

News Flash – US Tightens Vise

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16 January 2012: Last week the US sanctioned three Asian energy companies as tensions between the West and Iran continue to escalate without any signs of relenting. Fresh sanctions involve one Chinese company, Zhuhai Zhenrong Corp – Iran’s main supplier of refined petroleum goods, and two independent energy traders from Singapore, Kuo Oil and FAL Oil Company – who sell gasoline to Iran. Due to a lack of domestic refining capacity, Iran is dependent on refined product from foreign companies. Although the sanctioned companies do not have major business ties to the US, this recent move appears to be a “warning shot” to the global business community that the US is serious about implementing these new sanctions. This recent move seems designed to send a signal to larger players which do have significant investments within the US.

Russia and China have not supported US sanction efforts, while Japan has agreed to cooperate in principal but has yet to decide on how to implement these measures. All the while, EU officials appear to be getting closer to an agreement to phase in sanctions after a six month grace period, trying to accommodate the region’s most vulnerable economies (Italy, Spain and Greece) which are heavily dependent on Iranian oil.

Since the release of the IAEA’s report in November on Iran’s nuclear program, tension between the West and Iran has been steadily building. From the start of 2012 there has been a consistent flow of unsettling headlines involving the West and Iran and as a result, energy markets have become acutely attuned to headline risk. A timeline of recent actions taken can be summarized as follows:

- ❖ On 31 December 2011, President Obama signed the National Defense Authorization Act for Fiscal Year 2012 which included enacting sanctions targeting Iran’s oil exports.
- ❖ Iran undertook 10 days of military exercises in the Strait of Hormuz which concluded in the first week of January.
- ❖ On the heels of Obama’s decision, Iran sent a direct warning to the US not to allow the USS John C. Stennis to return to the Persian Gulf.
- ❖ The week of 9 January, Treasury Secretary Timothy Geithner traveled to Asia to convince China and Japan (two of Iran’s major customers) to support US sanctions on Iranian oil.
- ❖ During that same week, Iran sentenced an American citizen (accused of espionage) to death and announced the near completion of the Fordo plant, a second uranium enrichment site.
- ❖ Last week, Mostafa Ahmadi-Roshnan, nuclear scientist and deputy director of one of Iran’s uranium enrichment plants, was assassinated.

These recent events indicate that both the West and Iran are hardening their positions. For example, the Atomic Energy Organization of Iran released a statement following Ahmadi-Roshnan’s assassination, confirming its resolve to continue its nuclear program: “[w]e will continue our path without any doubt... [o]ur path is irreversible.” In addition, the OPEC governor from Iran, Mohammad Ali Khatibi sent out a clear warning to Gulf oil producers over the weekend, citing that any efforts to replace Iranian oil production would be seen as

unfriendly and that “these countries would be the main culprits for whatever happens in the region-including the Strait of Hormuz.”

The markets have witnessed similar tensions between the West and Iran in the past; however a key difference this time around is that the US is trying to garner multilateral support in order to isolate Iran from the global business community. At least anecdotally, it appears US sanctions are having some effect. Iran’s currency, the Rial, has recently fallen 20 percent against the US Dollar and a number of major importers of Iranian oil appear poised to reduce purchases. Clearly, Iran has no intention of sitting still as events unfold around it. As we stated in our previous News Flash, Iran seems focused on destabilizing the international oil markets in an attempt to dissuade the US and the EU from imposing new sanctions targeting its oil exports. Iran views the West’s dependence on foreign oil as its Achilles Heel – should Iran drive up oil prices, this will increase the risk of recession in the US and the EU, thereby forcing the West to back down from the latest implementation of sanctions.

Oil prices pulled back slightly due to news that the EU’s embargo on Iranian oil would be delayed and that Nigeria’s government settled its oil price dispute with oil union workers – however reports of new tensions between Saudi Arabia and Iran are once again upsetting markets. Wen Jiabao, China’s premier, is currently on a six day tour of the Gulf region in an attempt to strengthen China’s ties with the region and to secure its long term energy needs. While China asserts that Wen’s visit is purely for long term measures, it appears that some of Iran’s largest customers are seeking alternative suppliers as a measure of insurance in light of current tensions.

In our view prices will stay elevated due to headline risk and we are revising our near-term trading bands to \$95/105 for WTI and \$110/120 for Brent due to increasing geopolitical risk. The assassination of the Iranian nuclear scientist underscores the intensity and complexity of the Western-Iranian conflict. US officials have condemned the attack, but a muted Israeli response reminds us of its wild card status in this story. As Iran continues to conceal and move its nuclear efforts underground the potential window for an effective military strike by either the US or Israel is closing.

The next scheduled event relating to the sanctions against Iran will come from the European Union, whose ministers are scheduled to meet on January 23rd. The EU represents one fifth of Iran’s oil exports and sanctions from this customer could deal a significant blow to the Islamic Republic’s economy. As mentioned in our previous News Flash, tensions appear to be escalating faster than expected – therefore we expect pricing action in the global energy markets to be highly volatile over the coming weeks.

As always we will continue to monitor the situation and other developments affecting the energy markets and will be providing further commentary.

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