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US Treasury vs. US State Department, NSC on Iran Sanctions Waivers

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Despite recent positive comments by US Treasury Secretary Steven Mnuchin suggesting some flexibility in the implementation of US sanctions on Iran, and a possible case-by-case waiver for some countries such as India on Iranian oil imports, the US State Department, the White House and National Security Council are still firmly opposed to any weakened resolve. The market may now be underestimating US seriousness about rapidly bringing pressure to bear on Iran. Despite Mnuchin's comments, the details of the US policy position are being fleshed out in a way which means any flexibility will be minimal. This will leave the market adequately supplied heading into the fall and winter, but with very little spare capacity as tensions with Iran escalate.

Mnuchin's comment that "we want people to reduce oil purchases to zero, but in certain cases if people can't do that overnight, *we'll consider exceptions*" was taken by many market particpants that the US may be backing off a hard stance against Iran. That is not true. Also anonymously sourced press reports that the US is considering selling oil from the SPR to offset volume losses from Iran, are true but likely overblown. The Trump administration seems to have been caught off guard by the market's muted reaction to the OPEC meeting and Saudi increase, and the fact that comments in a State Department background briefing the last week of June indicating zero flexibility on sanctions implementation caused Brent to push back into the upper $70s. President Trump's tweet on 30 June about the Saudis increasing by 2 million bpd just showed his ignorance of both what they had actually committed to as well as the limitations on the short-term spare capacity (much of the last 1 million bpd is in a 'mothballed' state – not completely irrelevant but not usable on the 90-day timeframe the IEA claims as its standard for inclusion).

Mnuchin's effort to talk down the market should not be overblown. The formal US response to the EU's request for a waiver of sanctions was very blunt about the US having no intention of granting waivers to EU-based companies or banks. Mnuchin also emphasized that there would be no "blanket" waivers and that the goal was to get Iranian exports down to zero as quickly as practicable. The US may have left a small amount of wiggle room about the 4 November implementation deadline, but the volumes involved will be very minor. This is not the sort of carefully calibrated sanctions implementation by the Obama administration in 2012, where Asian buyers (including Turkey) were allowed to continue importing around 80% of pre-sanctions Iranian volumes after cutting by 20%. The 2012 implementation was aided by a Saudi increase from about 9 million bpd to about 10 million bpd, but left around 1 million bpd of Saudi spare capacity which was usable in the short-term.

Even with the assumption which we are making about very substantial Iranian export volumes remaining after the November deadline, the signs seem to be shifting toward a volume loss larger than the 500-700,000 bpd we had anticipated previously. India is the key wildcard, as its government has said publicly that it only recognizes UN sanctions, but which has reportedly had private conversations with its refiners about cutting back on imports. If there is a candidate for a small amount of US leniency on implementation, it is probably India.

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This uncertainty will probably not be resolved until shortly before the deadline, as negotiations play out in private. But even if we posit a volume loss from Iran of around 1 million bpd, we still are going to have a very thin amount of spare capacity which is truly usable in under 90 days – under 1 million bpd – and the potential for greatly heightened tensions with between Iran and the US, Saudi/UAE, and Israel, with a potential for Iran to end it compliance with the JCPOA. This will prevent any sustained collapse in Brent below the high $60s, and probably result in renewed upward pressure in the fall, limited by the threat of a US SPR release.

Libya will remain a wildcard

In Libya, the attempt in late June by Gen. Khalifa Haftar – leader of the self-styled Libyan National Army which controls the eastern half of the country – to take control over oil proceeds has failed, as he was forced to reopen export terminals and hand over control to the Tripoli-based NOC. However, the potential for this threat to re-emerge remains strong. Haftar moved too quickly on the assumption that tightening spare capacity would not allow buyers to eschew crude purchases from questionable sources, but with that structurally materializing later this year in our view, Haftar may have another opening to create mischief. Haftar also benefits from the support of Russia, Egypt, and the UAE, where the US and Europe have backed the government in Tripoli. But if the market tightens on sanctions on Iran, it is quite possible President Trump could shift the US view, as he had not yet personally taken an interest in US policy toward Libya, leaving coordination with the EU and UN to the State Department.

Saudi-Kuwait Neutral Zone dispute resolution could add 500,000 bpd

The frozen dispute over the management of the Neutral Zone between Saudi Arabia and Kuwait also could be unfrozen by the perception of waning spare capacity. Solving this bilateral dispute could free up around 500,000 bpd in capacity which has been offline since 2014, and US officials probably will seek to press both Saudi Arabia and Kuwait to seek a resolution as part of the effort to pressure Iran.

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