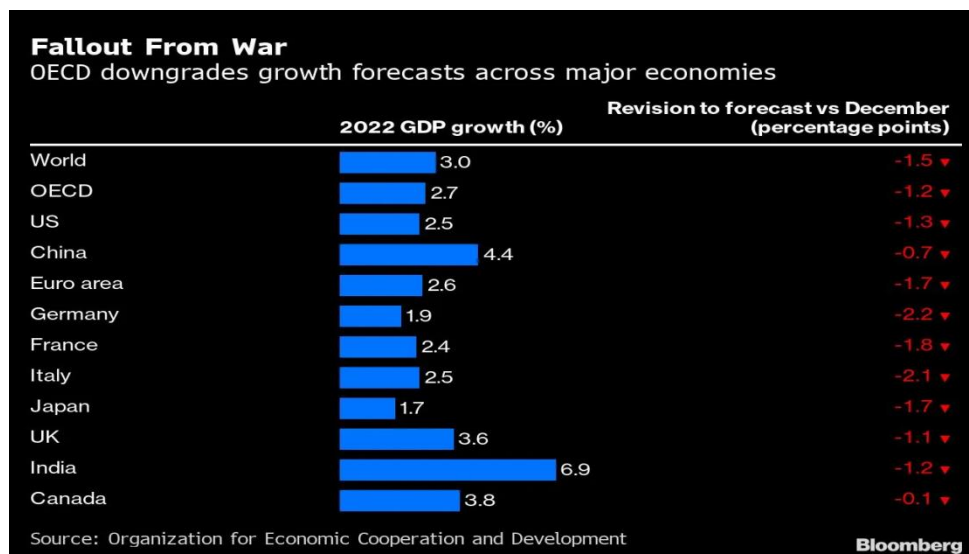
The world saw the invasion by Isreal very differently depending upon whether they are Jewish Israelis or Arab Israelis, 39% of Israelis say that Israelis response against Hamas is right. Most of them feel that Israel will probably achieve its goal but they want to constrain Israel to freeing the hostages rather than taking over the Gaza strip.

The conflict is now over and exchange of hostages have begun but the economic impact on Gaza has been very severe. The whole of Gaza’s townships has been raised to the ground. A large number of people have died. Israeli forces have killed 33000 Palestinians till June 2024 this number has further increased subsequently. This act amounts to “genocide”, and ‘clear violation of international humanitarian law.’. The war could have ignited parallel conflict amongst different Arab nations but luckily restraint has been practiced and ceasefire has been declared (declared on 15 January 2025 effective 19th January 2025).

4. IMPLICATION OF THESE WARS ON WORLD INFLATION

Rising inflation is a direct economic effect due to the conflict. The Russian invasion on Ukraine has led to a substantial increase in the price of food and energy. As both these commodities are primary and intermediated ones for various products it has led to an increase in the prices of most other commodities. The timing of the Russian Ukraine crisis was such that it occurred straight after the pandemic dealing a double negative impact.

Figure 7: Impact of the Russian Ukraine war on inflation



Source: www.blomberg.com

4.2 IMPACT OF THE WAR ON COUNTRIES INVOLVED IN THE CONFLICT

When countries fight a war inflation rises for the whole economy basically due to the fact that demand is higher than supply. Along with this there is a sharp increase in public expenditure due to rearmament and war effort to increase capacity utilisation of the economy. The revenue for this is obtained from:

- Increasing taxes
- Reducing other expenditure other than military
- Raising loans
- Making the central bank print more money.

Except for shifting expenditure heads all others lead to inflation.

The economic impact of the above can lead to a negative supply shock resulting in the production activity declining but prices rising at the same time. A combination of slow growth along with inflation. In such cases it becomes extremely difficult for the monetary policy of the government to manage the situation.

4.3 TYPE OF MONETARY POLICY ADOPTED IN THIS TYPE OF SITUATION

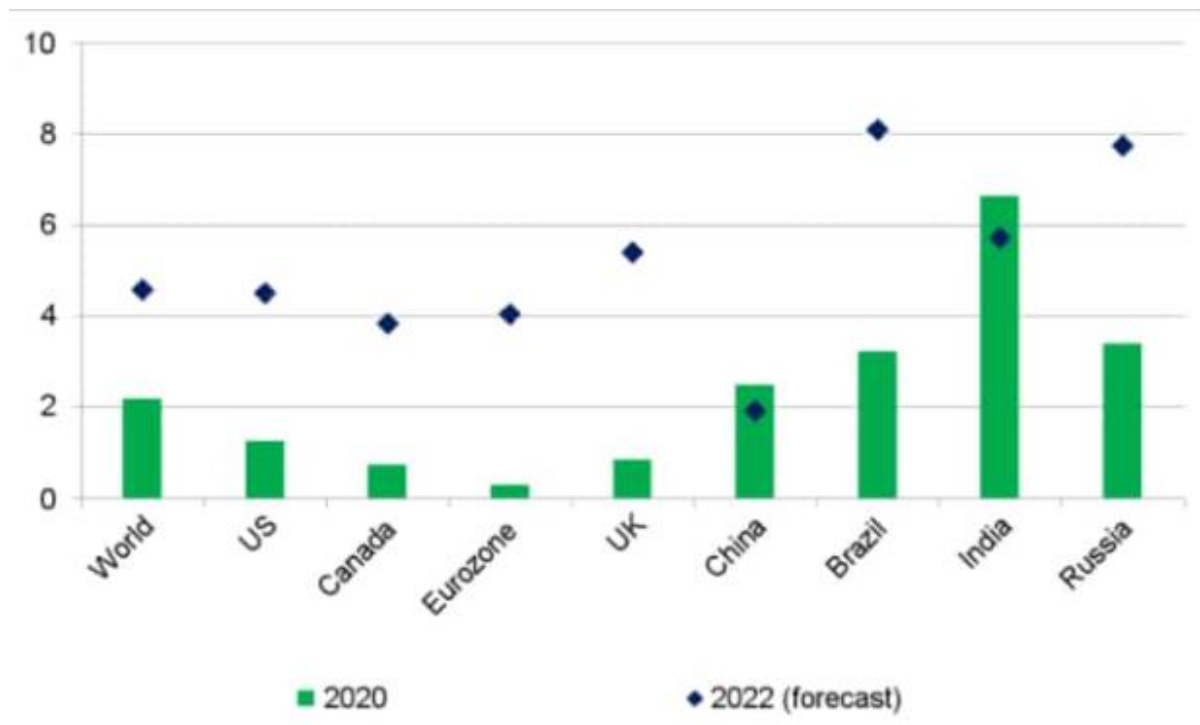
The European union and the member states were united in their support to Ukraine and condemned the Russian aggression. They respected Ukraine's territorial integrity sovereignty and independence. They have adopted massive and unprecedented sanctions against Russia. Due to this crisis energy crisis have been extremely volatile. The EU council have banned 90% of all Russian oil imports. They started working on phasing out EU's dependence on Russia's fossil fuel as soon as possible. They worked on new rules to set a market correction mechanism which protects citizen and the economy against excessively high prices. They imposed an oil price cap to limit price surge and help the consumers.

The impact of the war has been on global food security as well as the affordability of the products. For this the *common agricultural policy adopted by the world* has helped in absorbing price shocks, ensuring food security as well as guarantying income support for all farmers.

The war in fact has led to greater unity within the union. There was a sudden demand for government spending by refugees, and increase money required to meet the expenses due to higher costs.

How would this increased expenditure be financed was the main question that was facing all EU countries after the impact of the war. Would this increased expenditure come from fiscal policy measures through increased taxes or would it be through debt (increased borrowing by the government). If increased taxes in the form of ‘war tax’ was imposed it may lead to a detrimental impact on the economy as the citizens would have to deal with higher prices, weak demand leading to a decline in output. So, the best alternative would be to meet the increased expenditure through debt. This borrowing by the government according to most economist would be more sustainable than the increased taxation. The sudden borrowing as well as the war led to unprecedented inflation in almost all countries of the world.

Figure 8: consumer price inflation rate (%) 2020-2022



Source: S&P global

4.4 MONETARY POLICY BY ECONOMIES TO MITIGATE THE IMPACT OF THE WAR

They all lead to high inflation that was driven mainly by high energy prices and supply bottlenecks reaching levels of 7.2% in march 2022 and 7.5% in April 2020 in most European countries according to statistics available by Eurostat. The war in Ukraine certainly threatens to make inflation more persistent and broader based.

Apart from direct impact on energy, commodities and food prices there would be further impact due to wage increases and upward expectation of inflation. Beside this it is likely that the exchange rate of different countries would be impacted due to policy measures undertaken by the government.

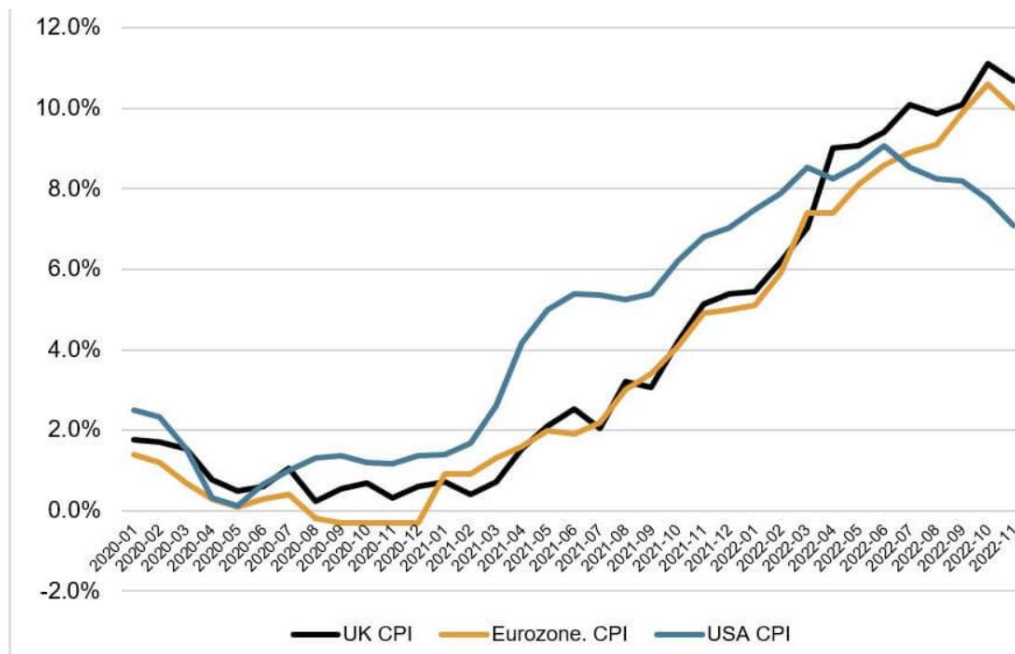
In March 2022 with inflation increasing much faster than anticipated, the European central bank made the following policy measures.

1. Removing the term “lower” in any formulation in interest rates.
2. Decoupling the interest rate hike decision from net asset purchases
3. Reconfirming the commitment to stabilize inflation at 2%

Euro liquidity swap lines were provided by the ECB to exchange euros against other currencies as measures adopted against galloping inflation.

During the war there was an attempt to segregate increase in prices due to the war and core inflation. Core inflation would be a better indicator to react on in terms of stabilizing prices. High inflation tends to lead to expectation of further inflation.

Figure 9: inflation levels in UK, Europe and USA



Source: Eurostat, BLS

Though the European banks maintained that the direct impact of the war was limited there is continuous concern on the increasing number of non-performing assets. The war has led to prioritizing reduction in energy dependency and accelerating movement towards non-conventional energy sources.

Even with the case of addressing inflation stability, rising prices have been divided into 3 different sources:

1. 'Climateflation' direct price increase due to result of climate change
2. 'Fossilflation' these are legacy cost of dependence on fossil fuels
3. 'Greenflation' increase in prices due to that transition to a greener economy

5. IMPACT OF THE WAR ON FDI AND FPI

FDI has the ability to change economic, social and political incentive and capacities of developing economies. The extent of change of FDI depends on the nature of projects across primary, secondary and tertiary sectors. The ability to attract FDI depends upon the stability of the economy receiving funds. If the political situation is stable and returns on investment is high then it is likely that FDI's earn high returns. There was a lot of inflow of both FDI and FPI in India post 2021 due to a stable economy and controlled inflation rates. Both FDI and FPI entering India reaped high earnings till Europe and USA controlled inflation. This coincided with the stock market in India booming resulting in even higher rates of return. This seemed larger than that could be attributed to fundamentals of the firms.

A correction of sorts has started occurring in the Indian stock market in recent months (from December 2024). One of the reasons could be that interest rates have risen in other countries leading to better earning on investment, resulting in funds being withdrawn from the Indian stock market.

6. BALANCE OF PAYMENT

The balance of payment of many countries were significantly impacted by the war, primarily due to an increase in energy prices. Countries like India were adversely affected due to its dependence on energy requirements. Not only did spending on imports increase due to disruption of supplies but freight also went up as trade routes became longer. Besides the above two reasons the conflict led to huge price fluctuation that severely impacted the value of exports and imports especially for countries trading with Russia. Another important area that war impacted was tourism due to higher flight fares and longer trade routes

The impact on the Russian and the Ukraine economy is worse as they are the two major countries involved in the conflict.

7. CONCLUSION

War is not the answer to conflicts, dialogue and discussion are always a better and a saner way to resolve differences. As can be seen all conflicts have adversely affected every aspect of life of people living around the world. This is with respect to higher valuation of goods that are produced in the warring economies as well as higher cost of freight and airfare which in turn has severely disrupted balance of payment, FDI and FPI in the world. A quick amicable resolution of the crisis would help the world economies in every which way.

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