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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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Latest US sanctions further restrict Iran's access to international trade

On the 6th of February, the US implemented its latest series of measures designed to further increase pressure on the Iranian government to comply with international demands regarding concerns over Iran's nuclear ambitions.

The most significant of the measures introduced, which target Iran's shipping and electronic industry among others, are the restriction on the movement of revenues generated by Iran from the export of its crude oil, and on the movement of precious metals into Iran.

Both of these measures are likely to hit bi-lateral trade between Iran and Turkey hard; not only will the measures curb Turkey's use of gold to cover payment for Iranian gas imports, they will also prohibit the payment mechanism currently used by India whereby Indian customers pay 55 percent of the cost of their imports of Iranian oil into EUR accounts with Turkey's Halk Bank.

As expected, it appears as though the authorities and organisations affected are taking the requisite action in order to comply with the new US measures. According to our sources, at the start of February Turkey's Halk Bank ceased accepting EUR payments from Indian customers importing Iranian oil.

Pressure on oil exports expected to increase

In contrast to press reporting that suggested that Iran's oil exports have remained stable at about 1 million barrels per day (bpd) over recent months, VERITY has learned that the true figure for oil exports in December 2012 was as low as 700,000 bpd. The discrepancy could be due to Chinese and Turkish customers lifting part of their allocations from oil shipped previously and stored in facilities in Malaysia and Egypt.

More worryingly for investors in Iran's oil sector is the lack of funds available to the National Iranian Oil Company (NIOC) to maintain production at even the current, much reduced level. VERITY has learnt that funds accrued by NIOC's internationally sanctioned trading arm, Naftiran Intertrade Company, which were previously re-invested in to the oil industry, are now largely being diverted to the Iranian Treasury to fund the import of basic goods and medicines to Iran. VERITY understands that funds allocated for maintenance and repairs of Iran's oil rigs and associated equipment are woefully inadequate and will force Iran to further reduce production, and perhaps in the case of certain wells, cease production altogether, before the end of 2013. Investors should anticipate a further reduction in Iranian exports of between 100,000 and 200,000 bpd by late 2013.

In our medium-term assessment for the Iranian oil sector there is little ground for optimism: Iran's key customer base will remain constrained by US measures which threaten damaging penalties for countries which do not display a significant commitment to reduce the amount of oil they import from Iran; and Iran's efforts to identify new customers have for the most part been frustrated by the inability to establish workable payment methods to pay for oil imports from Iran.

Increased Military involvement in the oil sector to replace foreign partnerships

As Iran's economic crisis has deepened, and foreign investment and cooperation, constrained by international restrictions, has decreased, an increasing number of state contracts and licences are being awarded to Iran's military and security services increasing their dominance of Iran's domestic economy at the expense of companies not enjoying the patronage of the state.

VERITY has learned that the Iranian military have been provided with a separate allocation of 250,000 bpd of crude oil in the hope that they will be able to utilise their network of front companies and facilitators to sell the oil and bring in much needed revenue on behalf for the Iranian Treasury.

In addition, it was announced that Iranian consortium Khatam ol-Osea, which includes the IRGC-controlled construction firm Khatam ol-Anbia, had been awarded the contract to oversee the development of Phase 11 of the South Pars gas field development project, a contract which had previously been held by China National Petroleum Company (CNPC).

The Rial slips to an all time low ahead of additional US measures

In the lead up to the implementation of the 6th of February US measures, the Iranian Rial (IRR) was being traded at some UAE exchange houses at an all time low of IRR40,000:USD1, reflecting fears that the further limitations on Iran's access to foreign revenues generated from oil sales will see the value of savings diminish once more.

The situation has been exacerbated by continued and ever more vociferous criticism of the Ahmadinejad government's management of the economy which President Ahmadinejad appears to be meeting with his trademark defiance and renewed attacks against his political rivals, in particular the powerful Larijani family, three of whom hold high-ranking positions with the Iranian system.

Rumours of renewed efforts by the Ahmadinejad government to implement a second phase of the subsidy reform programme before June's Presidential election have done nothing to ease relations. Despite public support for increased payments to households which would better reflect the rising cost of living, the Majlis remains strongly opposed given the already precarious state of the budget. Officially citing the negative impact previous programmes have had on the rate of inflation, the Majlis is also concerned to avoid allowing Ahmadinejad the opportunity to boost his popularity before election day. VERITY expects the in-fighting to continue at least until Ahmadinejad steps down as President in June.

Statistics

GDP Growth
-0.9% (IMF estimate for 2012)

Inflation
Estimated at c.70%+ across Iran
vs. Official figure: 31.5% (by the end of March 2013)

Liquidity Growth
Estimated to be 25%+ for 2012
vs. 21% (Official estimate)

Unemployment
Estimated at between 30 – 35%
Vs. Official figure: 14.1%
Vs. Official figure for youth unemployment: 28.6%

Exchange Rates
Rial:USD
CBI reference rate: IRR12,260:USD1
Currency Trading Center rate: c.IRR24,500:USD1
vs. Unofficial rate: c. IRR38,000:USD1