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2020 Begins with Growing Risk of U.S.-Iran Military Clash

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The year 2020 opened with turbulent developments in the Middle East. After the Iranian situation remained tense last year, the very serious risk and fear of a U.S.-Iran military clash grew rapidly, with the world breathless.

Triggering the risk was a U.S. drone strike in Iraq on January 3 that killed Qassim Suleimani, commander of the elite Quds Force of Iran's Revolutionary Guards Corps, as ordered by U.S. President Donald Trump. Claiming that Suleimani was a terrorist planning urgent attacks on Americans, Washington said it implemented the military operation to block the planned attacks. The killing of Suleimani, well known as a national hero in Iran, inflamed anti-U.S. sentiment and movements in the Islamic country. Amid growing anti-U.S. sentiment, Iranian Supreme Leader Ali Khamenei, President Hassan Rouhani and Revolutionary Guard cadres vowed retaliation against the United States. Iranian citizens also called for anti-U.S. retaliation while mourning for Suleimani.

Military tensions grew rapidly as Washington warned of a strong retaliation against any Iranian attacks in response to Tehran's retaliation threat. As anti-U.S. sentiment grew not only in Iran but also in Iraq where Suleimani was killed, pro-Iran forces throughout the Middle East jointly condemned the United States for killing Suleimani and called for anti-U.S. retaliation, heightening tensions in the region rapidly.

On January 8 after the funeral for Suleimani ended, Iran fired ballistic missiles against two Iraqi bases housing U.S. troops in Operation Martyr Suleimani. As Iranian attacks were realized, the world became breathless on growing concerns about whether a U.S. counterattack would come, what the counterattack would be and if any U.S. counterattack would escalate the bilateral standoff into the worst phase. Announcing that no Americans were killed or injured by the Iranian attacks, however, U.S. President Trump vowed to enhance economic sanctions on Iran without conducting any military counterattack, averting any escalation of the bilateral military clash for the immediate future.

Even amid growing military tensions, both the United States and Iran were willing to avert any all-out clash or war for their respective reasons. As far as Iran vowed retaliation, however, some Iranian action was seen as inevitable. Iran might have selected the ballistic missile attacks after carefully considering various conditions and possibilities regarding the international situation including its relations with the United States, analysists say.

Markets greatly reacted to the growing risk of a U.S.-Iran military clash. Crude oil prices soared as oil market players grew conscious of the possible military clash and its potential impact on oil supply. On January 3, the benchmark Brent oil futures price posted a sharp rise of $2.35 per barrel from the previous day to $68.60/bbl. On the next trading day of January 6, it rose beyond $70/bbl briefly before closing at $68.91/bbl, hitting the highest level in eight months excluding

September 16 when the price topped $69/bbl in reaction to attacks on Saudi oil facilities. Market participants then anticipated that crude oil prices would rise further if the United States and Iran escalated their military clash. As the United States refrained from conducting any military counterattack in response to the Iranian missile attacks, however, the Brent price fell to $65.37/bbl, with the market restoring stability. Stock markets also fluctuated wildly, plunging on the growing risk of a military clash and shooting up on the aversion of the risk. Markets were thus plagued with turbulence at the beginning of the year.

Factors behind the wild oil price fluctuations included not only the growing risk of a military clash but also market sentiment and trends since late last year. In December, the announcement by the Organization of the Petroleum Exporting Countries and some non-OPEC oil-producing countries to enhance their joint production cuts, the Phase 1 deal of U.S.-China trade talks, the subsequent receding of global economy risks and a stock price upsurge paved the way for crude oil prices to gradually rise. Then, the growing tensions between the United States and Iran and the fear of their possible military clash might have worked to accelerate the oil price hike. These developments in December made it easier for some geopolitical risk premium to emerge on oil prices or led market players to pay attention to geopolitical risks.

Given that the United States has refrained from implementing any direct military counterattack in response to the Iranian missile attacks and that both countries seem willing to avoid an all-out clash, as described above, they have averted the escalation of their confrontation or the worst scenario for the immediate future. However, no optimism can be warranted about future developments.

While both the United States and Iran hope to avoid an all-out clash, their structural confrontation has remained unchanged. No one can deny that some unanticipated or accidental developments would raise tensions again. We could see developments that are difficult to anticipate, such as the attack on and killing of Commander Suleimani. We must pay attention to what action Iran and pro-Iran forces would take in the future and how growing anti-U.S. sentiment and calls for the withdrawal of U.S. forces in the Middle East would affect the regional situation. The killing of Suleimani could change the regional balance of power to the advantage of the Islamic State and al Qaeda terrorist groups, according to some analysts. Anyway, the latest high tensions in the Middle East have led the world to recognize the importance of geopolitical risks in the region.

In considering the stability of international energy markets and crude oil prices, we now have no choice but to grow conscious of the Middle East situation. While crude oil prices have nominally restored their stability for the immediate future, the benchmark Brent price may range from $65/bbl to $75/bbl in the immediate future. Depending on future developments, market participants could grow conscious of the possibility of geopolitical risks surfacing again. After market participants anticipated even the worst scenario of the two countries' all-out clash during the latest tensions, market players could become conscious of such scenario again depending on future developments. In August 2018, the Institute of Energy Economics, Japan, released a report on a scenario analysis regarding the Iranian situation and its impact on the international oil market. Regarding various oil market fundamentals such as supply and demand, the current situation widely differs from the August 2018 situation. However, our conclusion then that crude oil prices would change sharply depending on the absence or presence of a military clash and on the degree of such clash's seriousness still stands even at present. The report pointed out that crude oil prices could top $100/bbl depending on an all-out military clash. We may have to deepen our analysis in line with the latest situation. In this sense, we would like to closely watch future developments.

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