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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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Stockmarket Tips

Iranian banks continue to come under pressure. The US is introducing legislation that will prohibit international banks with US clients from offering correspondent banking services to Iranian banks. This will make it difficult for Iranian banks to access the international financial system. In May the EU sanctioned Europaische-Iranische Handlesbank (EIH), denying the Iranian government and banking sector its most important channel for processing payments in Europe. We have heard that Bank Tejarat will soon be sanctioned. In Turkey several Turkish banks are refusing to do business with Bank Mellat.

Sector recommendation: We maintain our SELL recommendation on the banking sector.

The Iranian government is concerned that, following subsidy reforms, many customers are refusing to pay their utility bills, and that utility companies may have to reduce bills for some of their poorest customers. Companies such as MAPNA (MAPN1), a provider of electricity, are likely to have to absorb some of these costs.

SELL MAPNA

Insights – Currency

As predicted in our April newsletter, the Iranian currency has experienced further turbulence with the unofficial rate falling sharply to 12,300 Rials to the US Dollar (USD). This was the lowest point since September 2010, when the UAE stopped Dirham trade with Iran. The official rate also corrected, reaching a low point of 11,200 Rials to the USD. The large differential between the official and black market rates (recently fluctuating between 10% and 20%) is due to the inability of the Central Bank of Iran (CBI) to defend the Rial, because it does not have enough foreign currency to supply the moneychangers (serafi). Not surprisingly, the Rial was officially devalued on 8 June to 11,750 Rials to the USD. We expect the large differential in rates to persist, and our new target for the Rial is 14,000.

The Iranian gold market has also experienced turbulence, with continued shortages leading to domestic gold prices now being in excess of international levels. The CBI is trying to import more than USD 200 million worth of gold through Switzerland and Dubai to melt down into gold coins. We expect the Rial to continue its depreciation against gold.

Insights – Funding the Budget

Economists are puzzling over how the Iranian government will be able to fund the budget, as insiders in the oil industry are saying that Iran's principal customers for its crude oil are not paying for it. China, which accounts for 19% of Iranian crude oil sales, has stopped paying Iran for crude and insists that it will only pay through direct investment into the Iranian oil sector, or through barter trade. Iran has therefore been unable to realize more than USD 20 billion in cash revenues in oil sales to China.

Although Iran can barter crude oil for Chinese consumer products, it will find it much harder to do so with India. Iran's exports to India outnumber Indian exports to Iran by a factor of 10:1. India accounts for 17% of Iran's crude oil sales and is no longer able to pay for its Iranian crude through the Asian Clearing Union. India is building up a debt to Iran of over USD 1 billion a month.

Furthermore, oil majors such as Total and Shell are insisting that Iran settle billions of USD in outstanding contractual obligations in crude oil sales, fixed at a price at least 40% below the current spot price. If Iran is not receiving money for its crude oil sales from its principal customers, it is difficult to see how it can fund its budget for the Iranian year 1390 (March 2011 – March 2012). The 1390 budget has seen a 41.7% increase in volume over the budget for 1389.

The Budget Bill, signed off at the end of May, forecast that the Foreign Exchange Reserve Account (FERA) would meet USD 12 billion, or 7.4% of the government general budget. This seems unlikely given that there is currently less than USD 3 billion in the FERA. The government also expects to raise 14% of the budget through privatisations, which may not be possible if the Tehran Stock Exchange undergoes a much-needed and long overdue correction.

Insights – Inflation

Our economists expect that the Iranian government will have to print money to fund both the expansionary 1390 budget and ongoing subsidy payments. Inflation for the first quarter of 1390 was 20% compared with the last quarter of 1389. In May, Ahmad Tavakoli, Head of the Majles (Parliament) Research Centre, warned of 40% inflation this year. Even that figure seems conservative, if further quarterly increases match that of the first quarter of the year. The Iranian government's worst-case estimate of 70% inflation post- subsidy reform now seems plausible.

Statistics

GDP growth
-1% (2011 best case estimate)
vs. IMF estimate 1%

vs. CBI estimate 3.5-4.5% 1388

Inflation
1Q 1390 20% vs 4Q 1389
1390 (F) 70%

Liquidity growth
24% (2010 estimate)

Unemployment
Over 35% in much of the country

Forex Reserves
> USD 80 billion

Foreign Exchange Reserve Account
(Oil Stabilisation Fund)
< USD 3 billion

Government and private sector debt to banks
USD 29 billion in Dec 2010