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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

48 16th July 2015

Special Edition

Economic implications of the nuclear deal for Iran

In the wake of the momentous announcement that a deal has been done on Iran's nuclear programme this week, VerityIran reflects on the economic implications of the historic agreement.

There has been a palatable sense of excitement bubbling around Iranian and international business circles this week as details of the Joint Comprehensive Plan Of Action on Iran's nuclear programme emerged. This was the deal Iran watchers, investors and enterpreneurs were waiting for. After years of isolation and months of anticipation, Iranian businesses can now look optimistically to the future and begin to make real plans for investment in the Iranian economy.

What does the agreement say about sanctions relief?

Despite over-simplified claims in the media of the "complete removal of sanctions", the sanctions regime facing Iran is in fact highly complex and multifaceted, enforced through different agencies and legal channels and born of triggers for which the nuclear programme is only one. The agreement specifically states that it is sanctions "relating to Iran's nuclear program" that are to be lifted, but from the macroeconomic perspective these are the ones that really matter as they encompass the critical banking and energy sector sanctions. Also of significance, the deal extended the sanctions relief agreed in the November Joint Plan of Action, meaning the monthly repatriation of overseas assets from frozen accounts will continue until sanctions relief is delivered.

What will sanctions relief mean for the Iranian economy?

The economic impact of the deal is not likely to be directly felt until early 2016 as there are a number of procedural and legal obstacles to overcome before sanctions can be lifted. But from next year, VerityIran expects the impact to be profound if the deal matures as drafted.

It is difficult to overstate the importance of this deal to the Iranian economy. Iran is the world's largest economy closed off to institutional investors, it has a large, highly educated workforce, competitive wages, an abundant manufacturing base with plenty of spare capacity, and of course vast natural resources. The Institute of International Finance this week changed its GDP growth forecast for Iran from 3% to 6% in 2016/17 as a result of the deal.

Iran's economic chiefs will not face an easy ride, for sure. The economy is unbalanced, weakened by an under-capitalised banking sector, over-burdened by inefficient welfare systems, creaking infrastructure and high levels of corruption and cronyism. A low oil price will damage revenues and inflationary pressures may re-emerge unless the wind-fall is invested wisely in the supply side of the economy.

Nevertheless, dealing with Iran's structural problems just became immeasurably easier than it would have been without sanctions lift. There is $100-$150bn of overseas asset to liquidate and a boost to tax revenues associated with a likely increase in exports, consumption, employment and income levels. The private sector will also benefit from a likely productivity boost thanks to renewed access to lower cost imported technology and inputs to production.

The next few months…?

The major economic impacts will not be felt for some time yet but even in the short term, there will be repercussions. An improvement in business confidence should begin to mainfest itself in a revival of the stock market as well as in increased levels of household consumption and business investment. Investors are very well aware that Iran's stock exchange offers some of the world's hottest bargains if access to the market improves. The top 100 firms in the TEDPIX are trading at around 5.1 times their annual profits, compared to 20.4 in Saudi Arabia and around 15 in most developing economies.

What still stands in the way of economic relief?

To turn that superficial short term boost into medium term prosperity, there are a number of steps still to be made before sanctions can be lifted in a meaningful way. The US Congress has 60 days to review the deal and although expectations are low that they will overturn the agreement, there are interest groups that will do their best to delay and diminish it. The Iranian parliament will also have its own chance to scrutinise the deal and make life awkward fo the Iranian government too.

After that, sanctions lift will be contingent on Iran implementing the necessary changes to its programme, to be verified by the IAEA, as agreed in Vienna. After that, sanctions are engineered to "snap-back" into place should Iran voilate the terms of the agreement. In that event, the most powerful sanctions are also the most agile and enforceable. Aggressive, unilateral US measures will return to the forefront, immediately destabilising the international banks and businesses engaged in the nascent Iranian trade, which will send the Iranian economy crashing back downards into a brand new recession and a highly uncertain future. Let us hope that the chances of such a reversal of fortunes are small and from this week onwards will only ever get lower.