

Iran still a risky prospect for foreign banks

Constructive engagement at the highest levels leads to public assurances from the US administration about the legalities of doing business with Iranian banks. But Iranian authorities acknowledge the greatest problem facing the Iranian economy is inspiring confidence in Iran as a safe and stable investment environment. President Rouhani appeals for time to get it right.

The JCPOA was given a boost by the US Secretary of State's public assurances about the legalities of doing business with Iran. John Kerry met with representatives of European banks in London to discuss the issues involved in rebuilding relationships with Iranian entities. He attempted to clarify the distinction between the sanctions that remain in place and those covered under the JCPOA and said he wanted to "put to rest mere rumours about how the deal is applied".

The intervention came about as a result of constructive, bilateral discussions between senior figures in the US and Iranian administrations, which is a mark of how much bilateral relations have matured. The Central Bank of Iran's Governor, Valiollah Seif, used his attendance to the IMF and World Bank Spring meetings in Washington DC to meet with US counterparts. He reportedly asked them to take greater responsibility in resolving banks' uncertainties about Iranian transactions, arguing that Iran's access to the international trading system and dollars in international transactions were amongst the most important principles of the JCPOA. Iran's Foreign Minister, Mohammad Javad Zarif, also met with Kerry in the side lines of the UN Climate Change Conference in New York. Kerry's intervention is a positive step, although ultimately banks will look for assurances from the US regulatory and law-enforcement authorities as well as the State Department if they are to change their behaviour.

Even if more can be done to reassure foreign banks about the international legal risks they face from engaging with Iran, there are other sizeable obstacles to overcome. In response to Secretary

Fig 1. Tehran Stock exchange (TEDPIX All Shares Index)
Dec 2015 to present

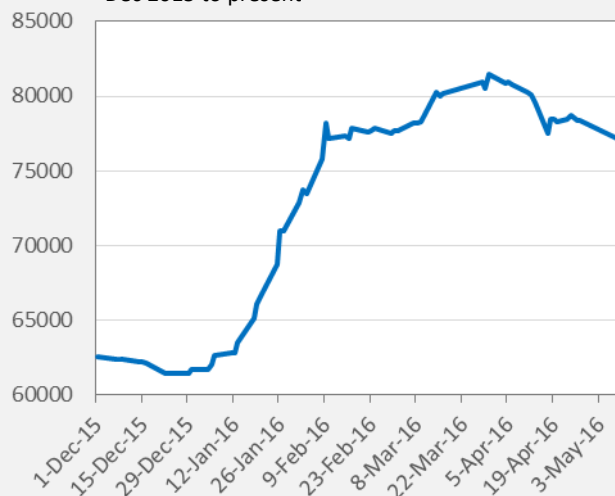


Fig 1. Brent Crude Oil Price \$/barrel
(Dec 2015 to present)



of State Kerry's outreach, banks made it clear that their international trading decisions are based on financial crime risk and the underlying conduct of its trading partners. Where banks have been unable to observe a change in behaviour among the Iranian entities that were until recently black-listed under US and European sanctions, they are systematically cautious about engagement. If an Iranian bank once had a relationship with an IRGC affiliated entity, they will look for evidence that the relationship no longer exists, and in many cases this evidence is hard to come by.

The Iranian Foreign Ministry acknowledged that the "biggest problem" facing the JCPOA was inspiring foreign investor confidence in Iran's internal business environment. In a leaked JCPOA Implementation Report to the Majlis National Security Committee, the Ministry recognised that private foreign investors act in accordance with economic logic not governmental instruction, and for that reason the atmosphere needs to be right for them. The presence of corruption, money-laundering, uncertain regulatory boundaries and opaque ownership eat away at the sense of security and control foreign businesses need to feel over their overseas investments.

The Rouhani administration recognises this and will require time to get it right. Verity-Iran has some sympathy for President Rouhani's line of defence, when he reminds his audience that "only 3 months have passed since implementation day, not 30 years". Rouhani claims the sanctions framework was so effective in halting the transfer of Iranian money through globalised banking systems that banks were effectively transported back to the 19th Century, entirely dependent on small brokerages. The Central Bank has to negotiate with foreign banks on a one-by-one basis in order to re-establish correspondent banking relations; it is not a quick or simple process. As of last month, still only 26 foreign branches of Iranian banks had reconnected back to the SWIFT system of global financial messaging service.

Nevertheless, there are signs of positive activity, including a constant flow of visitors exploring Iranian opportunities. Eight Presidents, five Prime Ministers and fourteen Foreign Ministers have visited Iran in the past three months according to Vice President Nobakht. Licences have been issued for US\$3.4bn of foreign investments in 41 projects and US\$73bn in lines of credit from 12 international banks and finance institutions. A Swedish firm recently announced it was launching an Initial Public Offering to raise capital for investment in Iran, the first of its kind in Europe since sanctions were lifted. The first Air France plane landed in Tehran after an eight year hiatus and will begin to fly to Iran three times a week. German carrier Lufthansa and Austrian Airlines also run several flights a week to Iran and British Airways will start offering six flights a week to Tehran from July.

A report by the International Energy Agency (IEA) suggested Iran's crude oil production had risen to pre-sanctions levels. Iranian producers are believed to have pumped 3.56 million barrels per day last month, a level not seen for four years. Exports expanded more than 40% to 2 million barrels per day and a National Iranian Oil Company spokesman said exports were

Fig 1. Iranian Crude exports, barrels/day

EIA, February 2015 and February 2016

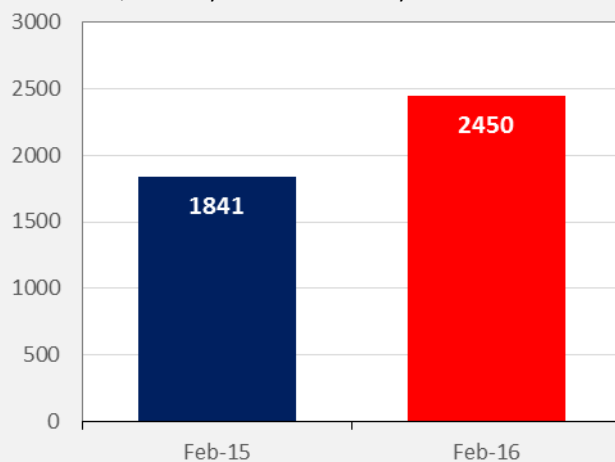
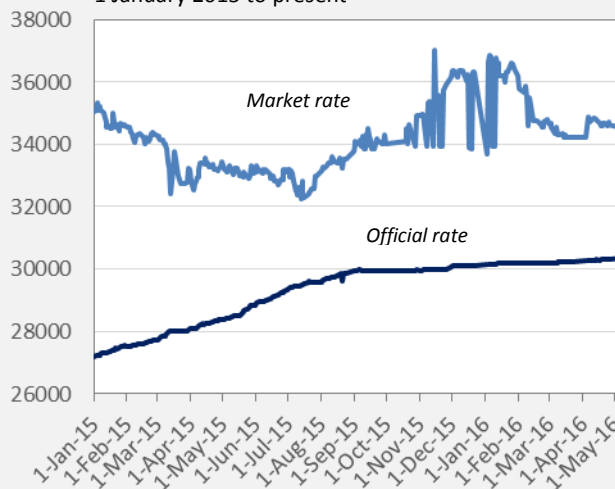


Fig 2. Iranian Rial to USD, dual exchange rates

1 January 2015 to present



expected to reach their pre-sanctions levels by June 2016. China was the biggest buyer, lifting more than 800,000 barrels per day, a 57% gain from March. Exports to India reached over 500,000 barrels per day, its highest level in five years. The IEA suggested Iran may post further gains in output, although its potential for substantial increases was limited.



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