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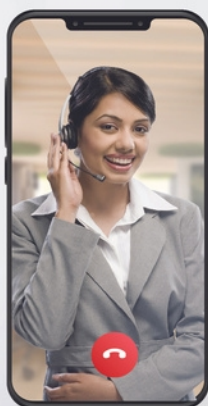
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Geopolitical Risks & Indian Banking

Navigating a fractured world order



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Geopolitical Risks & Indian Banking

Navigating a fractured world order

"We are facing a fundamental change in the global economic and geopolitical order... The era of deep globalisation and global peace that we assumed would last forever is now in question."

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Christine Lagarde

President, European Central Bank

The 'SIB Students' Economic Forum' is designed to kindle interest in the minds of the younger generation. We highlight one theme in every monthly publication. Topic of discussion for this month is **Geopolitical Risks & Indian Banking**.



The Indian banking sector stands at a pivotal intersection of domestic ambition and global turbulence. India's financial system has matured from a predominantly state-owned, domestically oriented architecture into a more diversified, internationally integrated

network. Yet, this very integration has rendered Indian banks increasingly susceptible to geopolitical shocks originating far beyond the country's borders. The Russia-Ukraine war, the US-China strategic rivalry, Middle East conflicts, and the fracturing of global supply chains have all created ripple effects that touch Indian banking in ways both direct and indirect.

For regulators at the Reserve Bank of India (RBI), for bank boards assessing strategic exposure, and for investors evaluating risk-adjusted returns, geopolitical awareness has become as fundamental as reading a balance sheet. As Christine Lagarde, President of the European Central Bank, observed in 2022: *"We are facing a fundamental change in the global economic and geopolitical order... The era of deep globalisation and global peace that we assumed would last forever is now in question."* This article examines the key risk channels affecting Indian banking, traces their transmission mechanisms, and explores how banks and regulators can build resilience.

The Geopolitical Landscape: A Structural Shift

The post-Cold War era of stable multilateral institutions, liberal trade frameworks, and globalised capital flows is giving way to a more fragmented world. The United States and China are locked in a prolonged strategic competition spanning trade, technology, finance, and military influence. Europe has been destabilised by Russia's invasion of Ukraine, which restructured energy markets and commodity

prices globally. In the Middle East, chronic instability has escalated into conflicts that disrupt oil supply chains and elevate global risk premia - most acutely in the ongoing 2026 Iran war.

India occupies an unusual position in this landscape - a member of both the Quad (with the US, Japan, and Australia) and the Shanghai Cooperation Organisation (with China and Russia). Its policy of strategic autonomy has served it diplomatically, but it means Indian banks operate in a world where the country's relationships with major powers are complex, multi-layered, and sometimes contradictory. Navigating this demands extraordinary sensitivity to geopolitical signals and their financial implications as listed below:

1. **Commodity Price Volatility and Import-Dependent Sectors**

India is one of the world's largest importers of crude oil, edible oils, fertilisers, and industrial metals. When geopolitical conflicts disrupt supply, price spikes pass through to the economy in ways that directly affect bank asset quality. The Russia-



Ukraine war illustrated this sharply: surges in wheat, sunflower oil, and fertiliser prices placed agricultural lending portfolios under pressure, compressed margins in energy-intensive industries - steel, cement, petrochemicals - and eroded the debt servicing capacity of road transport firms through fuel cost inflation.

Commodity shocks also force the RBI to tighten monetary policy. Rising interest rates increase repayment burdens across the loan book - floating-rate loans reprice upward, squeezing retail and small business borrowers.

Simultaneously, higher rates reduce the market value of government securities in bank investment portfolios, creating mark-to-market losses that pressure capital adequacy ratios. India's structural dependence on imported hydrocarbons means any sustained conflict in the Persian Gulf transmits directly into the banking system through commodity inflation and current account deterioration - a vulnerability the 2026 Iran war has demonstrated with brutal clarity.

The 2026 Iran situation: A Live Stress Test for Indian Banking

No analysis of geopolitical risk and Indian banking is complete without examining the most severe and immediate crisis currently unfolding. On 28 February 2026, the United States and Israel launched Operation Epic Fury - a joint military strike on Iranian military installations, government sites, and nuclear facilities. Iran retaliated with massive missile and drone strikes across the region and, critically, closed the Strait of Hormuz - the narrow waterway through which roughly 20% of global oil supplies and significant LNG volumes transit daily. A partial/conditional ceasefire was announced on 8 April 2026, but the Strait has not been fully reopened and negotiations remain deeply fraught.

The consequences for India are immediate and severe. India imports nearly 85% of its fuel needs and relies on the Strait for approximately 50% of its crude oil imports, 60% of its LNG, and virtually all its LPG. Brent crude surged past \$120 per barrel following the Strait's closure, having started the year below \$80. The International Energy Agency has characterised the situation as the greatest global energy security challenge in history. For Indian banks, this is not a theoretical scenario - it is a live, acute stress event demanding urgent responses across multiple portfolios.



Brent Crude Monthly Average Prices (USD/barrel)

<i>Period</i>	<i>Avg. Price</i>	<i>Key Driver</i>
Jan 2026	\$61–70	Started at \$61; rose on Iran tension risk
Feb 2026	\$71	Peaked \$72 before military action on Feb 28
Mar 2026	\$103	Strait of Hormuz effectively closed; sharp spike
Apr 2026	\$117	Supply shock peak; intraday high of \$138 on Apr 7
May 2026	\$96–106	Easing on ceasefire/deal hopes; \$96–97 as of May 28–29

The Rupee Under Siege

The rupee has been pushed to near all-time lows against the dollar, driven by surging import bills, persistent equity outflows, and a widening current account deficit. The RBI has reportedly deployed \$12–15 billion from its \$723 billion forex reserves to defend the currency, intervening across spot, forward, and offshore NDF markets to prevent a slide toward the 95-per-dollar mark. Rising currency volatility increases hedging costs for all market participants. Trade finance portfolios - particularly letters of credit for energy imports - have become acutely stressed as commodity costs have surged while the rupee has simultaneously weakened, a double blow for importers and their bankers. Prime Minister Modi has publicly urged citizens to cut foreign travel and gold imports to conserve foreign exchange - a visible signal of macroeconomic pressure.

Sectoral Credit Risk

The energy supply disruption has created differential credit stress across heavily banked sectors. Aviation is acutely exposed: the sector's heavy aircraft financing and lease debt makes it highly vulnerable to sustained fuel inflation. The paints, chemicals, and petrochemicals industries face severe margin compression from crude-derivative feedstock costs.

The Essential Commodities Act was invoked on 9 March 2026 to prioritise LNG distribution, cutting industrial gas allocations to around 70% of normal consumption. Fertiliser producers face restricted gas allocations and rising subsidy burdens. State-owned oil marketing companies - Indian Oil, Bharat Petroleum, and Hindustan Petroleum - which carry large credit relationships with public sector

banks, face the prospect of under-recoveries if retail price pass-throughs are delayed for political reasons, effectively shifting subsidy costs onto their lenders.

Gulf Diaspora and Remittances

Iran's strikes on Gulf Arab states - Bahrain, Kuwait, Qatar, and the UAE - have directly disrupted the livelihoods of approximately 8–9 million Indian workers in the region. Remittance flows have been further disrupted by banking system uncertainty in the Gulf. For Indian banks with strong NRI deposit franchises, this creates funding pressure: FCNR deposits, a reliable source of stable foreign currency funding, may face renewal delays at precisely the moment demand for foreign currency is surging.

Sanctions and Compliance

The 2026 conflict has intensified the sanctions environment around Iran to its most comprehensive level yet, with the US imposing sweeping sanctions on Iranian financial institutions, shipping companies, and oil infrastructure, and launching a counter-blockade of the Strait from 13 April.

Indian banks face an acute compliance dilemma: any transaction with Iranian counterparties risks triggering US secondary sanctions. The reputational and legal cost of a violation - potential loss of dollar clearing access, exclusion from US

financial markets, and correspondent banking damage - would be existential for any internationally active Indian bank. The UNDP estimates the conflict may cause \$299 billion in economic losses to the Asia-Pacific region - a macro backdrop that will keep credit growth under pressure and force a reassessment of monetary policy trajectory.



2. Currency Depreciation and Cross-Border Financing

Beyond the Iran war, currency risk is a structural and recurring geopolitical channel. Risk-off episodes cause foreign portfolio investors to withdraw from Indian equity and debt markets, depreciating the rupee.

Banks with foreign currency borrowings - through ECBs, FCNR deposits, or international subordinated debt - face higher repayment burdens in rupee terms. Indian corporates with foreign currency debt and rupee revenues face a mismatch that raises their probability of default and lifts credit risk for their lenders. The 2013 taper tantrum and the 2018 currency stress both generated precisely this kind of corporate distress. Letters of credit and bank guarantees for import transactions denominated in foreign currency become contingent liabilities that crystallise during rupee weakness, making trade finance portfolios a significant conduit for geopolitical stress.

3. Sanctions Regimes and Compliance Risk

Modern geopolitical confrontations increasingly weaponise financial sanctions. The SWIFT disconnection of Russian banks in 2022 pushed India and Russia toward alternative payment mechanisms - rupee-rouble settlement and bilateral SWIFT alternatives - but created novel compliance, convertibility, and legal enforceability risks. Indian banks handling Russian commodity transactions faced strained or suspended correspondent banking relationships with Western banks.

India's continued conformity with FATF standards and strengthening of regulatory frameworks reflect genuine systemic improvements in AML/CFT. However, navigating unilateral sanctions from multiple, sometimes conflicting jurisdictions remains a chronic compliance burden. Failures carry severe penalties - including the ultimate risk of losing dollar clearing access, which is existential for any internationally active bank.

4. Technology, Cybersecurity, and State-Sponsored Threats

Geopolitical rivalry is increasingly fought in cyberspace. India's digital banking infrastructure - UPI processing billions of transactions annually, core banking systems settling trillions of rupees daily, and the NPCI at the centre of interconnected payment networks - presents an attractive attack surface for state-sponsored actors. Attacks can take the form of ransomware, DDoS disruption, credential theft, or corruption of payment settlement records, each capable of imposing direct financial losses and triggering systemic confidence crises.

India's tensions with China along the Line of Actual Control and its complex relationship with Pakistan make state-sponsored cyber threats a live operational risk, not a theoretical one. CERT-In and the RBI have both elevated cyber resilience frameworks, but the pace of threat evolution remains challenging. Geopolitically motivated attacks are more sophisticated, persistent, and targeted than criminal intrusions - requiring correspondingly higher defensive sophistication in governance and incident response, not just technology investment.

5. Supply Chain Disruption and Sectoral Credit Risk

Geopolitical fragmentation is reversing the integration of global supply chains. Indian manufacturers in electronics, pharmaceuticals, automotive components, and specialty chemicals depend heavily on China for raw materials and components. When India-China tensions spiked after the 2020 Galwan Valley clash, supply chains were disrupted by policy decisions - import restrictions, retaliatory trade measures, and investment curbs - causing production stoppages and revenue shortfalls that translated into credit stress for their bankers.



However, geopolitical realignment also creates opportunities. As global corporations pursue China+1 supply chain strategies, India has become a preferred manufacturing destination in semiconductors, smartphones, pharmaceuticals, and defence - catalysed by the Production Linked Incentive (PLI) scheme.

For Indian banks, these new industrial clusters represent significant lending opportunities, but also concentration risks: the viability of new investments depends on sustained geopolitical alignment with investing nations - the US, Japan, and South Korea - introducing its own form of dependency risk.

6. Remittances, Multilateral Finance, and Sovereign Exposure

India is the world's largest remittance recipient, with annual inflows consistently exceeding \$80–100 billion. About a quarter originates from Indian workers in the GCC. Disruption in these source countries - from military conflict, restrictive immigration policies in Western nations, or economic downturns - reduces remittance volumes and NRI deposit inflows, affecting both household incomes and foreign currency liquidity in the banking system. The 2026 Iran war has made this channel acutely live.

At the sovereign level, public sector banks hold large government securities portfolios whose credit quality is tied to sovereign creditworthiness. Sustained geopolitical conflict damaging India's external sector - through reduced exports, higher import costs, or capital outflows - could in extreme scenarios pressure sovereign credit ratings and the market value of these bonds. The growing fragmentation between Western-led multilateral institutions and emerging alternatives like the BRICS-affiliated NDB and the Chinese-led AIIB also complicates India's sovereign borrowing environment and government-related lending portfolios.

Regulatory Responses and Strategic Implications

The RBI has progressively strengthened its frameworks: enhancing macro-prudential stress testing with global risk scenarios, upgrading cybersecurity and operational resilience guidance, and calibrating reserve management to ensure adequate external shock buffers. Indian banks have diversified correspondent banking relationships, expanded rupee settlement arrangements with trading partners, and built domestic payment network capacity to reduce dependence on dollar-clearing infrastructure that can be weaponised through geopolitical pressure.

For individual banks, the strategic imperative is clear: geopolitical risk management must be a board-level priority. This means investing in geopolitical intelligence and

scenario planning, deepening sanctions compliance expertise, maintaining diversified funding structures, and ensuring credit risk frameworks explicitly incorporate sectoral geopolitical exposures. Public sector banks - which dominate Indian banking by asset size - face particular urgency, as their governance and risk management capacity still lags behind global best practice in geopolitical scenario planning. Private sector banks are generally better positioned, but even they face the fundamental challenge that geopolitical events are unpredictable, rapid in consequence, and largely unhedgeable through conventional financial instruments.

End Note

Geopolitical risk is not new to Indian banking, but its scale, complexity, and impact have grown substantially. The transmission channels - commodity prices, currency movements, sanctions regimes, cyber threats, supply chain disruption, remittance flows, and sovereign financing - are multiple, interactive, and capable of amplifying each other in non-linear ways. The 2026 Iran war and the Strait of Hormuz crisis have transformed what were previously scenario-planning abstractions into live balance sheet events.

India's banking system enters this period in better shape than it did during the NPA crisis of the 2010s - capital ratios are healthy, NPA levels have declined, and forex reserves are substantial. But past resilience is not a guarantee of future stability in a world shifting faster and more profoundly than at any time since the end of the Cold War. Integrating geopolitical scenario analysis into credit decisions, capital planning, liquidity management, and operational resilience is no longer optional. It is a prerequisite for financial stability in the fractured world of the 21st century.

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