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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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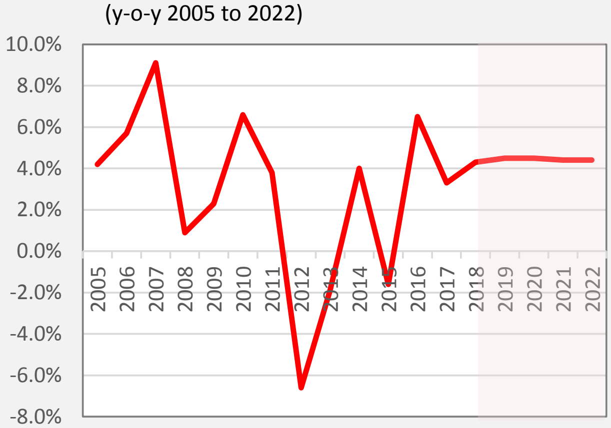
IRGC the enemy of "trust" in the Iranian economy

The Iranian President placed "trust" at the heart of this year's annual Norwuz address. Trust in the banks, in businesses and in policymakers is crucial to investors home and abroad. But it is being undermined by the dominant role of the IRGC and other military actors in business and the financial sector. The IRGC's brazen involvement in criminal activity, such as the industrial-scale counterfeiting of Yemeni banknotes, is an example of the difficulties legitimate Iranian businesses face establishing a reputation overseas.

President Rouhani ushered in the Norwuz celebrations with a self-congratulatory speech, in which he identified "trust" as the key to Iran's success over the coming years. Saying little to address head on the largescale unrest that characterised the second half of the year, Mr Rouhani dwelled on the economic issues that were largely behind it. The President drew attention to his government's "economic successes" in creating two million jobs (albeit not materially reducing unemployment or underemployment), growing the economy (albeit at a slowing rate) and achieving a second successive year of single digit inflation. Mr Rouhani continued to advocate his government's sensible economic reform agenda and claimed that creating trust amongst domestic investors, ordinary people and foreign investors in their economic management was key to success.

The President's comments could be seen as a thinly veiled critique of the excessive involvement of the IRGC and other military actors in the economy. The heavy hand of the Iranian military – and the IRGC in particular – is causing long-lasting damage to Iranian economic prospects. Through corruption, nepotism, skewed investments and inefficiency, their presence across many sectors undermines competition and innovation, and therefore the dynamism of enterprise. In turn, it stifles the government's ability to create jobs over the long term.

Fig 1. Real GDP growth rate (IMF)
(y-o-y 2005 to 2022)

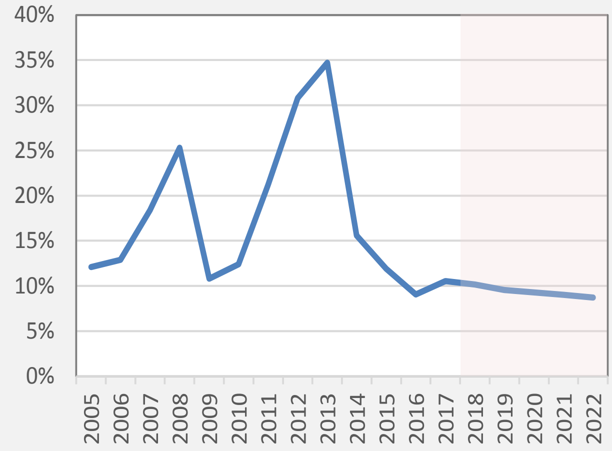


The IRGC Quds Force unabashed role in the counterfeiting of hundreds of millions of dollars' worth of Yemeni bank notes is a case in point. A US Treasury investigation revealed in November, a European based network of individuals and front companies operating under the instruction of Brigadier Qasim Soleymani's IRGC Quds Force in European countries to facilitate the fraud. German-based Reza Heidari, managing director of Pardavesh Tasir Rayan Co., which was owned by holding company Tejarat Almas Mobin Holding, was tasked with procuring the required equipment and materials from unwitting European suppliers. According to the US Treasury statement, Seif has previously supplied weapons to the IRGC.

This behaviour is highly damaging in the eyes of international financial institutions and investors. Firstly, this poorly planned Qods Force project, particularly in using an individual previously known for illegally supplying weapons to the IRGC, directly affects the willingness of partners to work with civilian institutions like the CBI and challenges the work of the President. This is seen as a state entity engaged in highly criminal activity, undermining the international financial governance to which all other nations adhere. Secondly, it is also a deception of European business partners, which could end up black-listed in their own right, taking place right under the nose of European regulators. These experiences instill fear in international businesses and their governing structures about engagement with Iran. They poison the chances of legitimate Iranian businesses to prosper in overseas markets.

Fig 2. Inflation rate (IMF)

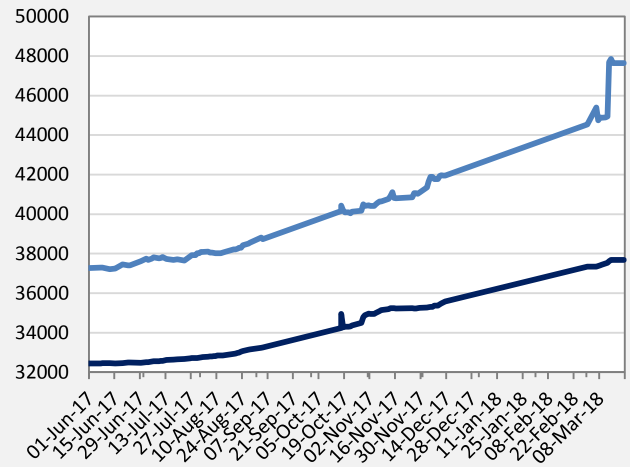
(y-o-y change in consumer price level)



The Central Bank of Iran (CBI) has announced plans to merge Iran's "military banks" by next Norwuz. According to the CBI, a plan has been actioned to formalise two unlicensed credit institutions, the IRGC's Samen Credit Institution and the Basij's Mehr Eghtesad Bank, under the umbrella of Ansar Bank, which is controlled by the IRGC Co-operative Foundation. Later, the CBI will merge this entity with licenced banks controlled by the Army, the Law Enforcement Forces and the Defence Ministry. It is unclear what this will all mean in practice. Whether it reduces the military dominance of the Iranian financial services sector, or ultimately consolidates power in fewer hands and increases the financial risk attached to it, will depend on how well the new entities are regulated and policed.

Fig 3. Rial to USD exchange rate

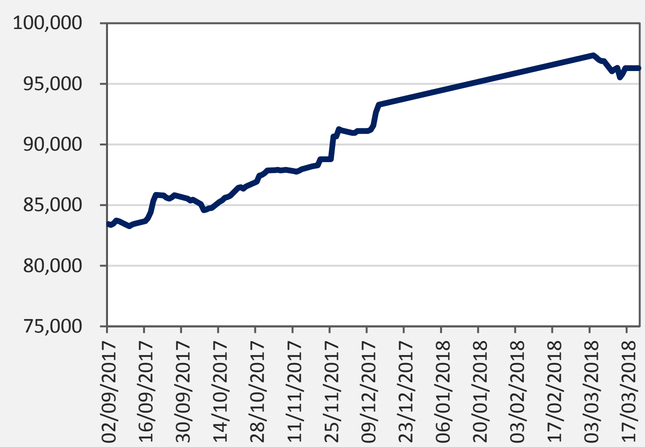
(Official (dark blue), market (light blue))



In the context of a hardening US stance on the JCPOA, which is influencing the European posture towards Iran, the banks are the battleground for Iran's economic survival. In his Norwuz speech, Mr Rouhani renewed his call for Iran's banks to clean up and catch up with the international competition. He claimed that trust had grown in recent years in the banking system – because some of the "cancerous cells" had been removed and capital adequacy had improved. But the sector needs discipline and transparency around an internationally consistent set of norms and practices to win trust. There are three bills currently sat with the Majles, aimed at money laundering, terrorist financing and a general reform of banking practices, which are three steps in the right direction. The President also called on the CBI to increase its monitoring of the financial system and to do so in a transparent fashion. Transparency is the difference between delivering short-lived returns and long-lasting profits.

Fig 4. TEDPIX (All Shares) Stock Index

01 Sept 2017 to present



Cleaning up Iran's financial sector is going to mean tackling "bad behaviour" at the highest level. There are institutional norms and practices, as well as greed, at the most executive level that aid and facilitate corruption more widely. For example, the Central Bank recently authorised a 20 trillion toman (approximately US$6 billion) credit line to sustain liquidity in the shadow banking sector. If this goes hand in hand with a formalisation of banking practices, then it is a step forward. If it just subsidises the misallocation, or theft, of capital by well-connected financiers then it overlooks the problems and adds fuel to the fire. The owners of bankrupt unlicensed credit institutions, like Samen al-Hajj, Afzal Tus, Fereshtegan, Alborz Iranians and Arman Esam, came into liquidity problems after having siphoned enormous amounts of cash into their own personal accounts and shady real estate holdings. The blind eye of the regulator can be just as damaging as the keen eye of the fraudster, and achieving a more transparent banking sector will mean tackling both.