COFACE BRIEF

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CONFIDENTIAL

US-Iran: amid rising tensions, enriching uranium may be a game changer

GDP forecast 2019: -6% 2020: +0.2%
Coface Country Risk Assessment: E (extremely high)

What

On July 7, Iran announced that it had enriched uranium beyond the key limit imposed in the 2015 nuclear deal, and that it will reduce its commitments to the pact. The International Atomic Energy Agency (IAEA) said that Iran had breached the 3.67% enrichment limit. The move came amid rising military tensions between Iran and the United States, as well as a series of attacks on tankers, which led to increased tensions between Iran, the United Kingdom, the United Arab Emirates, and Saudi Arabia.

Why

1) **A more demanding Trump administration.** In 2017, the United States strengthened its traditional alliances and regional partnerships against Iran. In May 2018, US authorities made **12 demands to Iran** for a new nuclear treaty (including a declaration by Iran to the IAEA giving a full account of the prior military dimensions of the nuclear programme and stopping plutonium enrichment).

2) **US withdrawal from the Joint Comprehensive Plan of Action (JCPOA) in May 2018; re-imposed sanctions.** In July 2015**,** Iran, the US, China, Russia, France, Germany and the UK signed The Iran Nuclear Deal. Iran agreed to eliminate its uranium stockpile and enrich uranium no higher than 3.67% for the next 15 years. In return, the US-, EU- and UN-related sanctions on Iran's oil, manufacturing and banking sectors were to be ceased. **However, in May 2018, after the US announced its withdrawal from JCPOA, the US re-imposed sanctions in November 2018.** As a result, Iran announced it had breached the cap set on its low-enriched uranium stockpile and an increase in uranium enrichment beyond the level agreed within the deal.

3) **Rising tensions with the US:** in early April, the US designated Iran's Islamic Revolutionary Guard Corps, a division of the Iran's army, as a terrorist organization. This is the first time that a government structure has been classified as such. In May, the US ended waivers for any countries importing oil from Iran, aiming to reduce Iran's oil exports to zero and put heavier economic pressure on the country. The US also issued additional sanctions prohibiting the purchase of Iranian iron, steel, aluminium, and copper as metals represent the third-largest source of export revenues for Iran after oil and petrochemicals. In late June, President Trump imposed new sanctions on Iranian Supreme Leader Ayatollah Ali Khamenei and other top Iranian officials. Iran said the US decision has permanently closed the path to diplomacy between the two countries.

4) **Attacks in the region**: in May 2019, four tankers were attacked close to the coast of the UAE. The US blamed those attacks on Iran, which was denied by Tehran. The US also accused Iran of attacking two oil tankers in the Gulf of Oman in June. Iran repeatedly said it had no knowledge of the attacks. Late in June, Iran downed an unmanned US drone, saying the aircraft violated its airspace.

Risks

1) **Following the downing of the US drone, President Trump said he ordered a military strike then pulled it back.** Although this suggests that the US does not yet wish to escalate tensions, their **stance remains tough**. Indeed, since its withdrawal from the deal, the US has repeatedly said that it is not aiming to change the regime in Iran, rather it is looking for a more appropriate nuclear deal and it was ready for unconditional talks with Iran. However, with rising tensions in the region, any reciprocal policy misreading may result in a direct conflict, which both sides have so far tried to avoid. According to some geopolitical analysts[1], the military capacities of US allies in the region remain quite low compared with Iran. As a result, the cost of a war with Iran may not be tolerable for any other country than the US.

2) **An intentional or accidental war between the United States and Iran could send oil prices to new peaks.** Already, around 2 million barrel per day (b/d) of Iranian crude and condensate have been removed from the world oil market due to the reintroduction of sanctions. Coface expects oil prices to average at USD 65 in 2019 pressured by slowing economic growth in major economies and trade wars. Prices would skyrocket if any clash between the US and Iran happens, which would weigh on purchasing power of US consumers as well.

3) **However, Iran's uranium enrichment decision may be a game changer.** The restart of nuclear activities may result in a confrontation of EU and Iran and reduce the political support of China and Russia to Iran. Mr Trump's strong warning to President Hassan Rouhani can be seen as the US President's patience coming to an end. In this case, Mr Trump may accept his hawkish officials' offer of a limited assault on some Iranian facilities. **Chances for Iran to close the Strait of Hormuz seem to remain low,** as it would bring reactions from other countries using the oil transported through this trade corridor. Closing this corridor would put at risk an estimated 17 million b/d oil exports (nearly one-fifth of global output).

4) **It seems quite unlikely for the US to bring Iran's oil export to zero.** The re-imposition of US oil sanctions and the end of waivers have drastically reduced Iran's oil exports, which are expected to average 400,000 b/d in the second half of 2019 compared with 2.5 million b/d before. **Yet the country is expected to use various means to evade sanctions, such as barter transactions and ship-to-ship transfers. GDP growth for 2019 stands at -6%** following a contraction of 4% in 2018. Lower oil revenue and economic growth is expected to **restrict government spending**. Inflation remains high (at 37.6% in the twelve-months to June). **Unemployment is set to rise** (11.7% at end-2018) due to the lack of investment. The Iranian rial continues to depreciate in the back market with a rate close to 130,000 to the US dollar compared with the official rate of 42,000 rials. These elements will adversely affect payment performance of companies and lead to cash squeeze and extended payment terms.

1 IRAM, Center for Iranian Studies in Ankara, *Iran's Uranium Enrichment Decision and Its Implications*, Hakkı Uygur, July 2019

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