The Aerial View
Markets Update

Iran, the US & the USD

- USD not always a beneficiary of heightened US/Iran tensions
- CHF & JPY have typically performed well
- No uniform picture for realized volatility

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With tensions rising around the Strait of Hormuz continuing to rise, it’s worth looking at how the USD has performed during times of Iran/US-related stress.

1. 1979/1981 (Iranian Revolution/Tehran Hostage Crisis)

A: Timeline

• February 1, 1979: Ayatollah Khomeini returns to Tehran.
• November 4: Sixty-six Americans are taken captive in Tehran.
• April 24, 1980: US military attempts a rescue operation for the hostages.
• January 20, 1981: Algiers Accords signed leading to release of US hostages.
• April 7: US breaks diplomatic relations with Iran.

B: Impact on USD

• Overall, the period of the Iranian Revolution and the subsequent energy crisis of 1979/1980 represented the point at which the USD finally began to stabilize after eight
years of sustained losses.

• Where USD losses emerged they tended to be connected to US-specific issues (the taking of the Tehran hostages, Operation Eagle Claw) rather than oil price issues per se.

• A more substantial rally for the greenback began to build following the signing of the Algiers Accords.

C: Beneficiaries

• While the return of Ayatollah Khomeini to Tehran had little impact on realized volatility in either USD/CHF or USD/JPY, the start of the hostage crisis in November was associated with heightened volatility in USD/JPY (less so in USD/CHF).

Initially, the JPY and CHF performed rather differently, with the former weakening against the USD while the latter began to strengthen straight away.

A rather more straightforward pattern emerged at the time of the failed rescue operation in April 1980, with sharply heightened realized volatility in both currency pairs while the USD lost ground against both the CHF and the JPY (albeit with the more sustained move occurring against the latter currency).
2: 1984 (The “Tanker War”)

A: Timeline

• March 27, 1984: Beginning of the "Tanker War." Over the next nine months, 44 ships, including Iranian, Iraqi, Saudi Arabian and Kuwaiti tankers, are attacked by Iraqi or Iranian warplanes or damaged by mines.

B: Impact on USD

• The USD began an 11-month rally at almost exactly the point that the Tanker War broke out. Between March 27, 1984 and February 26, 1985 the USD Index rose 28%.

C: Beneficiaries

• In sharp contrast to late 1979/early 1980, the start of the Tanker War marked the point at which realized volatility in both USD/CHF and USD/JPY began to decline while the USD was broadly bid.

3: 1987/1988 (Operation Earnest Will)

A: Timeline

• 24 July, 1987 - 26 September, 1988: Operation Earnest Will launched to provide US military protection of Kuwaiti-owned tankers from Iranian attacks.

• October 15, 1987: Reflagged Kuwaiti tanker MV Sea Isle City is struck by an Iranian Silkworm missile while at anchor near Kuwait City.

• October 19: The US Navy responds with Operation Nimble Archer, shelling two oil platforms in the Rostam oil field.

• April 18, 1988: US forces launch Operation Praying Mantis, attacking the Iranian frigate Sabalan and oil platforms in the Sirri and Sassan oil fields.

• July 18: Iran agrees to a ceasefire.

• August 20: Hostilities draw to a close.

B: Impact on USD

• The start of Operation Earnest Will preceded the end of a modest USD rally that had got under way in early Spring by a matter of days. The subsequent USD downtrend over the next five months saw the index lose 16%.

Although the stock market crash of October of that year was undoubtedly the primary driver of this move, it is always worth recalling that Operation Nimble Archer came on the morning of the crash.

• A rather different pattern emerged in 1988 following Operation Praying Mantis. The success of the operation was seen as being decisive in putting the US in a position to pressure Iran to agree to a ceasefire with Iraq. It is therefore important to note that the USD began a four-month rally in the immediate aftermath of the operation.

C: Beneficiaries

• Interestingly, while both the CHF and JPY began to gain ground steadily against the USD almost from the point that Operation Earnest Will began, there was little sign of sharply heightened realized volatility in either currency pair during this time.
This is doubly surprising when it’s remembered that the 1987 stock market crash occurred on the day of Operation Nimble Archer. What heightened volatility that did emerge was connected far more with the efforts to stem the USD’s decline that emerged in late December 1987.


A: Timeline

• February 28, 1995: The Pentagon announces that it monitored Iranian installation of
surface-to-air Hawk missiles in the Strait of Hormuz. The Iranians also take possession of and fortify the Abu Musa and Tunb Islands.

- January 30, 1996: Vice Admiral Scott Redd, commander of the Fifth Fleet, states that Iran test-fired a new anti-ship missile near the Strait of Hormuz on January 6. The missile is viewed as a threat to regional security by US naval forces operating in the area.

- December 18: Iranian Deputy Foreign Minister Abbas Maleki states that Iran supports the free flow of oil through the Strait of Hormuz, but reserves the option of closing off the shipping route if it is threatened.

**B: Impact on the USD**

- The USD fell sharply in the aftermath of the announcement that Iran had installed missiles in the strategically critical Strait of Hormuz, and it remained under pressure for two months after this.

  The pattern was repeated nine months later after the announcement that Iran had carried out a test-firing on an anti-ship missile. However, the impact was relatively short-lived.

- The subsequent Iranian promise to support the free flow of oil through the Strait proved a decisive turning point for both oil (sending it lower) and the USD (sending it higher).

**C: Beneficiaries**

- Consistent with this, realized volatility spiked sharply in both USD/CHF and USD/JPY in the aftermath of the Iranian announcement and remained elevated for the next two months.

  The CHF and JPY performed strongly from the day of the announcement. However, subsequent developments had a minimal impact on realized volatility while both the CHF and JPY lost ground.
Some Thoughts

It pays to be cautious when looking for simple overarching themes in past currency market activity during specific periods. There were, after all, a myriad of factors driving the USD throughout the 1980s and 1990s (not least US monetary policy itself).

Nevertheless, some consistent patterns have emerged over the past 40 years. The first is that, in the absence of direct US military involvement, the USD has tended either to stabilize or gain ground in the face of heightened Iranian activity (the “safe haven” effect).
The second is that the risk that the US will need to become involved militarily has, usually, been a fairly direct USD negative (a similar effect could be seen in the run up to Operation Desert Storm in early 1991). It’s also typically been connected to the JPY and CHF appreciating and, more often than not, heightened realized volatility.

The third is that if the US does become involved militarily then a decisive move to ensure victory (e.g. Operation Praying Mantis in 1988) has usually fed through into a stronger USD as well.

Please direct questions or comments to:

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