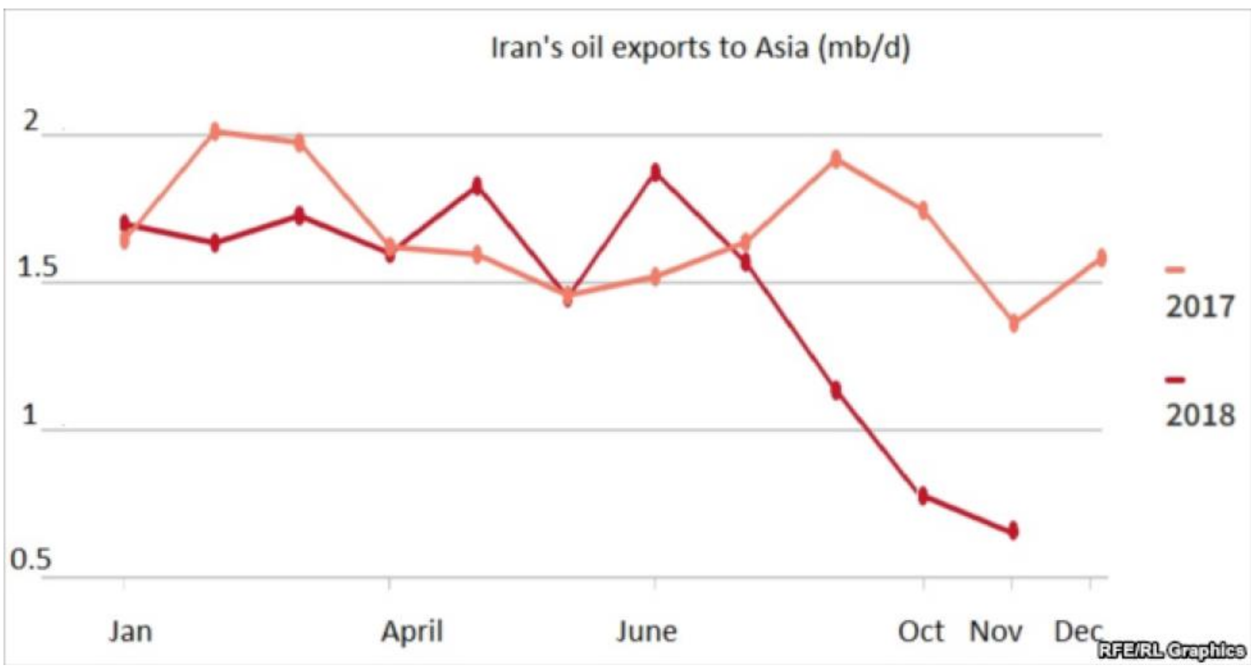
Asia Imports Now Minor

Despite an eleventh-hour White House decision to exempt the eight largest importers of Iranian crude from the new sanction regimen, "official" market figures show that Iranian oil exports have significantly declined.

Sometimes, it all depends on how you view the figures.

There is no question but that Iranian exports declined in the run up to a re-imposition of US sanctions. Figures for October and November of last year (the sanctions were scheduled for the first week in November) illustrated a dramatic decline from the same period last year. The following graph depicting Iranian declines to Asia (overwhelmingly Iran's primary oil export market) is from a source likely to provide the view mot favorable to US policy interests. Radio Free Europe (RFE) and Radio Liberty (RL) have been subsidized by Washington for decades.



The important point is that this decline was deliberate…on both ends.

I was receiving indications of a move down in both Iranian crude exports and Japanese, South Korean, Indian, and Chinese imports even before the US sanction deadline kicked in.

For the importers, the reductions were a predictable move prior to requesting an exemption from Washington.

All four of these importers (and four others) were successful in obtaining a six-month allowance to continue importing Iranian crude. In fact, since the end of November, no sanctions have actually been applied to any country.

The apparent rapid decline from Teheran's standpoint is intentionally meant to overweight the impact, much the same way Iran approached the earlier sanction regime in 2012. Much of the earlier excess production had been part of deliberate over-shipments with remainders stockpiled for later, less visible export venues.

The exemption period ends at the beginning of May. Several Trump spokespeople over the last several days have returned to the hardline rhetoric, pounding out a salvo of threats that there will be no more exemptions this next time around.

Alternate Financing

Easier said than done from the receiving side. The bulk of Indian refinery capacity—along with a large portion of Korean, Japanese, and Chinese capacity—has been built to process Iranian grade crude. India is particularly between a rock and a hard place.

During the earlier sanctions, New Delhi obtained a US exemption (again gaming the system by large earlier imports, followed by several months of "import cuts" closer to sanctions imposition, to show a trend deserving an exemption.

It was all a paper-serving "track record." Unfortunately, the problem rapidly approaching is on the other side of the sanction applications. Here, the intention is to cut off Iranian access to international banking and finance. And this is what happened last time.

The problem for India came once Washington succeeded in coercing the Asian Clearing House to stop accepting Iranian rials. Iran and India had been founding members of ACH, the rial-rupee ACH route allowing the bilateral trade to take place.

Once ACH was off the table, India had no way of paying for the imports, since the necessary global exchange of domestic currencies to US dollars (in which the overwhelming amount of international oil trade is designated) was prohibited.

Ultimately, Turkish banks (themselves provided an exemption from EU and US financial sanctions, largely because Ankara had multi-year pre-existing cross-border natural gas pipeline contracts with Teheran) provided a more inefficient way to allow a sanctions bypass – Indian importers established rupee-denominated accounts in Turkey and transfers directly into rials resulted.

Yet, the result added a new heavy mid layer of costs (along with an additional level of frustration and delay) to transactions. Washington, for its part, essentially looked the other way, allowing Turkey – both a NATO ally and at the time still an aspirant for EU membership – to provide a life line to the Iranians.

This time around, Ankara has already declared it will not abide by any of the US sanctions against Iran. That means Turkish banks will once again be providing the same services.

China largely finances Iranian crude purchases by using its trade surplus. Simply put, it pays for much if its imports by using goods rather than currency. That has allowed a significant excess trade capitalization for Chinese banks and resulting side channels through banks in Asia chartered by Bank Markazi (the Iranian central bank).

And after obtaining their exemptions, Japan, South Korea, India, and China are ramping up imports of Iranian crude beginning the first week of February.

Other Workarounds

According to my network of sources, Iran has also been setting up several avenues with which to circumvent the imposition of sanctions, should the Trump deliver on a “zero tolerance” approach to further exemptions in May.

Much of this I have noted in previous editions of ECRG Intelligence, but the five primary conduits are moving into high gear. All are intended to bypass US capital and banking sanctions.

First, barter of goods for oil will move beyond Chinese approaches to include other importing end users. An Indian network is already set up with both Asian and Turkish banking support.

Second, Russia has offered to swap consignments, effectively moving Iranian crude obtained via Caspian, Azerbaijani, and Kazakh intermediaries, into the Russian throughput oil exporting system. There are likely to be necessary quid-pro-quos on the Iranian side, including but not limited to Russian project and volume concessions in both Iranian oil and natural gas projects.

Already, there has been Chinese movement into a large liquified natural gas (LNG) project vacated by French major Total, along with positions in domestic oil/gas production projects. Gazprom already has a position in developing a stage of the huge offshore South Pars natural gas field and has a decided interest in moving further downstream into Iranian LNG exports (where it could then swap its own trade from Russian-sourced LNG, thereby extending global market penetration).

Third, Iranian export crude has a similarity in grade to that coming out of southern Iraq. The US has documented Iranian success in smuggling out volumes as Basra export crude during the earlier sanctions. This will certainly intensify, given the Shiite dominant population on both sides of the Shatt al-Arab, along with the traditionally strong cross-border family, tribe, and economic connections.

Fourth, an entirely separate northern “smuggling” route has emerged. There, the main Kirkuk-Ceyhan export pipeline from areas abutting Kurdistan in the Iraqi far north has experienced phantom volume. My sources in Irbil (the location of the Kurdistan Regional Government), Teheran, among Turkish oil majors, and at major commodity buyers in Switzerland and the Netherlands have either confirmed this route or are not denying it.

Kurdistan already has an ongoing disagreement with the Iraqi central government in Baghdad about its own exports of both crude and gas. Given that the eastern Kurdish-northwestern Iranian corridor already amounts to the main smuggling route for processed oil products (and other commodities), once Kurdistan effects its independent hydrocarbon exports to Turkey, Iranian volume will certainly emerge in the mix.

One signal already exists that this is coming. I received confirmation from my intel sources on December 31 that the National Iranian Pipeline Co. has been financing the refurbishment of a pipeline network southwest of Tabriz. The pipes have been languishing for decades and had been intended to move processed oil products from the refinery complexes surrounding Tabriz. They may now easily serve to pass raw crude through directly to refineries to Kurdistan.

Fifth, all European parties to JCPOA (Joint Comprehensive Plan of Action, the nuclear accord with Iran) have both rejected the US departure from the agreement and have further pledged to provide political as well as banking cover to Iran in an attempt to defend the pact. Those parties are the UK, France, Germany, and the EU.

Developments have included a strengthening of central banking connections and the support of continued banking connections with Iran. As the sanctions idle, the combination of a solid European opposition to Washington, with Russia and China (two other JCPOA signatories), along with now Turkish opposition has tempered policy expectations among the Trump Administration. Forget the strong rhetoric.

As of this week, no less than three exchange banks controlled by Iran but located in Europe and licensed by EU-member central banks continue to operate. These are known to, and ignored by, Washington.

I have suggested in the past that the real reason for the renewal of sanctions involved other global producers having to assume an increase in volume to make up for a decline in Iranian exports.

What resulted, however, was an oil glut in the market once the last-minute exemptions were provided. In fact, there has been little change in Iranian export flows. The only result was a dramatic decline in oil prices… just before an American election.

When put together with a noticeable US reluctance to cut the Iranian banking ties, one conclusion is inescapable. This has been about politics not policy.

The sanctions will result in lowered Iranian exports, although the actual volume decline is going to be less than "official" figures for the five reasons noted above. Nonetheless, it will have a negative impact on aggregate Iranian economic performance. All 2019 projections I have examined point toward a negative economic growth rate.

That is the most disquieting concern. My Iranian contacts may be correct. Trump's real agenda may not be improving the nuclear accord at all. Rather, the objective may involve regime change within Iran.

And that is exceptionally dangerous.

More to follow in due course about the saliency of economic sanctions in the absence of boots on the ground, a subject with which I have some personal experience.

About the Author

Dr. Kent Moors is an internationally recognized expert in oil and natural gas policy, risk management, emerging market economic development, and market risk assessment.

He serves as an advisor to the highest levels of 27 countries, including the U.S., Russian, Kazakh, Chinese, Iraqi, and Kurdish governments, to the governors of several U.S. states, and to the premiers of two Canadian provinces. He's served as a consultant to private companies, financial institutions and law firms in 29 countries, and has appeared more than 2,300 times as a featured radio-and-television commentator. He appears regularly on ABC, BBC, Bloomberg TV, CBS, CNBC, CNN, NBC, Russian RTV, and the Fox Business Network.

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