VERITYIRAN.COM
LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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January Overview

New US measures increase pressure on Iran to return to the negotiating table

The Iranian government appears to be willing to return to the negotiating table and is pushing for talks with the E3+3 over Iran's controversial nuclear programme to resume as soon as possible.

The sudden urgency from Iran is likely fuelled by fears over further sanctions measures being introduced by the US imminently. On 6th of February, an additional US measure passed in June 2012 will come into effect which will prohibit international banks from handling payments on behalf of 3rd countries purchasing Iranian oil. Effectively, this will mean that revenues generated from the sale of Iranian oil will remain in accounts in the country purchasing the oil and will only be accessible to Iran for the purchase of goods and services from that country i.e. barter. This will apply in particular to Indian oil companies which currently remit EUR payment to the National Iranian Oil Company through Turkey's Halk Bank.

It is expected that international banks, including Halk Bank, will comply with the US measures which could have a number of negative consequences for the Iranian economy. In particular, there is a high risk of Iran's access to its foreign exchange earnings being significantly curtailed, and investors should be alert to the possibility of a further sharp fall in the value of the Rial if this happens.

At the time of going to press, it remains unclear if and when representatives of the Iranian government and the E3+3 will next meet, and whether significant steps forward between the two sides can realistically be expected. If talks are not resumed soon, it is unlikely any meaningful progress will be reached on this front before the Iranian presidential elections currently scheduled for June 2013. This failure to act now to adequately address Iran's significant financial difficulties carries substantial downside risk to Iran's economic outlook.

Oil overview

Based on figures produced for 2012, Iranian exports of crude oil saw a year-on-year decline of over 20 percent to all of Iran's key markets, namely China, India, Japan, and South Korea, in line with US measures aimed at steadily reducing these countries' reliance on Iranian oil. Looking forward to 2013, unless a breakthrough is reached over the nuclear impasse, VERITY expects the US to continue to require, and importers to continue to comply with, further reductions in oil imports of around 15 percent every 180 days.

Currency overview

The last weeks of January has seen the Iranian Rial once again lose value, slipping to just over IRR35,000:USD1 at most exchange houses. Uncertainty over the Central Bank of Iran's (CBI) competence to stabilise Iran's struggling economy, together with intensified clashes between the Parliament and the Executive led to a fall in investor confidence and a further weakening of the Rial. These clashes culminated in calls for the removal of CBI Governor and Ahmadinejad place-man Mahmud Bahmani following allegations that the CBI illegally withdrew over USD 1 billion from commercial banks in one night. VERITY expects such in-fighting to continue until Ahmadinejad steps down as President in June and we hold by our prediction that the Rial will fall to IRR50,000:USD1 over the coming months.

VERITY Exclusive: Inflation climbs above 70 percent

Iranian officials have been more candid of late in admitting that the domestic rate of inflation is a serious problem. In early January, officials stated that the rate had now climbed above 27 percent and is still rising. However, VERITY has learned that economic officials privately assess that, following the depreciation of the Rial in the summer and autumn of 2012, the true rate of inflation is currently in excess of 70 percent across Iran.

The obvious consequence of such a high rate of inflation is severe downwards pressure in real wages, with few, if any, wage settlements rising in line with the real rate of inflation. The CBI's inability to control inflation has resulted in the cash payments, introduced in 2010 following the removal of subsidies on consumables and energy, failing to adequately compensate households for the rise in prices leading to a steadily increasing cost of living.

Lack of funding delaying South Pars development

Iran's development of the giant South Pars gas fields is experiencing further difficulties due to insufficient funds being allocated and seeming reluctance by international contractors to fulfill their obligations.

Iranian Minister for Oil Rostam Ghasemi recently threatened to sever ties with China National Petroleum Corporation, who were awarded the contract to develop Phase 11 of South Pars in 2010, if work had not progressed satisfactorily by March.

Iran's continued delays in exploiting their section of the South Pars/North Dome gas-condensate field, the largest such field ever discovered which is shared jointly with Qatar, has again raised concerns over migration of gas from South Pars to Qatar's North Dome field. The North Dome field is being exploited at twice the rate of South Pars, and which is, at a conservative estimate, contributing USD 50 billion per year to Qatar's booming economy.

US Oil Boom Pressure on Global Oil Prices

Opinion among experts continues to be divided over where the global oil price is heading in 2013. Few are predicting a significant price rise; however, a growing number of industry reports are pointing towards a possible and significant drop in the oil price due to rising production and stagnant demand linked to the continued economic down-turn affecting most developed world economies.

Credible observers of the current US shale-oil boom are predicting strong downward pressures on global oil prices. Although controversial, new studies predict major disruptions in prices. One recent study by Leonardo Maugeri, the former head of strategy at the Italian company ENI, sought to assess recent increases in global oil production capacity. Maugeri concluded, "Contrary to what most people believe, oil supply capacity is growing worldwide at such an unprecedented level it might outpace consumption."

Maugeri, a senior fellow at the Geopolitics of Energy Project at Harvard's Kennedy School, analyzed the world's big oil projects and found that additional production of about 49m barrels per day (bpd) of oil were being targeted for 2020, more than half the world's current production capacity of 93m bpd.

OPEC is watching the US oil boom with apprehension, and rightly so: it is the greatest threat to OPEC's power since the fields of Alaska and the North Sea were opened up in the 1970s. Consider the graph below, which tracks historical oil prices. Note in particular the period from 1980-2000. During this time the Alaska and North Sea oil fields came on-stream and led to an oversupply of oil. OPEC tried to maintain prices by curbing output, but cheating by individual members led prices to fall. A similar situation may currently be emerging.

As US and global fracking production grows, OPEC members will be forced either to restrict expected growth in their output – whether by slowing investment in new capacity or holding more unused capacity – or accept a much lower price for oil.

This development likely introduces a higher degree of risk for current Iranian government negotiations on international sanctions, with the domestic budget already at breaking point following a decrease of close to 50 percent in revenues generated from oil in 2012. Investors are urged to monitor this trend carefully as the loss of government revenues resulting from such a drop in oil price would have major consequences for domestic companies, in particular banks.

Statistics

GDP Growth
-0.9% (IMF estimate for 2012)

Inflation
Estimated at c.70%+ across Iran
vs. Official figure: 27.8%

Liquidity Growth
Estimated to be 25%+ for 2012

vs. 21% (Official estimate)

Unemployment
Between 30-35%
Vs. Official figure: 14.1%

Exchange Rates
Rial:USD
CBI figure: IRR12,260:USD1
vs. Unofficial rate: c. IRR35,000:USD1
vs. Estimate for March 2013: IRR50,000:USD17