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Uncertainties in the Future of Iranian and Middle East Situations and International Oil Market

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On July 7, the Institute of Energy Economics, Japan, held a webinar titled “Iran’s Presidential Election Result and Its Impacts on the Oil Market.” At the 14th IEEJ Energy Webinar, Sachi Sakanashi, senior research fellow and assistant director of the IEEJ JIME Center, made a report titled “Iran’s Presidential Election Result and Its Impacts,” followed by a report titled “International Oil Market after Iran’s Presidential Election” by Tetsuo Morikawa, manager, Fossil Energies & International Cooperation Unit, Oil Group, IEEJ. Later, Hirofumi Matsuo, editorial writer of Nikkei Inc., made comments on the two reports. Based on the reports and comments, I moderated a panel discussion and a question-and-answer session.

Since the inauguration of the U.S. Biden administration, Iran and the United States have negotiated their comeback to the Iran nuclear deal by the intermediary of the European Union. However, hardliner Ebrahim Raisi won in a presidential election on June 18 and is set to replace moderate Hassan Rouhani as Iran’s president in early August. Where will Iran go after the government change? How will the nuclear deal negotiations go? How will U.S.-Iran relations be affected? How will the Middle Eastern situation change over Iran? These questions are attracting global interest. On the other hand, crude oil prices rose from the second half of June to early July. On July 6 just before the webinar, the benchmark Brent oil futures price surpassed $77 per barrel for the first time since October 2018. Behind the oil price hike, global oil demand has followed an uptrend amid the global economy’s recovery from the COVID-19 disaster, while the future of coordinated oil production cuts by the Organization of the Petroleum Exporting Countries and non-OPEC oil-producing countries has become uncertain due to a dispute between Saudi Arabia and the United Arab Emirates. The OPEC-plus coordinated production cuts have contributed to rebalancing supply and demand in the international oil market. In such situation, how future Iranian developments would impact the international oil situation and crude oil prices has become a global matter of interest. In the following, I would like to summarize impressive points of discussions at the webinar.

The first impressive point in the Sakanashi report is that the situation would change depending on whether the United States and Iran would reach agreement on the nuclear deal under the current Rouhani administration. If the agreement is reached, it would become the base for Washington-Tehran relations under the new Iranian administration. If the negotiations are taken over by the new Iranian administration, however, the talks would be prolonged due to bilateral differences as described later. The second impressive point is that whether and how wide gaps between the United States and Iran over the comeback to the nuclear deal could be closed is still uncertain. Iran sees its economic reconstruction through the lifting of U.S. economic sanctions as indispensable and apparently hopes that at least sanctions regarding crude oil exports would be lifted. The fate of Iranian crude oil exports would exert great impacts on the future international oil market, the Middle Eastern situation and local geopolitical tensions. Third, the Sakanashi report presented a sanction-lifting scenario in which Iran's economic devastation and progress in nuclear development including uranium enrichment would prompt Tehran and Washington to reach a compromise to lift the U.S. sanctions regarding Iranian crude oil exports and reduce Iran's nuclear development scale to the level seen when the deal took effect originally. It also provided a scenario in which the two sides would reject each other's demands in economic and geopolitical conditions that would lead them to toughen their respective positions. In the latter scenario, Iran would promote nuclear development, with the nuclear deal collapsing, leading tensions to grow in Iran and the Middle East. In the question-and-answer session, questions came about the probability of the two scenarios. Anyone may have no choice but to view the probability as 50%. An interesting argument given in the session is that sanctions would be retained for a certain period of time before they begin to be lifted. In a debate on an argument that new President Raisi would give top priority to the survival of the Iranian regime, a participant in the session noted that a grave challenge for the new president would be how to respond to major changes in Iran's internal and external situations while reviewing the history from the Islamic Revolution to date and recognizing the strength of Iran and its regime. We will have to keep close watch on the future situation regarding Iran.

As for the international oil situation, Iran's crude oil exports in the abovementioned sanction-lifting scenario would differ far from those in the other scenario. In the sanction-lifting scenario, Iran's oil production would increase by about 1 million barrels per day towards the end of 2022. If the other important conditions such as global oil demand and U.S. shale oil production remain unchanged, Iran's oil production expansion would raise supply and ease the supply-demand balance in the international oil market. In the scenario where the sanctions would be kept in place, Iran's oil exports would be limited to the current levels (0.6-0.7 million bpd). If the other conditions remain unchanged, call on OPEC-plus supply, or OPEC-plus production required to balance global supply with demand, would gradually increase. The problem is whether the OPEC-plus group would fully respond to each of the two scenarios. The Morikawa report stated that in the sanction-lifting scenario, downside pressure on crude oil prices would grow in anticipation of Iran's oil export expansion before the OPEC-plus group reduces production further to prevent oil prices from plunging. For the other scenario, the report projects the Brent futures price to range from $70/bbl to $90/bbl in the second half of 2021 and from $65/bbl to $85/bbl in 2022 as the OPEC-plus group gradually narrows coordinated production cuts through its continuous micro management of the supply-demand balance. For the sanction-lifting scenario, the Brent futures price is projected to decline briefly in anticipation of Iran's comeback to the international oil market before rallying to the above forecast ranges. This means that oil prices in the two scenarios would not be so different as the OPEC-plus group successfully responds to any change.

Important here is whether the OPEC-plus group's production coordination would work sufficiently. The UAE, which has requested an increase in its production quota and raised opposition to a plan to extend the coordinated production cuts until the end of 2022, has clashed with OPEC-plus leader Saudi Arabia, leaving its original plan on hold to phase out the coordinated production cuts or gradually increase production from August. As the gradual production increase became uncertain while call on OPEC-plus supply was rising amid the global oil demand recovery, Brent rose above $77/bbl on July 6. The Saudi-UAE dispute would make the coordinated production cuts as well as the gradual production expansion plan uncertain. At an OPEC-plus meeting in March 2020, Saudi Arabia and Russia differed over the coordinated production cuts, making the coordination dysfunctional and leading oil prices to take a free fall. At a time when the coordinated production cuts are uncertain, any change in the Iranian situation may trigger a dramatic change. Oil-producing countries' coordinated production cuts have historically tended to be enhanced and maintained in response to remarkably weak oil prices. When oil prices rose back, however, their coordination tended to face more difficult and complicated situation. The latest Saudi-UAE dispute reminds me of the historical tendency. As oil prices have risen back above $70/bbl, the OPEC-plus unity may be challenged in the future. Any change in the Iranian situation may trigger geopolitical tensions in the Middle East and relevant oil supply risks. In this sense, any Iranian situation change is important for analyzing the international oil market.

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