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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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Iran preparing emergency rations programme as economic troubles mount

According to a leaked internal report produced by the Iranian government, officials are forecasting possible shortages of certain goods by the end of the Persian year (March 2013), and the introduction of rationing if prevailing economic conditions continue.

Despite publicly remaining defiant, officials have acknowledged privately that the rising cost of imports due to continuing financial and economic sanctions, combined with spiralling inflation would make rationing a necessity.

Measures such as these, which have not been seen since the Iran-Iraq war of the 1980's, would be a humiliating move for a country which boasts reserves of oil and gas to rival any country both within and outside of the Gulf region, and could lead to widening discontent among the Iranian populace over the political direction of the ageing regime led by Ayatollah Ali Khamenei.

The true rate of inflation as high as 90 percent as sanctions hit home

Central Bank of Iran (CBI) officials have agreed to connive with the government in continuing to publish statistics which mask the true extent of the economic crisis facing Iran. While the published figure for inflation would remain below 25 percent, the report estimates that inflation in certain regions of the country is running as high as 90 percent and, country-wide, the inflation rate is running at over 60 percent for basic food items as well as clothing and other essential items.

Combined with ongoing economic sanctions against Iran, the leaked report warned that if the second phase of the subsidy reform bill was implemented, inflation could spiral by as much as 200 percent and lead to hundreds of businesses going bankrupt resulting in a rise in unemployment of at least 7 percent.

An official CBI report for Persian year 1390 also revealed that approximately USD 30 billion worth of cheques issued by consumers and businesses in Iran had bounced, a 150 percent increase on the previous year. This was only serving to further weaken confidence in Iran's economy and had led to many bazaaris and other traders to cease business.

Rial set for a further slump as negotiations falter

In the immediate aftermath of the resumption in May of negotiations between Iran and the E3+3 over Iran's nuclear programme, the Rial strengthened to IRR16,500:USD1. The failure to reach agreement in Moscow has already caused the Rial to fall below IRR20,000:USD1. Officials within the CBI fear that the exchange rate will shortly depreciate to IRR25,000:USD1 as the negotiations stagnate. Looking forward, we expect a further sharp deterioration in the Rial as demand for Iranian oil slumps, and when both the US Congress and EU introduce further punitive measures against the Iranian economy which are likely to put further restrictions on Iranian trade, and to curtail the Iranian government's ability to exploit workarounds, such as Turkey's Halk Bank. We expect the new measures will cause a further run on the Rial, which could cause it to fall to as low as IRR50,000:USD1 (the Central Bank of Iran's estimate of the fair value for the IRR, if they are unable to support it).

Currency recommendations:

- We recommend that investors continue to buy US dollars.
- We continue to recommend that investors sell Japanese Yen, Sell Euros, Sell Australian Dollars, and the Brazilian Real.
- We have changed our buy recommendation on the Mexican Peso and the Chinese RMB to hold.
- We prefer Swedish and Norwegian Krone to Euros, but prefer USD to Krone.
- We continue to believe that Platinum is undervalued and is better value than gold.

Corruption investigation exposes top military official

VERITY has learnt that an official investigation into the disappearance of close to USD 2 billion from Parsian Bank appears to implicate one of the most powerful military officials within Iran. The Deputy Minister for Defence and Armed Forces Logistics, Ahmed Vahid-Dastjerdi, had diverted at least USD 1 billion of the missing funds for use by his department.

It was revealed that Vahid-Dastjerdi favoured the use of falsified invoices to raise letters of credit (LOCs), the same method which led to the embarrassing Amir Mansour Aria corruption investigations at Banks Melli and Saderat late last year. These LOCs which were being issued by Bank Sarmayeh were used to fund non-existent imports of commodities such as vegetable oil.

Plans to cut Iran's oil output by 500,000 barrels per day or more

VERITY can reveal that top officials in Iran's Ministry of Petroleum are considering decreasing oil production by 500,000 barrels per day or more due to the stockpile of unsold oil Iran has amassed which currently amounts to some 60 million barrels. The Ministry of Petroleum believes that the revenues lost by implementing such a measure would be offset in part by a resulting rise in the price of oil caused by taking the Iranian oil off the market.

Iran's decision to cut its oil output could also have the unwelcome consequence of it not being able to recover the market-share that it would lose as importers switch to alternative suppliers, especially Iraq and Libya whose oil output continues to recover as oil majors increase their presence there.

Outlook for global oil price

Taking advantage of Iran's difficulty the sell its oil, Saudi Arabia has raised production to its highest levels in decades and shows no sign of relenting, despite receiving fierce criticism at the recent OPEC Minister's Conference in Vienna. Some OPEC members fear that this could push the value of crude down to USD 80 per barrel by the end of 2012 and to USD 60 per barrel by the end of 2013, prices which would throw the Iranian economy into further turmoil.

Oil traders expect that the poor outlook for global growth will continue to depress oil prices: despite Chinese efforts to stimulate their economy, Chinese growth is moderating. The outlook for Europe remains very negative, and the US economy is growing less strongly than it was earlier in the year.

The price of crude oil dropped by over 40 cents per barrel over the last month and a half to below USD 100 per barrel (WTI: USD 83.02; BRENT: USD 95.19). Traders are also highly aware of a substantial overhang of supply (60 million barrels) building up in Iran, which may force Iran to sell its oil at a significant discount. This is also having a dampening effect on global oil prices.

New round of sanctions causes Iran oil imports to drop by 1mmbpd

The implementation of a further round of EU and US sanctions in late June/early July has seen Iran's oil imports drop by as much as 1mmbpd since the start of 2012.

EU Sanctions
The latest round of EU sanctions are already significantly denting Iran's ability to ship its crude oil. The sanctions prohibit companies registered in the EU from insuring Iranian vessels. As 95 percent or more of maritime insurers are registered in the EU, this has led to Iran being forced to put up billions of its own money as surety to cover its fleet against accident at sea. While the Indian Government is prepared to accept the Iranian insurance for its oil imports, other importers have made clear their opposition to such a move.

The Japanese and Chinese governments have chosen to put their own measures in place to insure shipments of Iranian oil themselves. However, the South Korean government (which accounted for 10 percent of all Iranian exports) has decided to cease all purchases of Iranian oil because it does not want to shoulder the additional insurance burdens.

US Sanctions

Anticipating the implementation of the Kirk-Menendez/National Defence Authorisation Act legislation in late June, customers have been scrambling to decrease their imports of Iranian oil and to find new suppliers in order to obtain an exemption from the US Treasury which had threatened to hit those countries that do not do so with tough financial penalties.

The US Treasury has granted waivers covering a period of 180 days to all of Iran's key oil customers and is satisfied, for now, that each importer has reduced its imports by between 10-20 percent. Once the 180 day period passes, the US will demand further cuts, likely to be an additional 20 percent, in order to secure another waiver.

Increasing use of barter trade to pay for Iranian oil

While they remain the two key import destinations for Iranian oil, both China and India are taking an increasingly hard line in demanding large discounts for their oil imports due to the added political and legal risk they are incurring.

In addition, China and India are paying for the majority of these imports in Renmimbi and Rupees respectively. The payment in Renmimbi in particular poses difficulties for Iran as, since the Renmimbi is not a reserve currency, Iranians are forced to use the revenues earned to purchase a limited selection of Chinese goods and services in return for oil.

Officials in Iran were said to be furious with the way China has repeatedly reneged on agreements to pay for its oil imports: At the end of last year, China had agreed to pay for 80 percent of its imports from Iran using foreign currency with the remainder being used for the purchase of Chinese goods and services; China cancelled this agreement at the beginning of the year unilaterally changing the payment terms to 50/50 between foreign currency and barter trade; Finally, in March of this year China announced that they would no longer transfer any of the money into Iran and that Iran's earnings could only be used for the purchase of Chinese goods and services. Iran is reportedly desperate to find alternative trading partners to China and is making overtures to Russia in particular in order for them to increase their purchases of Iranian oil.

Statistics

GDP growth
-2 % (2012 best case estimate)
vs. CBI : 5.8% (1389)

Inflation
Between 60-90%
vs. IMF estimate: 21.6% (by March 2012)
vs. Official figure: 21.5%

Liquidity growth
21% (Official estimate)

Unemployment
Over 35% in much of the country
vs. Official figure: 14.1%

Exchange Rates
Rial:USD
estimate for Summer 2012: >IRR25,000:USD1
CBI figure: IRR12,260:USD1
vs. Unofficial/Black-market figure: IRR20,000:USD1

Rial:Euro
CBI figure: IRR15,063:€1
Vs. Unofficial/Black-market figure: 25,500:€1