• Overnight, the US officially withdrew from the Iran nuclear deal as Donald Trump signed the Presidential memorandum to begin reinstating US sanctions on the Iranian regime.

• The US president stated the US is going to institute the highest level of economic sanctions on Iran and any nation that helps Iran in its quest of nuclear weapons can be strongly sanctioned by the United States.

The future course of events

In line with the President’s guidance, Departments and Agencies will begin the process of implementing 90-day and 180-day wind-down periods for activities involving Iran that were consistent with the U.S. sanctions relief specified in the Iran nuclear deal. This would entail extend relief to Iran for the duration of the relevant wind down period, after which the sanctions will come back into full effect.

Meanwhile, the US will be working with the other signatories of the deal in finding comprehensive and lasting solution to the Iranian nuclear threat which include elimination of the threats of Iran ballistic missile program and its terrorist activities in the Middle East and worldwide.

Ball lies in allies’ court

As such, the focus now shifts to the allies of the US and how the other members (EU, Russia, China) respond. Donald Trump mentioned a strong solidarity and understanding amongst its allies towards halting Iran from its nuclear weapon activity, in his speech. However, there is a divide in the very acceptance of Iran not complying in its part of the deal. While most members believe Iran continues to comply from its end towards this accord, as is being monitored by the International Atomic Energy Association, the US government believes Iran is getting away on technical aspects of the pact and also challenged the ability and intent of the current authority in verifying Iran’s compliance.

Response of other nations

Iran now hopes for a scenario where other members continue to be a part of the deal, by capitalizing on the fact that it is committed to the original terms of the JCPOA. In response to the Trump’s speech yesterday Iranian President Hassan Rouhani mentioned it will continue to remain in the nuclear deal without Washington. Alternatively, if EU comes on board with US, Iran will shift its operations to other Asian countries, as it already has already done to an extent post the 2012 sanctions.

EU members have responded in a unified manner that they regret US’s decision to pull out of the nuclear deal. As of now they remain committed to the deal and will continue to work on a broader agreement which covers Iran’s nuclear activities. However in the 180 day wind down period it is to be seen if EU is able to broker a deal with US and Iran again which would be in the best interest of all. In the recent past there have been instances of change in stance (with conditions attached), such as on the tariffs imposed on Russia and China by the US, which adds scope to negotiation. As a final card, US may impose the threat of putting sanctions on entities dealing with Iran (at the risk of US isolating itself), which is a little uncertain in terms of how EU would respond.

China and Russia – the two members remain committed to the deal and have a political inclination towards Iran. In the event of EU backing the US, there is a high possibility of these two countries supporting Iran in shifting its operation to Asian countries.
Efficacy of the sanctions

In terms of the effectiveness of sanction on Iran it should be noted that US actions in isolation will have minimal impact as US is not a significant trade partner to Iran. The sanctions from EU are much more binding not only because of being a large market for Iran exports, but also due to the provisioning of insurance for Iranian oil shipments. European insurers provide cover for the majority of the world’s oil tanker fleet and reduced insurance would make Iranian oil very risky and lead to crippling its oil exports. Therefore for the sanctions to be biting on Iran US needs other members to be on board, particularly the EU. If not directly, the US can ensure this by indirectly targeting the financial corporations that do business with Iran as it had done in 2012.

Impact on oil supply

Base Case: When sanctions were imposed on Iran in 2012, its oil exports fell by more than 1 million bpd from its peak in 2011 to mid-2015, when sanctions were again lifted. Following that oil exports quickly started to rise and Iran again retained its pre-sanction levels at around 2.3 million bpd in 2017. However, there has been a realignment in the outflow of Iran exports to countries. European countries, which had completely cut down imports from Iran during sanctions, saw a partial recovery to its earlier export volumes, a change witnessed by Japan and Korea. China and India largely filled in the vacant spots and are now among the top three export destinations for Iran. With respect to the current sanctions and noting the changing dynamics we see an outage to the amount of 300,000-400,000 bpd in the short-term.

Extreme case: In the possible scenario where EU backs the US and imposes sanctions similar to 2012 we expect an outage of around 600,000-700,000 bpd. However, this would come into play only in the medium term as there is a wind-down period of 180 days and we expect Iran would realign its exports further as it has done previously and reduce its dependence on EU further. After the JCPOA deal, Iran had reduced its export dependency on European countries by almost 200,000 bpd compared to its 2012 export volumes. We believe China and India have the capacity to absorb approximately 200,000 bpd from the oil displaced from European refineries. The total outage after the 2012 sanctions was close to 1.2 million bpd of Iran exports.

![Impact of sanctions on Iranian oil exports](source)

![Re-alignment of Iran export destinations after 2011](source)
Impact on Oil prices

In a tightly balanced market as of now, a further drop in output levels has an incremental impact on prices due to the convexity of oil price elasticity. Due to the hard sanctions on Iran, a worsening of the Venezuela crisis and with the peak demand summer driving season in sight prices have exceed our short term view of USD 75/barrel as Brent now sits above USD 76/barrel.

As a large part of yesterday’s decision was priced in, we expect prices to move up at least another 2-3 Dollars before it settles lower. However, we maintain our medium term view of crude settling lower after the attention moves away from the geo-politics to fundamentals.

Role of Venezuela and its impact on oil prices

It is important to note that the uncertainty around the Iran nuclear deal is not the only geo-political risk premium that is driving prices. Venezuela’s oil production has been on a downward trend the past two decades, but since early 2016, the output has deteriorated steeply from close to 2.4 million bpd to 1.5 million bpd now, which is tantamount to 1% of global supply. Shockingly the worst is still not over in the economy which suffers from an economic, political and humanitarian crisis. A series of potential disasters and leading indicators point to further declines in Venezuela production. According to reports, ConocoPhillips is moving in to seize assets from the Venezuela state oil company PDVSA, which would be further detrimental to the government revenues and oil production.

Moreover, US Vice President Mike Pence unveiled new sanctions on 20 Venezuelan firms with ties to the authoritarian President Nicholas Maduro ahead of the elections on May 20th. The impact of the sanctions were minimal in nature but it highlights the political crisis engulfing the Latin American country which would only delay the recovery of its oil production.
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