DaMina Advisors

Frontier Markets Specialists

JUNE 01, 2018

EU workarounds US sanctions won't be sufficient to save Iran deal

Greg Priddy – DaMina Senior Fellow, Oil Geopolitics

Last week's meeting in Vienna between the remaining parties to the 2015 Iran nuclear deal, the EU-3 (Germany, France, UK), China, Russia, and Iran signaled support for keeping the JCPOA in place. However, the positions of the US, Europe, and Iran are completely incompatible, and the deal will eventually collapse, even though Iran will not resume prohibited activities immediately.

For the world oil market, the surge we had seen through the middle of last week had priced in the expectation that there would be a modest loss of export volumes from Iran (300,000-500,000 bpd), and little additional output from OPEC and Russia. The selloff in crude oil beginning last Friday reflects a development we had forecast in a prior note – US pressure on the Saudis to increase production to offset the lost volume anticipated from Iran and curb prices increases. Looking forward, there is still potential for upward pressure, but it would take an Iranian decision to expand uranium enrichment or an escalation of regional conflict later in the year.

US, EU, and Iran have completely incompatible positions

Despite the support for continuing the JCPOA by all parties other than the US, Europe will not be able to develop a workaround which will ensure enough economic benefit to keep Iran on board with the deal. US Secretary of State Mike Pompeo last Monday gave a speech laying out the Trump administration's position, presenting a list of 12 demands on Iran. The key new development in the speech, which broke new ground even for the Trump administration, was that Pompeo demanded that any new deal with Iran acceptable to the US would bar Iran from any uranium enrichment at all, in perpetuity. The decision by the Obama administration in 2013 to offer Iran flexibility on this point was the key US concession which made the eventual negotiation of the JCPOA possible, and it is highly unlikely that Iran would ever agree to completely give up enrichment. Pompeo also slammed the door on the notion of any US concessions to protect the business interests of US allies. The German foreign minister met with US National Security Advisor John Bolton at the White House last week, and his remarks afterward did not suggest any progress.

Iran also has staked out a tough position. While still complying with the JCPOA restrictions on its nuclear activities, as confirmed by the International Atomic Energy Agency (IAEA) in a report circulated this week, Iran has made clear that what it needs to stay in the deal is for Europe to take measures which allow Iran to receive the full economic benefits is expected from the deal. Symbolic actions by the EU-3 to support economic engagement despite US sanctions would not be enough.

Policy tools realistically available to Europe are insufficient to save deal

Despite tough talk from EU-3 officials, particularly Germany, the policy tools on hand will not be sufficient to satisfy Iran's expectations. The two sets of actions under discussion revolve around a "blocking statute" similar to the one in place in the late 1990s after the passage of the Iran Sanctions Act (ISA) in 1996 threatening US sanctions on companies which invested in upstream oil or gas projects in Iran, and also government-backed payment mechanisms to facilitate transactions.

AFRICA-ASIA POLITICAL RISK RESEARCH, DUE DILIGENCE, GEOPOLITICAL, REGULATORY RISK ADVISORY SERVICES

Sebastian Spio-Garbrah
Managing Director & Chief Analyst,
sebastian@daminaadvisors.com

Greg Priddy
Senior Fellow, Oil Geopolitics
Greg@daminaadvisors.com

ABOUT DAMINA

DaMina Advisors is a preeminent Africa-Asia focused independent frontier markets political risk research, due diligence, M&A transactions consulting and strategic geopolitical risks advisory firm.

DaMina Advisors is legally registered and has offices in the US, Canada, The UK and Ghana. DaMina is headquartered in Toronto.

The “blocking statute” concept was never really tested, since President Clinton issued waivers on three occasions for EU companies which would have been subject to sanctions. After George W. Bush came into office and the September 11 attacks took place, EU companies fully understood no more waivers would be granted, and refrained from backing further projects (though Bush left the Clinton-era waivers in place). In theory, a blocking statute would forbid EU companies from complying with US sanctions, but the fines are nominal amounts of money, and were never invoked. It also would compensate companies for US penalties imposed, but that would not really provide a remedy for the draconian sanctions the US would impose under the National Defense Authorization Act (NDAA) sanctions targeted at oil sales by Iran – cutting banks and oil companies off from the US financial system.

There also has been some talk of using European central banks to facilitate a sovereign payment mechanism in Euros bypassing the US control over the US dollar, but that also does nothing to mitigate the vast exposure all of the major European oil companies have to US assets and transactions. This is a business decision, and some major EU companies already have made their intentions clear. Total, the only EU company with a binding contract for upstream gas development, had said they would suspend their activity unless the US issued them a waiver, which it clearly will not. Maersk, the Danish shipping company, also announced that it was halting all business with Iran.

Sanctions priced in to crude oil, but potential for volatility remains

Crude oil had continued to fall since last Friday’s statements from both the Saudi and Russian oil minister telegraphing their intention to put addition volumes on the market over the summer months. As we had expected, pressure from the Trump administration on the Saudis and their Gulf Arab partners was critical to driving the shift in policy, as Crown Prince Mohammed bin Salman would have preferred to see stronger prices and enjoy the short-term benefits. The US politics of this is important, given the strong Saudi and Emirati support for Trump’s confrontational stance against Iran. US average gasoline prices have reached the psychologically important $3.00 per gallon level, and Democrats in Congress as well as candidates challenging Republicans have started to explicitly blame this on President Trump undermining the Iran deal.

There is still potential for renewed upward pressure on crude oil prices, but it is probably not immediate. While there is continuing potential for conflicts in Syria or Yemen to escalate and impact the oil market, we are probably going to see a delay of a few months before Iran takes any concrete steps to undo its commitments under the JCPOA. Iran’s government wants President Trump to be seen as the one breaking his promises, and will show forbearance for a decent interval, though upward pressure on the oil market could come back into play in the likely event that they formally renounce their commitments later this year.

Contact Stephanie@DaMinaAdvisors.Com

To schedule in-depth Q&A with Greg

DaMina Advisors is a preeminent Africa-Asia focused independent frontier markets political risk research, due diligence, M&A transactions consulting and strategic geopolitical risks advisory firm. DaMina Advisors is legally registered and has offices in the US, Canada, The UK and Ghana. DaMina is headquartered in Toronto.

www.daminaadvisors.com

On Twitter @DaMina_Advisors