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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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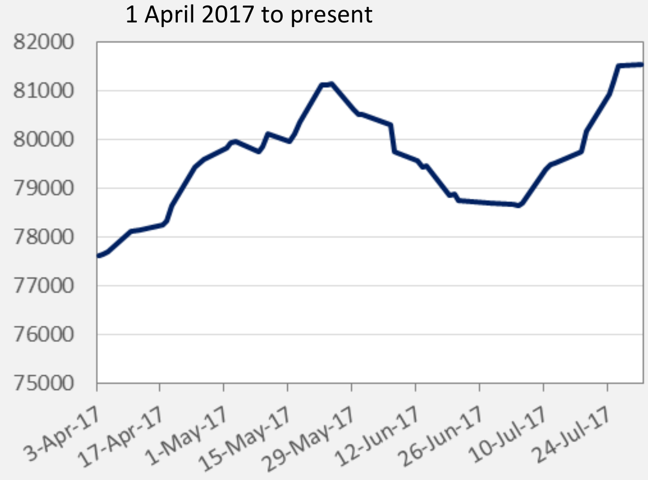
US$5bn gas deal a reward for JCPOA compliance

The Rouhani administration enjoyed a significant win for its approach to the JCPOA, with the completion of a major inward investment deal. The deal sends a signal to Iranian businesses that prospective investors can follow through, and to international investors that Iran is managing the risks of international sanctions "snap-back". President Rouhani's ongoing spat with the IRGC is raising the profile of the IRGC's damaging role in the economy.

Iran's momentous deal with French oil major, Total, delivered an early boost to the incoming Rouhani administration's economic prospects. The US$4.9 billion gas production deal for South Pars development phase 11 has raised hopes of a new era of international cooperation in the energy sector, and set an example for the rest of the economy. The first major deal to be signed under Iran's new International Petroleum Contract model gives the French company a 50.1% stake in the project, with China's National Petroleum Corporation taking a 30% stake and 19.9% held by Iran's Petropars.

Total's gamble has reverberated around the international investor community. The investment is the first by a European firm in the Iranian energy sector in over a decade. The Total CEO reasoned that after weighing up the possibility of sanctions "snap-back", amongst other risks, the long term opportunity justified the investment. Time will tell if this deal marks a new era of investor sentiment in Iran, in which international investors from outside the United States find the confidence, and the payment channels, to make business with Iran viable. The Rouhani administration has repeatedly stated its target of securing US$200 billion investment within the current five year plan. It is hoped 70 percent of this will come from foreign investment, which remains highly ambitious.

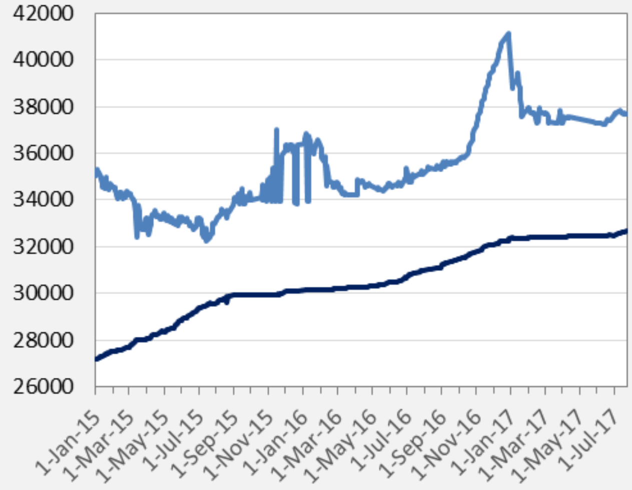
Fig 1. TEDPIX (All shares index)
1 April 2017 to present



The Total investment could be seen as a reward for the Rouhani administration's compliance with the JCPOA. The investment, which involves a US$1 billion initial commitment from Total, was a long time coming. But the finalisation of the contract is a testament to the faith the French company has in Iran's ability to avoid sanctions "snap-back", referring to a reapplication of US financial sanctions due to a breach of the agreement. The deal is a win for the Rouhani administration's approach to JCPOA compliance and its economic reform agenda. One month after the US Secretary of State officially reported Iranian compliance with the terms of the JCPOA, and shortly following the JCPOA Joint Commission representatives' praise of Iran's actions regarding the agreement, this 20 year investment deal shows a way forward for Iranian businesses.

The deal irked some hard-liners, however, including IRGC leadership figures, who have been embroiled in an ongoing spat with the administration over the military body's domineering role in the Iranian economy. The head of the IRGC's giant construction company, Khatam al-Anbia's, contracting division argued that the South Pars deal should have remained exclusive to Iranian entities and that the IRGC could have handled the multi-billion project itself, without foreign involvement. It is a brazenly backward vision of Iran's future, and one that clashes with the government's economic aspirations. The prevailing expert consensus is that the Iranian economy has become bogged down by corrupt and wasteful state entities, nowhere more so than in the energy and construction sector, in which IRGC companies are heavily embedded. Foreign inward investment brings much needed capital, technology and expertise from the world's most successful companies.

Fig 2. RIal to USD exchange rate
(Official (dark blue), market (light blue))



Most economic analysts, including Verity Iran, agree with President Rouhani's stated position that the IRGC's "takeover" of the state's privatisation agenda has been economically damaging. Hard-line critics have been attacking the President's comments on the issue as "unpatriotic" or "ungrateful" for the role the IRGC has played in peace-time construction and the development of Iran's energy sector. It is a puzzling argument. The President has not criticized the IRGC's role in defending the revolution or the security of the country, far from it. His stated opposition applies to the IRGC's role in the private economy, which is directly responsible for the suppression of competitive market forces and is detrimental to Iran's economic prospects. This is not to mention the insidious nature of corruption and illegality that often defines IRGC business activities. With regards to patriotism, it is the well-being of the Iranian people that is the paramount concern. That will benefit from greater competition, less corruption and more opportunities for small and medium sized enterprises to flourish and create jobs.

Elsewhere, the President's election campaign pledge to purge Iranian institutions of corruption faced its first stern test with the arrest of the President's brother on corruption charges. Some commentators have criticised the timing of the arrest, suggesting it was coerced as part of the broader rift between the President and the IRGC. But the President's brother, Mr Fereydoun, a senior diplomat who played a role in the nuclear negotiations, has been dogged by accusations of financial crime and abuse of his position for many months. He was released on bail after reportedly paying a 50bn Toman bond (equivalent to over US$9 million). The President reacted to the arrest by saying it was a source of pride in the Islamic Republic that everyone should be equal before the law. Certainly, if the allegations are true, this is precisely the kind of behaviour the President vowed to clear out of government activities.

On a wider, positive note, Iranian exports to the European Union jumped 700% in Q1, compared with the same period last year. This was driven predominantly by oil-related goods, with non-oil products, including fruit and nuts and plastic products, still making up a very small share. Iran's efforts to recover historical market share in southern European states appear to have begun to pay off, with Italy, Greece, France and Spain the largest importers. In return, the European Union maintained a substantial trade surplus, exporting 8.2 billion Euros of goods to Iran in 2016, compared to 5.5. billion Euros in 2015.

Fig 3. Iran exports to EU 28
(1995 to 2016, USD)