

Why Iran might be Saudi Arabia's best hope in 2019

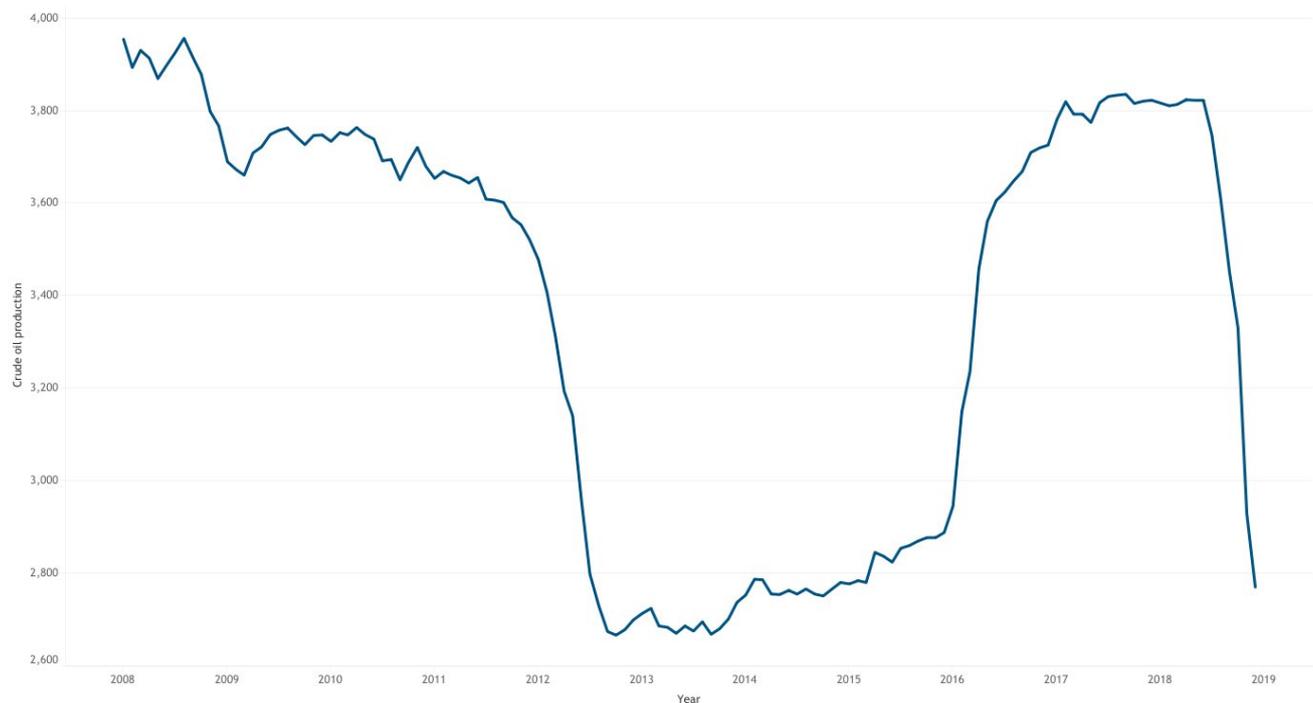
Blog post by Practice Lead Thomas Gratowski, 29 January 2019

The last couple of months have been “suboptimal” for Saudi Arabia, to say the least. The Khashoggi murder has brought the leadership around the crown prince, Mohammad bin Salman under severe international and domestic pressure. Rumours of wider discontent with “MBS” were likely one reason why King Salman extended by another year costly household allowances at the expense of fiscal consolidation. As if that wasn't bad enough, the drop in the oil price in the last quarter of 2018 has reduced the kingdom's growth prospects. The [IMF's recent WEO update](#) downgraded the country's GDP growth forecast by 0.6 percentage points. It is perhaps ironic then that Saudi Arabia's arch rival, Iran, might well be Riyadh's best hope in 2019 to reset some of its current problems.

The Saudi leadership never liked the nuclear deal (or JCPOA) between Iran and major world powers. Tehran's view of the deal might soon converge with that of Riyadh. The Iranian government led by president Hassan Rouhani is increasingly under domestic pressure to withdraw from it. Back in 2016, the supreme leader, Ayatollah Ali Khamenei, threatened to “set the JCPOA on fire” should the US withdraw from the deal. Ayatollah Ahmad Jannati, who is the chairman of two of the most influential bodies in Iran, the Guardian Council and the Assembly of Experts, earlier this month criticised Rouhani for not following through on Khamenei's promise. Jannati predicted that the president would ultimately have to terminate the accord.

We don't know yet whether Jannati's view will prevail. But pressure on Rouhani will rise the more Iran's oil exports dwindle. Recent data showed that despite US sanctions waivers for eight countries that are Iran's main oil export markets, Iranian exports fell by almost 60% since the US withdrawal from the deal in May, to 1.2m barrels per day in December. The EU has still not agreed on a “special purpose vehicle” which would allow for the continuation of trade with Iran. A rumoured compromise, which is expected to be announced soon, could exclude oil trade and only focus on facilitating exports for humanitarian purposes. Rouhani will wait for the concrete European proposal to come out, but he knows that time is not on his side in a low-price environment. US sanctions waivers will need to be renewed in May and Washington is likely to demand further reductions from oil importing nations.

Iran's oil production is collapsing
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There are of course reasons why Tehran could continue to abide by the nuclear agreement despite severely reduced economic benefits - it is the only way to maintain the diplomatic appearance of commitment to nuclear self-limitation. But the Iranian leadership might also judge that its credibility or even political survival is at stake and the cost from a withdrawal manageable. Terminating the deal would certainly be perceived as aggressive and could pose a binary choice to the US and Israel to either accept a potentially nuclear Iran or to strike militarily. How does this help Saudi Arabia? First, an escalating standoff between Washington and Tehran could provide a welcome deflection from the Khashoggi murder. Second, it would emphasise Saudi Arabia's geostrategic importance for those inside the DC Beltway and in the US Congress who are weighing up the US-Saudi partnership. Third, sabre-rattling in the Persian Gulf would add to wider oil market uncertainties sparked by the Venezuela crisis, and increase the "geopolitical risk premium" on Saudi Arabia's most important export commodity - at a time when it's fiscal outlook is pretty dire. None of this is especially good for the world, or the region. But it might be good for Riyadh.