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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

Issue 66 January 2017

Iranian businesses taking the "long-view" despite new sanctions

Following a ballistic missile test, Iran has seen its first new sanctions of the US Trump administration. In the context of the past forty years of Iran-US bilateral relations, in fact the Trump administration does not yet stray far from trend. Iranian businesses are decoupled from the US market and appear to be taking the long-view. The course of Iran's economy will depend on whether it can convince the rest of the world of its commitment to the JCPOA and its reintegration into the global economy.

Iranian ballistic missile tests have sparked international controversy, leading to an urgent UN Security Council meeting and a set of targeted sanctions from the US. Iran denies that the missile tests breached the legal conditions of the UNSC resolution by which it is bound, but the new Trump administration responded aggressively to the missile launch. The US Treasury has imposed new sanctions on 25 individuals and companies connected to Iran's ballistic missile programme and/or providing support to the IRGC.

The Iranian reaction to the new sanctions, which they regard as breaching the spirit of the JCPOA, has been relatively sanguine. The Iranian Supreme Leader and other prominent figures have publicly criticised recent US policies, but there are few signs so far of an escalation that would undermine the JCPOA. The Rouhani administration has been on record stating the value of acting cautiously and refraining from giving the new US administration any excuse or pretext to intensify sanctions against Iran.

On the 38th anniversary of the Islamic Revolution, Iranian business leaders are accustomed to taking the long-view on US relations and foreign investments. Despite the short-term psychological impact of the new measures, investors are minded to view recent events in the context of a longer pattern of activity that stretches back to the Carter administration in 1979. Since President Clinton's total trade and investment embargo in the 1990s, Iran's trade and investment prospects have decoupled entirely from the US market and still thrived in the rest of the global economy. It was only under the Obama administration's extra-territorial sanctions-regime,

Fig 1. TEDPIX All Shares index
20 March to present

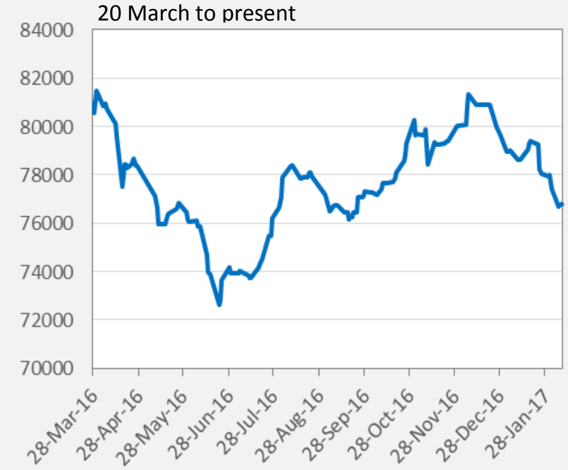
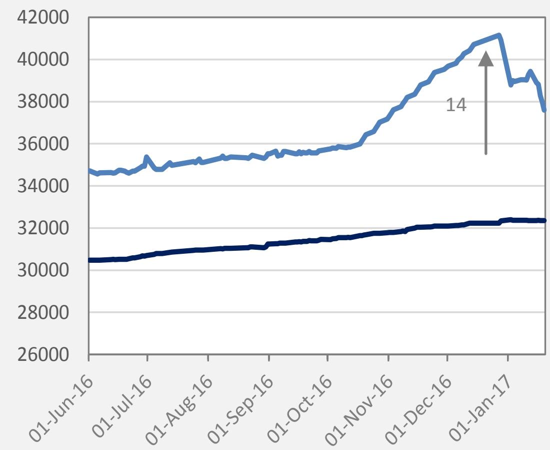


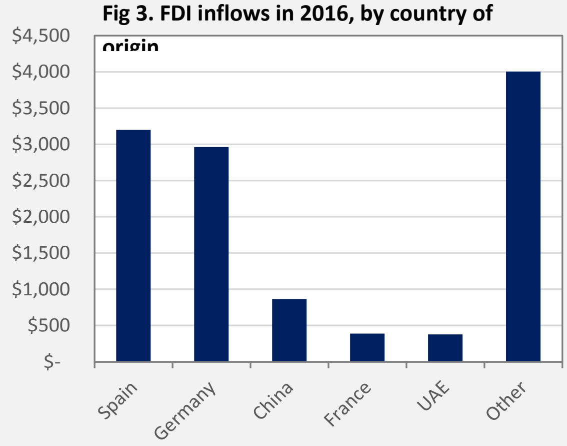
Fig 2. Rial to US dollar exchange rate
Official rate (dark) and market rate (light)



which won the collaboration of the world's major economies and finance centres, when that long term trend was destabilised. With Iranian oil output now back to pre-2012 levels, the business community appears relatively at ease with the new US administration's announcements because, up to this point, they do not themselves change the course of Iran's economy. Iranian business leaders believe that Iran's economic prospects will depend on whether it can continue to convince the rest of the world that it is adhering to the JCPOA and open for business.

Iran's 6th five-year development plan was released last month, based on a highly ambitious projected inflow of $22bn per year of foreign direct investment. The figure appears to be aspirational given that Iran has only received half this figure ($11.8 billion) since the JCPOA was implemented over one year ago. A breakdown of the origin of these investments (Fig 3) shows the importance of the non-US members of the P5+1 countries, which negotiated the JCPOA with Iran, in achieving that target and underlines the importance of the deal to Iran's economic trajectory.

Fig 3. FDI inflows in 2016, by country of origin



The Tehran Stock exchange registered significant losses in January but these were not ostensibly linked to rising tensions with the US. January's 2.3% loss (Fig 1) can be largely attributed to a general global downturn, compounded by the return of a set of large Iranian banks to the market that have been suspended for the past six months while they upgraded their reporting standards. Bank Mellat lost 37.5% of its share value in one day, when the TEDPIX reopened its ticker for trading.

Meanwhile the Iranina rial has strengthened over the past month, following a dramatic deterioration in November and December. Analysts point to a number of forces behind the sudden weakening, from a seasonal "new year" boost in consumer demand, to the outcome of the OPEC meetings and President Trump's election. The government has rebuffed accusations from some quarters that it is resorting to Ahmadinejad-era tactics of manipulating the currency to balance the books. A weaker rial is a problem for the Rouhani administration as it nears March's election as it pushes up the price of domestic consumer goods.

Central Bank Governor Seif warned that the enormous, and rising, share of bad loans in the banking system continues to pose a substantial macroeconomic risk. Seif blamed the growth in unpaid loans on an overreliance on the banking system "to solve the country's structural economic problems", which stem from weaknesses in the financial market. He called on banks to revise their lending practices and to increase their efforts to collect on unpaid debts. Debts to the Central Bank broke the 100 Trillian Toman Mark (approx. US$31 billion), having grown by more than 20 percent in the last 6 months. Government debt to the Central Bank has grown from around US$13 billion 5 years ago to more than US$35 billion this year (Fig 4).

Fig 4. Debts outstanding to the Central Bank of Iran