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Macroeconomic Implications of the Iran-U.S. Conflict on the Indian Economy: An Analysis of Oil Price Volatility, Inflation, Trade, and Economic Growth

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Abstract

The Iran–U.S. conflict represents one of the most significant geopolitical risks affecting the global economy, particularly for energy-importing countries such as India. As the world's third-largest consumer and importer of crude oil, India remains highly vulnerable to disruptions in global energy markets arising from tensions in the Middle East. This study examines the macroeconomic implications of the Iran–U.S. conflict on the Indian economy by analyzing its effects on oil price volatility, inflation, international trade, exchange rate movements, and overall economic growth. The paper adopts a qualitative and analytical research methodology based on secondary data collected from reports published by the International Monetary Fund (IMF), World Bank, Reserve Bank of India (RBI), Ministry of Petroleum and Natural Gas, Government of India, Organization of the Petroleum Exporting Countries (OPEC), and relevant scholarly literature. The study explains the transmission mechanism through which geopolitical tensions increase crude oil prices, raise transportation and production costs, disrupt global supply chains, and generate inflationary pressures across various sectors of the Indian economy. It further examines the consequences of rising energy prices on India's current account deficit, fiscal balance, industrial production, foreign trade, and exchange rate stability. The findings indicate that prolonged geopolitical conflict adversely affects macroeconomic stability by increasing import bills, reducing household purchasing power, widening trade deficits, and slowing investment and economic growth. However, the study also highlights India's policy resilience through diversified energy sourcing, strategic petroleum reserves, inflation-targeting monetary policy, and fiscal interventions aimed at mitigating external shocks. The research concludes that strengthening energy security, expanding renewable energy capacity, enhancing strategic oil reserves, diversifying trade partnerships, and promoting domestic manufacturing are essential for improving India's resilience against future geopolitical crises. The paper contributes to the literature on geopolitical economics by providing a comprehensive macroeconomic assessment of how international conflicts influence the economic performance of a major emerging economy and offers policy recommendations for sustaining long-term economic stability amid global uncertainty. The study underscores that while geopolitical conflicts are largely external shocks, effective macroeconomic management and structural reforms can substantially reduce their adverse impact on India's growth trajectory.

Keywords: Iran–U.S. Conflict, Indian Economy, Oil Price Volatility, Inflation, International Trade, Economic Growth, Energy Security, Macroeconomic Stability, Current Account Deficit, Geopolitical Risk.

Introduction

The global economy is increasingly vulnerable to geopolitical conflicts, particularly those occurring in strategically important regions such as the Middle East. Among these, tensions between Iran and the United States have consistently emerged as one of the most significant sources of uncertainty for international energy markets, global trade, and financial stability. The geopolitical rivalry between the two nations, driven by disputes over nuclear development, economic sanctions, regional security, and military interventions, has repeatedly disrupted global crude oil markets and affected the economic performance of both developed and developing countries. As a major emerging economy that depends heavily on imported crude oil, India remains particularly exposed to the macroeconomic consequences of such geopolitical disturbances. India imports more than 85 percent of its crude oil requirements, with a substantial share originating from the Middle East.

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Consequently, any escalation in the Iran–U.S. conflict that threatens oil production, transportation, or shipping routes—especially through the Strait of Hormuz—can significantly increase international crude oil prices and create supply-side uncertainties. Since nearly one-fifth of global petroleum trade passes through this strategic maritime chokepoint, even the possibility of disruption introduces a geopolitical risk premium into oil prices, thereby affecting energy-importing economies worldwide.

Oil is a critical input in virtually every sector of the Indian economy, including transportation, manufacturing, agriculture, power generation, and logistics. Therefore, fluctuations in international crude oil prices are rapidly transmitted to domestic production costs, transportation expenses, and consumer prices. Higher oil prices contribute directly to cost-push inflation, reduce household purchasing power, increase production costs for industries, and weaken overall economic competitiveness. Persistent inflation also complicates monetary policy by forcing the central bank to balance inflation control with economic growth objectives. The macroeconomic effects of geopolitical conflicts extend beyond inflation. Rising crude oil prices substantially increase India's import bill, thereby widening the trade deficit and current account deficit. A deteriorating external balance often exerts downward pressure on the Indian rupee, making imports more expensive and increasing the burden of servicing foreign liabilities. Currency depreciation further fuels imported inflation, creating a cycle of rising prices and declining macroeconomic stability. Moreover, uncertainty arising from geopolitical tensions often leads to capital outflows, financial market volatility, and reduced investor confidence, thereby slowing economic growth.

Economic theory provides several explanations for these transmission mechanisms. According to supply shock theory, a sudden increase in oil prices raises production costs across industries, shifting the aggregate supply curve inward and leading simultaneously to higher inflation and lower output. Similarly, the balance of payments framework suggests that a surge in oil imports worsens the current account, depreciates the domestic currency, and affects macroeconomic equilibrium. Keynesian perspectives further argue that heightened uncertainty reduces private investment and aggregate demand, while open-economy macroeconomic models emphasize the interconnected nature of global commodity markets, exchange rates, and international capital movements. Although some periods of de-escalation have subsequently reduced prices, the repeated occurrence of geopolitical shocks highlights the vulnerability of energy-importing economies like India to external geopolitical risks. Recent developments also demonstrate that changes in diplomatic relations or ceasefire agreements can rapidly influence global oil prices, inflation expectations, and investor sentiment. For India, the implications are multidimensional. Higher crude oil prices increase fuel subsidies or reduce government

revenue from excise taxes, depending on the fiscal response adopted. Public expenditure priorities may be affected as governments allocate additional resources to energy security and inflation management. Industrial sectors with high energy intensity, such as aviation, chemicals, transportation, fertilizers, and manufacturing, experience rising operating costs, while consumers face higher prices for essential goods and services. Consequently, economic growth may slow as investment, industrial production, and household consumption weaken simultaneously.

The conflict also has important implications for India's trade relationships. Rising freight charges, marine insurance costs, and disruptions in shipping routes increase the cost of international trade. Export-oriented industries may lose competitiveness due to higher production and logistics costs, while import-dependent industries face supply-chain disruptions. Such developments can adversely affect India's merchandise trade balance and overall external sector performance. In addition, prolonged geopolitical uncertainty may discourage foreign direct investment (FDI) and portfolio investment by increasing country risk perceptions among international investors. India has adopted several policy measures to reduce its vulnerability to external energy shocks. These include diversifying crude oil import sources, expanding strategic petroleum reserves, promoting renewable energy, increasing domestic refining capacity, encouraging biofuels, and implementing energy efficiency initiatives. Nevertheless, given India's continuing dependence on imported fossil fuels, external geopolitical developments remain a major determinant of domestic macroeconomic performance. The effectiveness of these policy interventions depends largely on the duration and intensity of geopolitical conflicts and the resilience of global energy supply chains. Against this backdrop, the present study examines the macroeconomic implications of the Iran–U.S. conflict on the Indian economy by focusing on four interrelated dimensions: oil price volatility, inflation, trade performance, and economic growth. The study seeks to understand how geopolitical instability in the Middle East transmits through international energy markets to influence India's macroeconomic indicators. It further analyzes the interaction among crude oil prices, exchange rates, inflation, external trade, and GDP growth while evaluating the policy responses available to mitigate adverse economic consequences. The significance of this research lies in its contribution to the growing literature on geopolitical economics and energy security. As geopolitical conflicts increasingly influence global economic outcomes, understanding their transmission mechanisms becomes essential for designing effective fiscal, monetary, and trade policies. The findings of this study are expected to provide valuable insights for policymakers, economists, researchers, and strategic planners concerned with strengthening India's macroeconomic resilience against external geopolitical shocks and

ensuring sustainable economic growth in an increasingly uncertain global environment.

Objectives of the Research Objective

1. **To examine** the impact of the Iran–U.S. conflict on global crude oil price volatility.
2. **To analyze** how fluctuations in international crude oil prices influence inflation in the Indian economy.
3. **To assess** the impact of the conflict on India's external trade, including imports, exports, trade balance, and current account balance.
4. **To investigate** the relationship between oil price shocks, exchange rate movements, and macroeconomic stability in India.
5. **To evaluate** the effects of geopolitical uncertainty on India's economic growth (GDP), industrial production, and investment.
6. **To examine** the fiscal and monetary policy responses adopted by the Government of India and the Reserve Bank of India to mitigate the economic consequences of geopolitical shocks.
7. **To identify** the challenges and opportunities for India's energy security arising from the Iran–U.S. conflict.
8. **To recommend** policy measures for enhancing India's macroeconomic resilience against future geopolitical and energy market disruptions.

Review of Literature

The relationship between geopolitical conflicts, crude oil price volatility, inflation, trade, and economic growth has been widely examined in the fields of international economics and energy economics. Numerous empirical and theoretical studies suggest that geopolitical tensions in the Middle East significantly influence global energy markets, with important macroeconomic consequences for oil-importing countries such as India. The following review summarizes the major contributions of previous research related to the present study.

James D. Hamilton (1983) pioneered research on the macroeconomic effects of oil price shocks by demonstrating that increases in crude oil prices have historically preceded most post-war recessions in the United States. His study established that oil price shocks reduce economic output, increase production costs, and create inflationary pressures, highlighting oil as a critical determinant of macroeconomic stability.

Ben S. Bernanke, Mark Gertler, and Mark Watson (1997) argued that oil price shocks influence economic activity not only directly but also through monetary policy responses. According to their findings, rising oil prices contribute to inflation, prompting central banks to tighten monetary policy, which subsequently slows investment, employment, and economic growth.

Lutz Kilian (2009) challenged the traditional assumption that all oil price increases originate from supply disruptions. He demonstrated that oil price fluctuations arise from multiple factors, including global demand shocks, precautionary

demand, and supply constraints. His structural approach has become one of the most widely accepted frameworks for analyzing oil price volatility and its macroeconomic consequences.

Dario Caldara and Matteo Iacoviello (2022) introduced the concept of geopolitical risk as an important determinant of macroeconomic performance. Their research showed that geopolitical uncertainty negatively affects investment, international trade, financial markets, and global economic growth while increasing commodity price volatility. Several studies have specifically examined India's vulnerability to international oil price fluctuations. **Surender Kumar and Prabir De** found that rising crude oil prices significantly increase India's import bill, widen the current account deficit, and place downward pressure on the Indian rupee. Their findings suggest that India's dependence on imported energy exposes the economy to external geopolitical shocks.

Similarly, studies conducted by the **Reserve Bank of India** have consistently highlighted that crude oil prices are one of the principal determinants of inflation, exchange rate movements, and external sector stability in India. RBI reports indicate that sustained increases in international oil prices raise headline inflation, complicate monetary policy, and adversely affect economic growth. Research published by the **International Monetary Fund** and the **World Bank** also emphasizes that geopolitical conflicts in major oil-producing regions create uncertainty in global commodity markets, increase transportation and insurance costs, and weaken international trade performance. These institutions argue that energy-importing developing economies are particularly vulnerable because higher oil prices worsen fiscal balances and reduce economic growth. Recent research has increasingly focused on the economic implications of the Iran–U.S. conflict for India. **Rasam Setty Satya Venkat Krishna and Kshirod Kumar Pradhan (2026)** employed scenario analysis to estimate the short-, medium-, and long-term effects of a prolonged Iran–U.S. conflict on the Indian economy. Their study concluded that a sustained conflict could significantly increase inflation, widen the current account deficit, depreciate the Indian rupee, reduce GDP growth, and increase fiscal pressures through higher fuel subsidies and import costs.

Similarly, **Deepak Kumar Chachda (2026)** examined the implications of the Iran–Israel–U.S. conflict for India's energy security and strategic interests. The study found that disruptions in the Strait of Hormuz could severely affect India's crude oil imports, liquefied natural gas supplies, shipping costs, and overall macroeconomic stability, emphasizing the importance of energy diversification and strategic petroleum reserves. Another recent study by **Ramanjeet Kaur (2026)** analyzed the macroeconomic consequences of a broader U.S.–Israel–Iran conflict. The research identified oil price volatility, inflation, capital outflows, exchange-rate depreciation, and fiscal deficits as the primary

transmission channels through which geopolitical instability affects the Indian economy. **Anamika Kaushiva (2026)** investigated the economic consequences of disruptions in the Strait of Hormuz and concluded that prolonged blockades could trigger supply-chain disruptions, imported inflation, and slower economic growth in India because of its heavy dependence on imported crude oil. Overall, the existing literature establishes a strong relationship between geopolitical conflicts, oil price volatility, inflation, trade performance, exchange-rate movements, and economic growth. Most studies conclude that oil-importing economies such as India experience adverse macroeconomic effects when geopolitical tensions disrupt global energy markets. However, much of the earlier literature focuses either on oil price shocks alone or on individual macroeconomic indicators such as inflation or GDP. Comprehensive studies integrating oil price volatility, inflation, trade, exchange rates, and economic growth within the specific context of the Iran–U.S. conflict remain relatively limited. This gap provides the basis for the present study, which adopts an integrated macroeconomic perspective to assess the implications of the Iran–U.S. conflict for the Indian economy.

Research Methodology

This study adopts a **descriptive and analytical research design** to examine the macroeconomic implications of the Iran–U.S. conflict on the Indian economy. The research investigates how geopolitical tensions between Iran and the United States influence India's macroeconomic performance through fluctuations in international crude oil prices, inflation, trade, and economic growth. Since the study primarily aims to analyze the interrelationship among these macroeconomic variables rather than establish causal relationships through experimental methods, a qualitative and quantitative secondary-data approach is considered appropriate.

Research Design

The study employs a **descriptive, analytical, and exploratory research design**. The descriptive approach is used to explain the nature of the Iran–U.S. conflict and its impact on global energy markets, while the analytical approach evaluates the relationship between oil price volatility and India's macroeconomic indicators. The exploratory component helps in understanding emerging geopolitical risks and their implications for economic policy.

Nature of the Study

The research is based on **secondary data** collected from reliable national and international sources. The study synthesizes economic statistics, policy reports, academic literature, and institutional publications to provide a comprehensive assessment of the economic consequences of geopolitical conflicts.

Sources of Data

The study relies exclusively on secondary data obtained from authentic and internationally recognized sources, including:

1. International Monetary Fund (IMF)
2. World Bank
3. Reserve Bank of India (RBI)
4. Ministry of Commerce and Industry, Government of India
5. Ministry of Petroleum and Natural Gas
6. Petroleum Planning and Analysis Cell (PPAC)
7. Organization of the Petroleum Exporting Countries (OPEC)
8. International Energy Agency (IEA)
9. National Statistical Office (NSO)
10. NITI Aayog
11. Peer-reviewed journals
12. Research reports
13. Government publications
14. Working papers and policy briefs

Period of the Study

The analysis primarily focuses on the period **2018–2026**, covering major geopolitical developments such as the re-imposition of U.S. sanctions on Iran, heightened tensions in the Persian Gulf, disruptions in the Strait of Hormuz, and recent geopolitical developments affecting international oil markets. Historical references are included where necessary to provide context.

Variables of the Study

The study considers the following variables:

Independent Variable

Iran–U.S. geopolitical conflict

Dependent Variables

1. International crude oil prices
2. Inflation rate
3. Trade balance
4. Current account deficit
5. Exchange rate (Indian Rupee)
6. Gross Domestic Product (GDP) growth
7. Industrial production

Data Collection Method

Data are collected through a systematic review of:

1. Official statistical databases
2. Annual reports
3. Economic surveys
4. Central bank publications
5. International organization reports
6. Scholarly journal articles
7. Books and conference proceedings

The collected information is organized, classified, and interpreted to identify trends and relationships among the selected macroeconomic variables.

Analytical Techniques

The study employs the following analytical methods:

1. Descriptive statistical analysis
2. Trend analysis
3. Comparative analysis
4. Content analysis of policy documents
5. Graphical interpretation of macroeconomic

- indicators
6. Correlation-based discussion using published economic data
 7. Comparative evaluation of previous empirical studies

Where appropriate, tables and figures are used to illustrate trends in crude oil prices, inflation, trade, and GDP growth.

Conceptual Framework

The study is based on the following conceptual framework:

Iran–U.S. Geopolitical Conflict



Global Crude Oil Price Volatility



Increase in India's Oil Import Bill



Inflation and Exchange Rate Depreciation



Trade Deficit and Current Account Deficit



Decline in Investment and Economic Growth



Government Policy Response

Scope of the Study

The study focuses on the macroeconomic implications of the Iran–U.S. conflict for the Indian economy. It examines the effects of geopolitical uncertainty on oil prices, inflation, trade, exchange rates, and economic growth. The analysis is confined to national-level macroeconomic indicators and does not include firm-level or household-level impacts.

Limitations of the Study

The study has certain limitations:

1. It is based entirely on secondary data.
2. Geopolitical developments are dynamic and may change rapidly.
3. The study does not employ primary surveys or interviews.
4. The findings depend on the reliability of published data and official reports.
5. Other global factors, such as pandemics, financial crises, or other geopolitical conflicts, may also influence India's macroeconomic performance and cannot be completely isolated.

Results and Discussion

The analysis of the Iran–U.S. conflict demonstrates that geopolitical instability in the Middle East has substantial macroeconomic implications for India. As one of the world's largest importers of crude oil, India's economic performance remains highly sensitive to fluctuations in international energy markets. The findings indicate that increases in geopolitical tensions lead to higher crude oil prices, which subsequently affect inflation, trade balance, exchange rates, fiscal stability, and overall economic growth.

Oil Price Volatility and India's Import Bill

The study reveals a strong positive relationship between geopolitical conflicts in the Middle East and international crude oil prices.

Historical evidence from previous periods of heightened Iran–U.S. tensions shows that oil prices often increase sharply due to fears of supply disruptions in the Strait of Hormuz, through which nearly one-fifth of global oil trade passes. India imports approximately 85–90 percent of its crude oil requirements. Consequently, even a modest increase in international crude prices significantly raises the country's import expenditure. During periods when Brent crude prices increased from approximately USD 70 to over USD 100 per barrel, India's annual oil import bill expanded substantially, increasing pressure on the country's current account deficit. The findings suggest that every sustained USD 10 increase in crude oil prices increases India's import bill by several billion US dollars annually. Such increases reduce fiscal flexibility and divert government expenditure away from developmental priorities.

Inflationary Effects

The results indicate that oil price shocks are rapidly transmitted into the domestic economy through higher transportation costs, electricity generation expenses, industrial production costs, and agricultural input prices. Wholesale Price Index (WPI) inflation generally reacts faster to rising crude prices because fuel constitutes a major production input. Consumer Price Index (CPI) inflation follows as transportation and commodity prices increase. The analysis indicates that food inflation also rises indirectly because higher diesel prices increase irrigation, harvesting, storage, and transportation costs. Consequently, inflation becomes broad-based rather than being confined solely to the energy sector. Higher inflation reduces household purchasing power, particularly among lower-income groups, thereby weakening aggregate demand.

Exchange Rate Depreciation

The study finds that rising oil imports increase demand for foreign currency, particularly the US dollar. This exerts downward pressure on the Indian Rupee. Currency depreciation further increases the domestic cost of imported crude oil, creating a reinforcing cycle in which expensive imports contribute to additional inflation. The Reserve Bank of India often intervenes through foreign exchange reserves and monetary policy measures to stabilize financial markets during periods of heightened uncertainty.

Trade Balance and Current Account Deficit

The findings indicate that higher crude oil prices significantly worsen India's trade balance.

Although exports may remain relatively stable, the value of imports rises sharply because petroleum constitutes a major component of India's import basket. A widening Current Account Deficit (CAD) increases external financing requirements and may reduce investor confidence if sustained over long periods. However, the study also notes that India's diversified export structure and growing service sector partially offset the adverse effects on merchandise trade.

Economic Growth

The analysis demonstrates that persistent oil price shocks negatively affect India's GDP growth. Higher production costs reduce industrial competitiveness, while elevated inflation suppresses household consumption. Businesses delay investment decisions due to uncertainty regarding future energy prices and geopolitical developments. The manufacturing, transportation, aviation, logistics, fertilizer, chemicals, and power sectors are identified as the most vulnerable industries. Conversely, renewable energy industries experience relatively positive effects because higher fossil fuel prices improve the competitiveness of solar and wind energy investments. Overall, prolonged geopolitical instability is associated with slower economic expansion.

Monetary Policy Response

The findings indicate that the Reserve Bank of India typically adopts a cautious monetary policy during periods of oil-driven inflation. When inflation exceeds the target range, the RBI may increase policy interest rates to control inflationary expectations. Although tighter monetary policy helps stabilize prices, higher borrowing costs may reduce private investment and slow economic growth. Therefore, policymakers face a difficult trade-off between controlling inflation and sustaining economic growth.

Financial Market Performance

The study finds that geopolitical conflicts generally increase volatility in Indian financial markets. Equity markets often experience temporary declines as foreign institutional investors reduce exposure to emerging markets during periods of global uncertainty. Energy-intensive industries usually underperform, while companies involved in domestic energy production and renewable energy occasionally benefit from higher energy prices. Bond markets also experience increased volatility as inflation expectations rise.

Energy Security and Strategic Response

One important finding is that repeated geopolitical crises have accelerated India's long-term energy security strategy. The Government has expanded the Strategic Petroleum Reserve (SPR), diversified crude oil suppliers beyond the Middle East, strengthened diplomatic relations with multiple energy-exporting countries, and increased investments in renewable energy. India's growing solar capacity, expansion of green hydrogen initiatives, promotion of electric vehicles, and bio-fuel policies contribute to reducing long-term dependence on imported fossil fuels. These structural reforms improve resilience against future geopolitical shocks.

Conclusion

The present study examined the macroeconomic implications of the Iran–U.S. conflict on the Indian economy, with particular emphasis on oil price volatility, inflation, trade, exchange rates, fiscal stability, and economic growth. The findings demonstrate that geopolitical tensions in the Middle

East have significant spillover effects on oil-importing economies such as India. Since India relies heavily on imported crude oil to meet its energy requirements, any disruption in global oil markets directly influences domestic macroeconomic conditions. The analysis reveals that heightened Iran–U.S. tensions lead to increased crude oil prices, which subsequently raise India's import bill and widen the current account deficit. Rising energy costs contribute to inflation by increasing transportation, manufacturing, agricultural, and logistics expenses. Persistent inflation reduces household purchasing power, affects consumer demand, and creates challenges for monetary authorities in maintaining price stability. Furthermore, higher demand for foreign currency to finance oil imports places depreciation pressure on the Indian Rupee, increasing the domestic cost of imports and reinforcing inflationary pressures. The study also finds that elevated oil prices negatively affect industrial production and economic growth by increasing production costs and reducing business profitability. Energy-intensive sectors, including manufacturing, aviation, transportation, chemicals, and fertilizers, are particularly vulnerable to prolonged periods of high oil prices. At the same time, financial markets experience increased volatility due to investor uncertainty and fluctuations in global capital flows. These developments collectively influence investment decisions and overall economic confidence. Despite these vulnerabilities, the research indicates that India's macroeconomic resilience has strengthened considerably over the past decade. The adoption of inflation-targeting monetary policy by the Reserve Bank of India, the maintenance of substantial foreign exchange reserves, prudent fiscal management, diversification of crude oil import sources, and the expansion of renewable energy initiatives have enhanced the country's capacity to withstand external economic shocks. Strategic Petroleum Reserves, increased investment in solar and wind energy, the promotion of electric mobility, and efforts to reduce dependence on imported fossil fuels represent important long-term policy measures that improve national energy security.

The study further highlights that geopolitical risks are becoming an increasingly important determinant of macroeconomic performance in an interconnected global economy. Economic stability is no longer influenced solely by domestic policies but also by international political developments, energy market dynamics, and global supply chain disruptions. Consequently, policymakers must continuously monitor geopolitical developments and adopt proactive strategies to minimize their economic consequences. From a policy perspective, the findings suggest that India should continue diversifying its energy import sources, strengthen strategic petroleum reserves, accelerate investments in renewable and alternative energy technologies, improve energy efficiency across industries, and maintain coordinated fiscal and monetary policies to contain inflation without significantly compromising economic growth. Strengthening domestic manufacturing under

initiatives such as "Make in India," expanding green hydrogen production, and promoting electric vehicles can further reduce long-term dependence on imported crude oil. In conclusion, the Iran–U.S. conflict underscores the close relationship between geopolitical instability and macroeconomic performance. While India remains vulnerable to external oil price shocks, its growing economic resilience, institutional reforms, and commitment to energy diversification provide a strong foundation for mitigating future risks. Continued policy reforms, strategic planning, and investment in sustainable energy systems will be essential to ensuring long-term macroeconomic stability and sustained economic growth in an increasingly uncertain global environment.

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Conflicts of interest

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