

Goldman Sachs Exchanges

Iran Conflict: How Long, and How Bad?

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Allison Nathan: With the Iran conflict now in its fourth week, uncertainty around its duration and associated disruptions to energy supplies remains high amid continued swings between de-escalatory and escalatory headlines. So, how long could this conflict last? What's at stake for the key players? And what will it take to restore global energy flows?

I'm Allison Nathan and this is Goldman Sachs Exchanges.

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Each month I speak with investors, policymakers, and academics about the most pressing market moving issues for our Top of Mind Report from Goldman Sachs Research. This month I spoke with Sanam Vakil, director of the Middle East and North Africa program at Chatham House, Ambassador Dennis Ross who served as a Middle East advisor in five US administrations, and Vice Admiral Kevin Donegan, former Commander of the US Navy's Fifth Fleet.

I started out by asking Sunam what this conflict is about for Iran.

Sanam Vakil: For Iran, this is seen to be a regime change war with objectives of overthrowing or destabilizing the Islamic Republic in a significant way. So, the system or what remains of it is fighting for its very survival with the aim to spread the costs of the war horizontally and as widely as possible so that when offramps do appear, that this war is so costly for everyone that Iran could perhaps

obtain guarantees that it will not be repeated again in six months or a year or in a few years when external powers might think that the time is right to revisit another round with the Islamic Republic.

Allison Nathan: So, Iran is viewing this as an existential risk, right?

Sanam Vakil: Yeah. More than a risk. They weren't prepared for this war. They knew after last summer's war, the 12 Day War, that there would be a boomerang effect from the Israeli strikes and the US entry because no side in the war really achieved full victory. The war showed for Israel, that strikes on Iran were possible. And that Israel had the capability of inflicting damage.

The Israelis very much wanted to continue the war. But President Trump called time on the war after the B-52s struck at Iran's nuclear facilities. And Iran also after the war ended calculated that it conceded to the ceasefire too early. And so, there were perceptions that Iran was weak. And that opened the door to this thinking that because Iran was weak, this was the perfect opportunity to go for another round.

Allison Nathan: Right. So, they're fighting against that perception. But from the beginning, President Trump has wanted to portray this war as a short-term conflict. How realistic is it that the conflict resolves soon?

Sanam Vakil: President Trump has shifted the aims and objectives and timelines of this war since it began. He first indicated that this was going to be quick and easy and that they would pause on day four or five of the war. And since then, the administration has been all over the place. And they quickly understood that Iran came ready for this war on February 28th. And since then, they've been playing catch up.

The costs of this war have spread quite significantly, not just through strikes across the Gulf States, but we've seen market impact on the energy side, the Strait of Hormuz while not formally closed, has been shut down, and the president is, in effect, locked in to a conflict that he'd like to claim victory on, but he hasn't quite delivered an outcome that he can claim victory for.

Allison Nathan: But Sanam, let me ask you, is it even up

to the US on when this war ends at this point?

Sanam Vakil: I wish it was that easy. But what the Iranians learned from last summer's 12 Day War is that this war also has to end in a conclusive way that benefits the Islamic Republic or what's left of it. What are they trying to achieve? They're trying to survive. And they're trying to guarantee their longer term survival through some kind of agreement that will prevent another round of conflict from emerging.

And in tandem to that, of course, they have right now some very extreme zero sum demands. But ultimately, what they really need is sanctions relief. And that is going to require some sort of negotiation where both the United States, and the Islamic Republic make concessions over the same issues that were being discussed prior to the war. So, nuclear program and what's left of it needs to be addressed. And then a broader discussion on regional security. And only through that negotiation can we imagine sanctions relief.

Allison Nathan: But Iran is also bearing a tremendous cost in this conflict. So, how long can it continue to do so?

Sanam Vakil: There is a bit of military math going on here. If you look at it in terms of conventional math, the United States and Israel are the formidable military players in this war. They will succeed in destroying or degrading Iran's ballistic missile capabilities, its defense industrial complex. And take out what's left of Iran's nuclear program. So, from a military perspective, there's no doubt that the US will be able to declare victory.

But Iran has asymmetry in this war. So, it can use drones that are low cost in order to inflict damage. And it continues to do so despite the conventional military successes that Israel and the United States are making.

Allison Nathan: Let me look forward to how this all ends. There seemed to be hope from the Trump administration when this all started that given the domestic unrest in Iran heading into the war, the Iranian public itself would rise up against the regime and that that's going to be part of the resolution of this. At least that's what President Trump seemed to be hoping. What's realistic to expect from this perspective?

Sanam Vakil: For the Islamic Republic continuing this war also has a domestic motivation. The war allows for enhanced security across the country. It's important to remind everyone that there were serious protests seen in January. And those protests were brutally repressed in a very serious way.

Effectively, the system is trying to manage an existential external crisis and prevent an existential internal crisis. So, continuing the war allows for a heightened security environment internally as well.

But having said that, and also being conscious that the Islamic Republic is going to be severely weakened from a military perspective after this war, I still see them as of today as deeply entrenched and having the capability to repress internal dissent should it emerge. And that has to be juxtaposed to the Iranian opposition, both internally and externally, that is wholly divided and very unprepared to present a so called "day after" alternative to an entrenched regime.

So, I certainly see more protests. But a revolution is very hard to build. And it requires mobilization, unity, and

planning. And in the context of a war underway, it doesn't look favorable for revolutionary conditions.

Allison Nathan: So, you don't see a scenario where domestic unrest hastens the end of the war?

Sanam Vakil: No.

Allison Nathan: So, Sunam, what are you watching most closely to see when and how this could all end?

Sanam Vakil: I think we have to be watching Iran's appetite for further escalation. Right now, Iran continues to respond and obstruct, particularly Gulf economic activity. The Strait of Hormuz still has not been, you know, quote/unquote, "opened." And so, that's what I'm most watching for. I'm also watching for statements indicating that there is an interest in an offramp. And it's not the statements themselves, but the terms and conditions that the Iranians are messaging.

Right now, the demands are so out of left field that it's very clear they're not interested in ending this war any time soon.

I would like nothing more than to tell you that this war will end with some kind of deal soon. My instinct and every time I hear myself talk, I know that I think this war is going to last much longer.

Allison Nathan: Next, we turned to Ambassador Dennis Ross and asked him what it will take to end the conflict.

Dennis Ross: I think the key is the following. It's the Strait of Hormuz. The president left to his own devices would quite probably have declared we've won. And even if the Iranians said, "Well, we don't agree and we're still here," he could claim success and say, "Look it. Here's all the targets we took out. Here's how much they can't go back to the nuclear weapon process or program. Their ballistic missiles have been set back dramatically. The same with the drones. They can't pose a conventional threat to-- to their neighbors for at least five years. So, we won."

But he can't say that if they still control the traffic in and out of the Strait of Hormuz. So, he can't end this war with them in that position.

Right now, the Iranians-- the capacity to threaten hasn't disappeared. But it's been dramatically reduced. And if we are able to establish convoys through the Strait of Hormuz, we put the Iranians in a position where they could no longer control who's coming in and going out. And at that point, Trump could declare an end to the war. The Iranians might say, "We're not agreeing." But they won't have a lot of different alternatives then.

Allison Nathan: But Dennis, as we sit here, the US hasn't established convoys and the Strait of Hormuz is still under Iranian control. If that remains the case, is a quick end to this war possible?

Dennis Ross: I think then it only resolves soon if there's an effective mediation. I don't think he can end unilaterally in a circumstance where Iran has this complete leverage over the Strait of Hormuz. So, I think a mediation is the only thing that would produce it more quickly.

Even then, I still think that Trump needs to show we changed the reality in the Strait of Hormuz. Because if doesn't, if he can't show that, then it looks like he's the one

looking for a way out.

The other problem with a meditated outcome is that Ali Larijani was killed. If there was one person who embodied the leadership, it's not Mojtaba Khamenei. It was Larijani. Larijani is the one who had a relationship with all the different factions, including the Revolutionary Guard. If anyone was going to be able to orchestrate a move to end the war through a meditation, it would have been Larijani. Pezeshkian doesn't have the same kind of access to all the different factions. Doesn't have the same kind of authority or credibility. And there isn't really anybody else, the equivalent of that. Maybe Ghalibaf who's the speaker of the Parliament. But right now, there is uncertainty in terms of where the authority lies.

Allison Nathan: So, Dennis, what are you watching to gauge whether this can resolve any time soon?

Dennis Ross: I think it comes down to both the Russians and the Chinese. The Russians can play a major role in terms of being a mediator. The Chinese, though, can put more pressure on the Iranians.

The Iranian position has always been if we can't export, nobody can export. But right now, they're saying, "We can export. And we'll determine who else can export." The minute the US would say, "If we can't export out of there, our friends can't export out of there, you're not going to export," that would create huge incentives for the Chinese to say, "Hold the phone. Now you're hurting us." And they have a heavy dependency on Middle East oil.

So, I'll be looking to see what do the Russians and the Chinese do. I'll also be looking to see how soon we're able to do more to limit what the Iranians can do in terms of threatening who can move in and out of the Strait of Hormuz. That really, for me, is a pivot point.

Allison Nathan: So, clearly the Strait of Hormuz is key here. I asked Vice Admiral Kevin Donegan whether the US and its allies had the capability to open the strait.

Kevin Donegan: Can we get through it? Yes. And I can say this with some confidence, and let me tell you why. We spend a lot of time planning for a contingency, along with other nations, on if Iran in the past had declared the straits closed, we had built plans to then get ships through there.

We've had this contingency for a long time before I was director of operations of CENTCOM , well before I was Fifth Fleet Commander and we would rehearse elements of it quite often. Right?

Most recently was last year where we had 30 nations come together. And the Fifth Fleet Commander knows exactly what each nation can do. Because of the fact that we've rehearsed this exercise each year for the past 15 years, we now know what each nation can really do. And the higher end contributors going to be, if they were to participate, France has ships that are equally capable. Australia has ships that are equally capable.

When I say equally capable, maybe not the same quality and training and experience that the US has, but France is very experienced because of their fight against the Houthis. The Greeks have gotten tremendous training because of the Houthis in particular. So, yes, France, UK, Greece. If Turkey were to participate, they can as well. Egypt as a tier below that. Australia, absolutely. Japan, absolutely. The Koreans, absolutely. Others can contribute. Officers. The staff. The team that's doing the scheduling, etcetera, etcetera, etcetera.

But if you can think about creating a moving sanctuary of security that moves with the convoys and sails through the straits, and not just through the straits, but from the northern part of the Gulf wherever they assemble all the way through. Not hard to do, especially if it's sequenced after this operation is over because now all those assets that are there can be focused on this mission.

And the second thing, we have now complete air superiority over the Iranian coast. And with our plan that I described before, we never had that. Right? Because we didn't have attacks on Iran that preceded us building a plan to be able to do this.

But if you think about a layered defensive plan that includes drones overhead the coastline, airplanes flying at will, helicopters in close, ships, satellite assets, intelligence, cyber warfare, and you think of all of that to protect a convoy as it's going through with an Iran that has no radar anymore, is going to have to use other cueing methods to find the right assets. Not hard to do because they know where they're going to end up, right? So, they can focus in certain places. They'll have visual observers out there.

But we're going to have a lower tolerance for allowing all the little boats out in the water that we did before. When we built this plan before, we assumed all the dows that were out there in the waters were there reporting back to Iran exactly where we were. We'll probably have a little tolerance for accepting those there.

Allison Nathan: But Kevin, even if convoys could allow some ships to pass through the strait, is that really a solution here?

Kevin Donegan: To be frank something like this, would never be to replace the flow of oil out of the straits, it can't be done. You need a good number through the straits a day. And convoys don't just have to get escorted out, they have to get escorted back in. So, what are you going to get? Maybe 20 percent of the normal flow. It really depends on what the Iranians start doing after the first one.

It goes to the point that there won't be an on/off switch that the war stops on Tuesday oil flows on Wednesday. I don't see that scenario happening at all. I think the shipping companies, the insurance companies, the

tankering companies, the LNG companies, they're going to need lag time to sort out what's really happening, what's the threat. Iran said no, but did they really mean it? There's going to be a trust component relative to Iran because of what they've been doing thus far. So, they're going to have to see how that plays out before they start committing to passage.

Allison Nathan: So, it sounds like for oil flows to return to normal, Iran is going to have to stop threatening ships. But is it motivated to do so at this point?

Kevin Donegan: Eventually. They have to turn inward here and start getting after their own problems. Right now, it's a question of how much is the IRGC controlling this? One of the problems with taking out leadership like was done here is that is where the folks that, even though they're hard liners, are much more seasoned in the longer term look than the IRGC, which may just be focused on what they know their task is. Those people are always there. But there's always also been the seasoned folk that want Iran as an entity to still move on, not only with them in control, but they also know they have to do better at taking care of their people.

But think about it through the lens that their number one thing is regime survival. It's not closing the straits. It's regime survival. Then in the end, they also know that when this is over, they have an economy that's in collapse. They have a people problem they're going to have to deal with. And they're going to need cash. And sanctions have not gone away. That's their issue.

There are cards that the US can play in this too. Iran knows that the US holds Kharg Island hostage. And without Kharg Island flow, they can't get anything through. Iran knows that we could stop that in a second if we chose to. We could also just stop the shadow fleet carriers on either side of the gulf that are moving Iranian oil.

Allison Nathan: My conclusion from all of this is that it's going to take time for this conflict and the energy disruptions it's caused to end. But as with any event that involves politics, anything is possible. So, we'll keep watching this closely.

Let's leave it there. My thanks to Sanam Vakil, Ambassador Dennis Ross, and Vice Admiral Kevin Donegan. And thank

you for listening to this episode of Goldman Sachs Exchanges. I'm Allison Nathan.

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