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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY



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## In this Issue

- Majlis report reveals investors and domestic industry the big losers in Iran's stand-off with the West
- Official report confirms that sanctions are destroying Iran's economic life-line
- The Resistance Economy: A viable solution to Iran's problems or merely wishful thinking?
- Government cracks down on Exchange Houses. Can it prevent a run on the Rial?
- Rationing by the end of the Persian year a growing possibility
- Statistics

## Majlis report reveals investors and domestic industry the big losers in Iran's stand-off with the West

VERITY has learnt that, in a report produced by the Iranian parliament which has been banned from publication, officials assessed that the value of people's savings in Iranian banks had fallen by more than 20 percent since the start of Persian year 1391(March 2012).

The report also found that importing essential items at the official rate of IRR12,260:USD1 was far cheaper than producing those same goods domestically. Despite hopes that sanctions would have a positive effect on domestic production, on the contrary, the government's policy of restricting access to foreign currency at the official rate was actually bankrupting domestic producers who were bearing the brunt of import costs for primary goods as well as rising labour and energy costs.

Iran is caught in a "Catch 22" situation: if the government scraps the remaining access to the official rate of IRR12,260:USD1, then inflation on the most important commodities of all will rise rapidly with dangerous social consequences; but if it maintains the official rate it risks (as the Majlis report makes clear) bankrupting crucial domestic producers of the same products and further increasing its reliance on imports.

## Official report confirms that sanctions are destroying Iran's economic life-line

VERITY has also learnt that a number of Iranian officials are privately candid in admitting that the June/July 2012



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EU and US sanctions round has had a major destructive effect on Iran's foreign exchange revenues and on its trade and banking relationships.

On the US NDAA sanctions, they acknowledge that the sanctions have had a very damaging effect on Iran's oil, shipping, and banking industries, and have almost destroyed Iran's important trade connections with other countries.

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## **The Resistance Economy: A viable solution to Iran's problems, or merely wishful thinking?**

Speaking in mid-September, Mohsen Rezaei, the former Head of Iran's Revolutionary Guards and current Secretary of the Expediency Council, claimed that international sanctions targeting Iran represent a unique opportunity for Iran to rebalance its economy away from its overwhelming dependency on oil.

Rezaei claimed that a plan was in place, which would come into effect following next year's presidential elections, which, by shifting Iran's economy away from export dependency and concentrating on domestic industry, would thereby enable Iran to increase its investments abroad and reduce the rate of taxes at home.

In a normal economic environment, VERITY would agree with the outline of Rezaei's plans to diversify the Iranian economy. When compared to other economies in the region such as Saudi Arabia, the UAE, or Kuwait, Iran's economy is already less dependant on oil as a source of government revenue and maintains a comparatively low non-hydrocarbon fiscal deficit. Iran has also amassed high, but diminishing, reserves of foreign currency. In a normal economic environment, Iran would undoubtedly attract large sums in Foreign Direct Investment given its large, young, and well-educated population and its proximity to the Chinese and Indian export markets.

However, the plan outlined by Rezaei would have to be gradually phased in over a number of years if not decades, and, given the drastic impact sanctions have had in the first three quarters of 2012 alone on the value of the Iranian Rial, as well as inflation, and shrinking government revenues, it is clear that Rezaei's plan fails to address Iran's acute economic crisis with anything close to the urgency required.

With an estimated 50 percent of government revenues coming from the export of hydrocarbons, Iranian ministries are likely to experience extremely large budget shortfalls this year. And Iranians, rather than enjoying tax breaks, are likely to experience years of harsh austerity measures and a decline in their standard of living unless a more workable economic solution than that outlined by Rezaei can be drawn-up.

VERITY strongly recommends against investing in domestic industry at the current time. With high risk and uncertainty surrounding the value of the Rial, uncertain domestic demand/purchasing power, and the very real possibility of the nationalisation of key industries and assets, investors are urged to seek alternative, safer investment opportunities.

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## **Government cracks down on Exchange Houses. Can it prevent a run on the Rial?**

Following the dramatic events in late September/early October which saw the value of the Rial plummet to around



IRR37,500:USD1 as investors rushed to convert their Rial holdings into more reliable assets, the government cracked down firmly by closing exchange houses and arresting up to fifty traders who did not heed their warnings.

The Exchange Houses were finally allowed to resume trading on October 10, but only at the government-defined rate of IRR28,500:USD1. Sources in Tehran reported little activity in the exchange houses following the re-opening as traders were unwilling to convert USD at a rate they rightly judge to be far above the Rial's true value. There have been reports of black-market traders exchanging dollars for as high as IRR:40,000:USD1. But with the current restrictions in place, it is difficult if not impossible to assess whether this represents a realistic and fair rate of return on the Rial.

Investors looking to convert their Rial holdings into foreign currency are likely to face increasing difficulties as the government moves to bring such trade under state-control. VERITY recommends however, that prudent investors convert their Rial holdings into alternative fixed assets such as gold or property until they can be certain that the Rial will hold its value in the medium to long term.

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## **Rationing by the end of the Persian year a growing possibility**

As reported in issue 12 of VERITY, government officials in Iran have drawn up plans to introduce the rationing of essential commodities by the end of the current Persian year, should prevailing economic conditions persist. In recent weeks, prominent MP and outspoken critic of the Ahmadinejad government, Ahmad Tavakoli, has led calls in the Iranian parliament to revive the coupon system in light of growing concerns over an increasing number of families falling below the absolute poverty fresh-hold.

VERITY understands that, for now at least, senior officials are resisting calls to introduce rationing due largely to the negative psychological effect that this would have on the Iranian population, as well as the signals this would give to Western governments eagerly monitoring events in Iran for signs that the economic situation is coming to a head.

Despite resistance to such measures, VERITY predicts that rationing, on a limited scale to begin with, is increasingly likely to be introduced towards the final months of the Persian year, especially if officials are unable to take effective action to remedy the slide of the Rial and growing inflation.

### **Statistics**

#### **GDP growth**

-0.2% (IMF estimate for 2012)

#### **Inflation**

Around 50% and likely to climb sharply  
vs. Official figure: 23.5%

#### **Liquidity growth**

21% (Official estimate)

#### **Unemployment**

Between 25-35% and rising  
Vs. Official figure: 14.1%



**Exchange Rates**

Rial:USD

Estimate for December 2012: IRR30,000:USD1

CBI figure: IRR12,260:USD1

vs. Unofficial rate: IRR30,000>:USD1



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Page 4 of 4