



# After the attack: What comes next?

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The U.S. attack on Iran's nuclear facilities has significantly increased geopolitical risk, raising concerns about oil prices and the potential for escalating military conflict. Short-term disruption aside, we believe the profound changes in the political dynamics in the Middle East should play to the advantage of the U.S. once the dust settles.

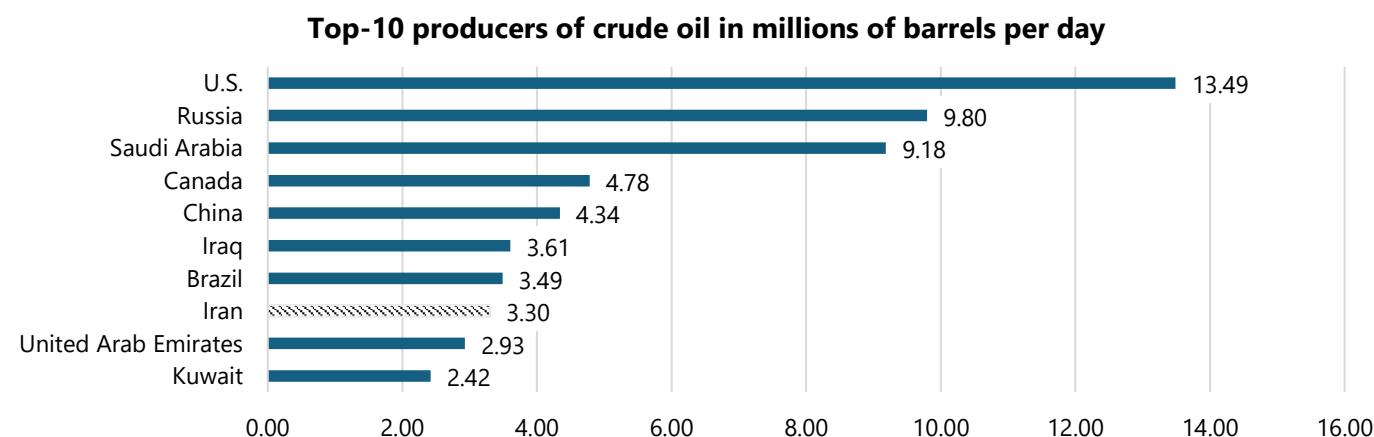
Geopolitical risk has taken a leap forward now that America has entered the fray. While there is always the chance that Iran will lash out and disrupt shipping through the Strait of Hormuz or attack some oil-producing and refining facilities and export terminals in the neighboring Gulf States, we see this as a low-probability event for more than one reason:

- **Iran cannot disrupt its neighbors' exports without disrupting its own;** some 95% of Iran's oil exports are loaded onto tankers docked at Kharg Island, which is near the northern end of the Persian Gulf. In addition
- **Iran cannot afford to lose friends, especially its most powerful friend;** China is one of Iran's strategic partners, receiving almost half of its imported oil from the Middle East.

Even in a worst-case scenario, in which some sort of supply blockage occurs, SEI assumes that it wouldn't last long. Such a move by Iran also would give the U.S. justification to retaliate and do even more damage, this time to economically important assets. Oil prices may jump sharply, but the rise would likely be ephemeral. There is plenty of excess capacity to replace Iranian production.

The exhibit below provides a list of the 10 largest producers of crude oil. Iran produces about 3.3 million barrels of oil per day, of which only about two million barrels are exported. Saudi Arabia alone has enough idled capacity to replace any Iranian crude taken off the market.

## Exhibit: Oil's well



Source: Trading Economics, SEI.

## What's next?

A more concerning issue following the attack on Iran's key nuclear facilities by the U.S. is the possibility of attacks against U.S. military personnel and assets in the surrounding countries. Terrorist activity targeting soft targets in Europe and America itself cannot be ruled out either under this scenario. One thing is clear, however: Iran's nuclear ambitions have been dealt a severe blow. The regime's foreign-policy strategy also is in tatters following the military setbacks endured by Hamas and Hezbollah and the fall of the Assad regime in Syria. The nation's ability to defend itself against Israeli attacks has been severely degraded to being nearly non-existent. It may not have any choice but to capitulate to U.S. demands and agree to a highly intrusive oversight of its nuclear program.

There is also the possibility of a regime change. No one can be sure what that would look like. Unfortunately, regime change in a repressive state like Iran can be a messy affair as different groups vie for power. The Revolutionary Guard probably is in the best position to take over the country given its military and economic power. We would not be surprised if the country remains an implacable enemy of Israel and the U.S. The big difference is that Iran's nuclear program has suffered a significant setback. Taken as a whole, the profound changes in Middle East political dynamics should play to the advantage of the U.S. once the tension settles.

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