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The Iranian Surprise

On June 14, Iranian voters went to the polls and overwhelmingly supported Hassan Rouhani. Pre-election handicapping did not give Rouhani much of a chance but a series of events led to his unexpected crushing victory. Rouhani won just under 51% of the vote, eliminating the need for a runoff (presidential candidates must secure a majority to win). The next closest candidate was Mohammad Baqer Qalibaf, with 17%. The supposed front runner (and favorite of Ayatollah Khamenei), Saeed Jalili, secured a disappointing 11%.

The screening process for candidates (see WGR, 5/28/2013, [Elections in Iran](#)), which is performed by the Guardian Council, narrowed the field to eight candidates. Of this group, only one was a left-wing reformist, Mohammad Reza Aref. Six were considered hard-line supporters of Khamenei, and Rouhani was slotted as a moderate technocrat. The clerical leadership believed it had a field of compliant candidates; the primary worry was turnout. A low turnout would de-legitimize the new president. In fact, the turnout was large but the expected candidate did not win.

In this report, we will offer a short biography of the Iranian president-elect, discuss the campaign, analyze whether this outcome was a surprise to Ayatollah Khamenei and examine what this election means for Iran and the region. As always, we will close by discussing the ramifications of this situation on the financial and commodity markets.

Who is Hassan Rouhani?

Hassan Rouhani is a 65-year-old cleric and lawyer. He has studied both Shiite Islamic theology and law and holds advanced degrees in both. He is fluent in several languages. The key insight to Rouhani is that he is firmly in the establishment. He has been a member of the Assembly of Experts since 1999. This body is best described as the board of directors for the Supreme Leader; it elects the Supreme Leader and supervises his activities. He has been a member of the Expediency Council since 1991. This group is an advisory board for the Supreme Leader. Rouhani has been a member of the Supreme National Security Council since 1989. This body formulates national security policy, including nuclear policy. He has also been a member of the legislature (Majlis).

Rouhani was the chief nuclear negotiator from October 2003 to August 2005. During this period, he negotiated a suspension of uranium enrichment, which led to harsh criticism from hardliners. When Ahmadinejad was elected in 2005, he quickly replaced Rouhani. Rouhani's "decision" to suspend enrichment had raised hopes in the West that Iran may halt its current nuclear program. However, three key points should be noted. First, Ayatollah Khamenei is in charge of the nuclear program. A suspension could not occur without his approval. Second, the suspension occurred soon after U.S. forces quickly ousted the Hussein regime in Iraq.

The Iranian government had every reason to believe it was the next target of the Bush administration and wanted to take away the best reason for the U.S. to turn its military against Iran. Third, although enrichment activities appeared to have been suspended, other research continued which means that the rest of the program was not suspended. In effect, Rouhani was able to negotiate a temporary deferral of a key activity but was able to maintain progress toward completing the nuclear cycle. Thus, once the suspension was lifted, Iran would be able to make progress. Rouhani shows clear evidence he is a skillful negotiator.

Since he was a young man, Rouhani has been committed to the Iranian Revolution. He has worked directly with both Ayatollahs Khomeini and Khamenei, and is embedded in Iran's clerical establishment. He only appears moderate by comparison to the hardliners he ran against. At the same time, because he speaks in tones of moderation, he has credibility with the reformist and pragmatist wings of the Iranian establishment.

How did he win?

Although there is a tendency in the West to view Iran as a totalitarian regime, the reality is far more complicated. It is a theocracy that overlays an unelected clerical leader with a parallel elected government. The latter runs most of the day-to-day operations of the nation while the Supreme Leader approves and guides domestic policy and mostly runs foreign policy.¹ However,

¹ It is worth noting that Ahmadinejad actively supported the idea that the clerical leadership should only have an advisory role and that only elected officials have the legitimacy to conduct policy. Needless to say, Khamenei was not swayed by that argument. This disagreement goes to the heart of the Iranian theocracy and explains why the clerical class has turned against Ahmadinejad, who was clearly the preferred candidate in 2009.

elections, with the exception of 2009, tend to be rather open and campaigning does matter.

Rouhani ran a very good campaign. Instead of focusing on ideology, he promised to improve the economy. In debates, he hammered on Jalili, the current chief nuclear negotiator, accusing his poor negotiating tactics for giving the West the excuse for tightening sanctions. He issued his own campaign videos on the internet that allowed him to outflank the state-run media. However, even up to a few days before the election, Rouhani did not appear to have much of a chance.

A late endorsement by former presidents Rafsanjani and Khatami seemed to have swung the election. The former is considered a pragmatist and the latter is a reformist. It appears that up until these endorsements, turnout was expected to be low and one of the hardliners would likely win. After the endorsements, pragmatists, moderates and reformers threw their votes to Rouhani. In addition, after the endorsements, Mohammad Reza Aref withdrew, making Rouhani the only choice for a non-hardline voter.

Finally, the fact that none of the other hardline candidates would withdraw meant their votes were split among the rest of the group. The combination of hardline stubbornness, timely endorsements, stronger campaigning and the lack of liberal alternatives gave Rouhani a landslide.

Was this the plan all along?

In the aftermath of the election, the question of whether Ayatollah Khamenei had supported this outcome from the start was debated by analysts. The fact that the Supreme Leader encouraged people to vote before the elections, regardless of affiliation,

seemed to suggest that he may have decided that Rouhani would be a good candidate after all. We strongly doubt, however, this was the case. Khamenei's primary goal was to avoid a repeat of 2009; as such, he needed a high turnout and confidence among voters that the outcome reflected the will of the people. It should be noted that the Guardian Council, the body that approves the candidates for elections, eliminated any serious threats to the hardline clerics. It appears that Khamenei overestimated the popularity of the conservative hardline candidates and tactically had too many on the ballot. In addition, Rouhani's focus on the economy likely resonated with voters who are worried about the dire state of the Iranian economy.

Instead, we believe Khamenei actually "fell" into a good outcome. The landslide gives Rouhani democratic legitimacy. The president-elect is not a threat to the clerical system (unlike the current president, Mahmoud Ahmadinejad). Rouhani is clearly an establishment candidate. He appears non-confrontational and will work within the current system. At the same time, he is not a reformist in the mold of Khatami and so he will not be a threat to the current government structure.

What does this mean?

Simply put, the way the West and the Sunni powers in the Middle East deal with Iran has just gotten much more complicated and difficult. Ahmadinejad was almost cartoonish in his dealings with the region and the rest of the world. His belligerent statements about Israel and his confrontational stance on Iran's nuclear weapons program were extreme enough to allow the Obama administration to persuade the U.N. Security Council and the EU to agree to harsher sanctions. And, clearly, the sanctions have hurt the Iranian economy.

The mandate from the voters to Rouhani seems to be, "do what it takes to improve the economy."

At the same time, there is almost no chance that Iran stops its nuclear program. Iran cannot help but notice that Iraq and Libya, two nations that had nuclear weapons programs but failed to develop a bomb, have seen their governments ousted by Western forces. At the same time, North Korea, who has tested a nuclear device, remains unscathed. Based off this knowledge, the only guarantee Iran has of not being subject to forcible regime change is a nuclear weapon.

Rouhani is a skillful negotiator. He will project a conciliatory image that will divide the allies aligned against Iran. At the same time, he knows that the Iranian economy will struggle to improve without an easing of sanctions. Rouhani will argue that Iran has the right to nuclear power and that the West has mischaracterized its program as a weapons development plan. Thus, expect Iran to offer the West inspections and promises of not enhancing uranium enrichment in return for easing sanctions. The goal will be for Iran to reach the point of being able to technically make a bomb without completing the final assembly step that would likely trigger a Western military response.

Although we believe Khamenei wanted a different outcome, he may have accidentally gotten the best presidential candidate for Iran at this particular moment. If Khamenei lets Rouhani operate, look for Iran to make significant strides in improving its position.

Ramifications

Assuming the Supreme Leader allows the president-elect to become the face of Iran, the nations aligned against Iran will face a

formidable opponent. We would expect Israel to become increasingly isolated as Rouhani offers nuclear concessions that will allow Europe and the U.S. to back away from conflict but not completely ensure that Iran will never develop nuclear weapons. This change will likely bring some sanctions relief which will boost Iran's economy.

The situation in Syria will likely worsen as the U.S. arms the rebels. Syria is rapidly turning into a proxy war between global and regional powers. Iran is both directly and indirectly involved; it has sent Iranian Republican Guard Corps soldiers into the conflict and has "encouraged" Hezbollah into the fray as well. The West will likely settle on a never-ending conflict in Syria because it cannot support Assad or Jihadists taking control. A partition will be the most likely outcome; Rouhani won't be of much help in this area.

For the markets, oil prices are the most vulnerable to a reduction in tensions. The sanctions regime against Iran has been successful in undermining its economy and it will need a few years to recover. In this interregnum, its ability to project power will be rather limited. However, without economic recovery, Iran could be in serious trouble, so if we are correct and Rouhani is successful in achieving sanctions relief, it is an important first step on the road to regional hegemony.

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