

May 13, 2019

## Tension in the Strait of Hormuz Raises Concerns About Supply Disruption

Stratas Advisors

After the unilateral withdrawal of the United States from the JCPOA and the end of waivers granted to eight countries that bought Iranian oil, tensions have been on the rise between Iran and the United States. What first started as a diplomatic strain is now escalating into a show of force in the Strait of Hormuz.

### **The Iranian Reaction**

The Islamic Republic has been experiencing a deep economic crisis since the announcement of the withdrawal of the US from the JCPOA. Teheran has decided nonetheless to remain in the agreement to give the Europeans a chance to save the deal. In February 2019, the Europeans created INSTEX (Instrument in Support of Trade Exchange). This Paris-based mechanism consists of a financial package aiming to curtail American sanctions against Iran and maintain trade with Teheran in the form of barter. However, a few months since its inception, the mechanism is a failure, the volume of trade using this mechanism is very low and European companies, and especially European banks, do not have the necessary guarantees to engage in trade with Iran.

Indeed, the reluctance of European banks to finance all activities related to Iran, including legal activities, highly affect INSTEX's efficiency.

A record fine of 8.9 billion euros imposed by the US government on the French bank BNP Paribas 2014 for violation of the embargo on several countries, including Iran, has warned European banks that now refuse to finance any projects related to Iran.

As a result, Teheran, noting the failure of INSTEX and after the end of Washington's exemptions to eight Iranian oil importing countries, decided on May 8, 2019, one year to the day after the US withdrawal, to issue an ultimatum of 60 days to the Europeans to propose a viable solution to save the agreement in which case Tehran would withdraw from a number of points in the agreement. The same day, President Trump imposed new sanctions against "the Iranian sectors of iron, steel, aluminum and copper" to reinforce the pressure on the Tehran regime.

Indeed, for Tehran, Iran continues to respect the JCPOA agreements but derives no benefit to the extent that sanctions are even more severe than before the agreement. The Europeans immediately reacted by rejecting the ultimatum, which

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reflects more of the political incapacity of the Europeans to give a viable counterpart to Iran.

### **Military Tension**

These political tensions quickly took a military turn. The Americans announced the deployment of the USS Abraham Lincoln aircraft carrier and a bomber force in the Middle East in response to a "credible threat" from Tehran. "The United States does not seek war with the Iranian regime, but we are fully prepared to respond to any attack," said John Bolton, the national security advisor. A few days later, on May 10, a patriot missile battery was sent to the Middle East. In turn, the commander of the Revolutionary Guards Council's aerospace force said the US aircraft carrier, with about 50 fighter jets and 6,000 troops, was a potential target for the Islamic Republic of Iran. This escalation has a thread of psychological wars and it is in the interest of none of the belligerents to declare hostilities.

### **Barrels at Risk**

On May 13, an incident took place in the port of Fujairah, UAE. On Sunday, after denying, the UAE had finally reported "acts of sabotage" against four commercial ships of different nationalities east of the emirate Fujairah, without identifying the perpetrators but calling the event "serious". Saudi Arabia said that two of its oil tankers had been sabotaged in attacks it described as posing a threat to the security of global oil supplies.

This incident is important as the port is not inside of the strait of Hormuz but on the north shore of the Oman Gulf. The UAE authorities established a 350 km pipeline from the Habshan oil field from Abu Dhabi to Fujairah in 2007.

The main goal of the construction of the pipeline to Fujairah was to decrease the dependence and the risk of the strait of Hormuz. This sabotage can directly be linked to the increasing tensions in the Strait of Hormuz. The target of Saudi tankers in Fujairah can be interpreted as an Iranian warning on the consequences of oil in the event of increased tensions in the region while showing the extent of its range. However, Iranian diplomacy has expressed concern and regret at the incident in Fujairah and called for an investigation.

This incident immediately brought ill effects. Oil prices have gone up right away on Monday due to growing concern about supply disruptions in the Middle East.

Brent crude futures were at \$72.43 a barrel by 13:21 GMT, up \$1.81 in the US.

West Texas Intermediate (WTI) futures were up \$1.49 at \$63.15.

With rising tensions in the region, as the US strives to reduce Iran's crude exports to zero and crush its economy, there is a real risk for the oil market.

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