Waiver Wire

So much for a relaxing Easter holiday! Beginning Saturday evening, my network of contacts was reacting to the latest US foreign policy decision. This one calls for no new waivers on sanctions against any country still importing Iranian crude oil by May 2.

The US Department of State is expected to make the policy public shortly, but the move has been confirmed by a number of policy making sources both domestic and abroad.

Those sanctions were supposed to come into force during the first week of November last year. But at the eleventh hour, the Trump Administration provided 180-day waivers to the eight largest importers of Iranian oil, effectively allowing most of the exports to continue operating. Those waivers are now expiring.

On several occasions, I have noted here in ECRG Intelligence that failure to move forward with enforcement of the sanctions this time around would effectively end any US credibility on the matter.

However, assuming the sanction are exercised, a much higher geopolitical threat level is being introduced. My sources and contacts agree on the following four overriding considerations.

Tough, Customers

First, among the eight countries about to lose sanction-free access to Iranian oil, India' refineries are dependent upon Iran's grade of crude and China is Teheran's biggest customer. It is unknown at this time what impact the sanctions will have on economic expansion in either country. The other six affected are Greece, Italy, Japan, South Korea, Taiwan, and Turkey.

Sources confirm that China and India have been stockpiling crude imports on the likelihood that Washington would enforce sanctions. Both are expected to continue trading in Iranian oil through shadow markets, although the cost to both importer and exporter increases by so doing. China will also consider retaliations against the sanctions in tandem with other moves folded into the broader tariff tiff with the US. Chinese reprisals may once again include increased tariffs applied to US oil product and liquefied natural gas (LNG) imports.

Turkey has already condemned the sanctions and had earlier pledged to assist Iran in both the transit and financing of oil transport. That Ankara is now facing its own US sanctions has hardened the Turkish position.

Greece and Italy are expected to petition the European Union for coverage under promised EU statutory protection to transform the matter to a US-EU sovereign issue.

Second, the EU has further established central banking connections with Bank Markazi (the central bank of Iran) to underwrite trade. In addition, EU country companies are to be protected by policies intended to remove risk from “third party” interference in European-Iranian transfer of goods.

A move is expected in Brussels to put US LNG on a list of commodities against which EU reprisals can be applied.

Nonetheless, the primary immediate beneficiary is Russia. As the US sanctions increase the complexities of importing Iranian crude, Moscow has realized an improvement in exports to Europe, a development that is now expected to increase. Usually, Russian Urals Export Blend crude, the grade constituting most of the export to Europe, usually sells at a discount to Brent of at least $1 per barrel. As of last week, that discount has been reduced by at least 40%.

Third, I forecasted last October (in the run up to an expected early November implementation of the sanctions) that a full application would withdraw some 1.4 million barrels of Iranian exports a day from the global market. Some of that has already taken place even in the face of the 180-day waivers. I now expect the May 2 US move to drain at least another 900,000 barrels a day from the market.

The new dynamics will allow OPEC+ (essentially, OPEC plus Russia) to add to both their production and exports without bringing down the price. Combined with a faster than forecasted collapse in Venezuelan volume, civil war declines in Libya, and rising instability in Nigeria, there is a widening leverage for other producers to increase exports.

Don’t Play With Me

Fourth, Iranian responses are worrying. None of my contacts at the National Iranian Oil Company (NIOC) or the Ministry of Petroleum are responding to the latest US decision (hardly unusual in such circumstances). But there are areas of expected counter measures, nonetheless.

These would run the gamut from applying pressure across the Persian Gulf on Saudi Arabia—including intensifying the long-running strife in Yemen—and the United Arab Emirates, to the more extreme step of interdicting oil trade through the narrow Strait of Hormuz connecting the Persian Gulf and the Gulf of Oman.

Closing the Strait would immediately imperil about 22% of all global oil trade and move Brent close to $200 a barrel in short order.

There is wide consensus that Iran does not have the naval presence to keep the Strait closed, especially in the face of the US Fifth Fleet. However, a new directive has been issued to all US-flagged vessels on maintaining contact with the fleet when traversing Hormuz.

As several NIOC contacts confirmed to me late last year, closure of the Strait may not be an Iranian objective. But creating uncertainty about access would be.

Teheran sees the US sanctions as doing the bidding of Saudi Arabia and Israel, both avowed opponents of Iran in the region. Iran has used surrogates in the recent past against the Saudis. These have included using the Shia majority in Bahrain (connected to Saudi Arabia via a causeway), employing Houthi rebels in Yemen to launch missile strikes toward Riyadh and domestic oil installations, and fomenting dissent in the Eastern region of the country.

This last matter remains a particular concern of the Saudis. The region includes most of the nation’s oil production and is the nation’s only Shia majority province. During the 1979 Iranian Revolution, Ayatollah Khomeini invited Shiites living in Saudi Arabia to join the uprising. Those in the eastern Province did and Riyadh had to put its own population down by force of arms.

As several in Teheran have told me, the Iranian Revolutionary Guard Navy is prepared to confront the US Navy and there are some in the leadership of the broader (and at least 125,000 strong) Iranian Revolutionary Guard Corps (IRGC) that take such a hardline. The IRGC may be technically a part of the military, but it reports directly to the current Supreme (Religious) Leader Ayatollah Khamenei. The IRGC also runs Al Quds, an elite force for covert activity.

Recently, the Trump Administration labeled the IRGC a terrorist organization. In response, Khamenei replaced the IRGC commanding general. New Major General Hossein Salami is a vocal opponent of both Israel and Saudi Arabia.

“All cards are on the table,” an Iranian contact living in London told me this weekend. Unintended consequences and misreads on both sides are disquieting.

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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