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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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July overview

A summary of the top Iranian finance news stories from the last month:

Iran scraps official currency rate

Iran withdrew its official 'reference' exchange rate in early July. According to the Governor of the Central Bank of Iran (CBI), Mahmud Bahmani, quoted in *Fars News* on 4 July, the reference rate was being removed in accordance with the budget law. Traders would no longer receive a rate of IRR 12,260 to the dollar for imports of most food stuffs and medicine; instead, traders would have to use the government-supported currency-centre rate of IRR 24,775 to the dollar. Bahmani reiterated the Government's promise not to allow the change in the exchange rates to cause rises in the cost of staple goods. This promise was first made in mid-April when the Government announced that it was planning to abandon the official rate.

The withdrawal of the reference rate, several months after it was first announced, and shortly before President elect, Hassan Rouhani, takes office, was welcomed by the markets. With the Government no longer committed financially to support the reference rate, it will have more hard currency available to bring the unofficial rate closer to the currency-centre rate. In the days following the change, *Bloomberg* reported a 1.3 percent rise in the unofficial value of the dollar, up to 33,850. At the end of July, the unofficial free market value of the Rial was reckoned to be in the region of 31,500 to the dollar.

Nevertheless, it seems unlikely that the recent rise in the value of the Rial can be sustained in the medium-term given the continued squeeze on export earnings caused by sanctions. VERITY stands by its prediction that the value of the Rial will return to its pre-election value by the autumn, with the possibility of further devaluation thereafter.

New US sanctions come into force

A variety of new US sanctions came into force on 1 July. Trade with Iran's shipping, ship building and port management, automotive sectors, was blacklisted. Any person or company involved in the supply of various metals, including gold, conducting significant trade transactions in the Rial, or provides material support to the Iranian Government, could be designated. The Iranian Government attempted to play down the impact of the new sanctions. Foreign Ministry spokesman Abbas Araqshi described them as part of a broken policy. However, on the following day, two major Chinese shipping lines, China Shipping Container Lines (CSCL) and COSCO Container Lines, announced that they had suspended all business with Iran.

Indian oil trade with Iran halves in June

Reuters reported on 24 July that India's imports of crude oil had fallen by about 60 percent in June 2013 compared to June 2012. *Reuters* data revealed that Indian imports from Iran totalled about 140,800 bpd, down 45% from May 2013. Essar oil was now the only remaining Indian client of Iranian oil. Although month-by-month figures are volatile, the scale in the reduction of India's oil purchases from Iran is becoming evident.

The Times of India reported on 14 July that Iran was now prepared to receive 100 percent of its oil payments from India in Rupees. Iran was optimistic that this agreement would allow India to clear its debts to Iran, which some estimated to total over USD 1.5 billion.

At first glance, this appears to be a good news story for Iran, allowing Iran access to the full amount of unpaid Iranian debts. The devil, however, is in the detail. Under the terms of the 6 February US sanctions the Rupees must be spent in Indian markets, and it remains to be seen how effectively Iran is able to increase its imports of Indian goods. Separate reporting has suggested that Iran has decided not to import wheat from India due to concerns about fungal infection of the grain. Iran's Government Trading Company had announced that it would import over 23 million tons of wheat from India in 2013. With Iran unable to repatriate the Rupees, and its ability to spend significantly more in Indian markets limited, it appears that the most likely outcome of this development will be a greater volume of Iranian-owned Indian Rupees stockpiling, unused, in Indian banks.

Iran offers tax exemptions to attract foreign investment

Deputy Economy Minister Behrouz Alishiri was quoted in the *Tehran Times* in early July, offering significant tax exemptions in a bid to attract foreign direct investment (FDI). For investors considering investing in Iran's agricultural sector, Iran is prepared to offer a 100 percent tax exemption for an unlimited period of time. For investment in the industry and mining sector, Iran is prepared to offer 80 percent exemptions, as well as 100 percent for 10 years for investment in underdeveloped areas. Tax exemptions in free trade zones will be extended for 20 years.

On the face of it, the tax exemptions should make Iran an attractive proposition indeed for potential investors. Opportunities to recoup 100 percent of profits are rare, particularly in countries as rich in natural resources and with workforces as educated as in Iran. However, investors will be wary. There are many high hurdles to be jumped before investments in Iran can be made. In addition to navigating the increasingly complex legal environment set by US, UN and EU sanctions, investors will need to secure the co-operation of a vanishingly small number of commercial banks prepared to do business with Iran.

Mixed messages on economy

A senior member of President-elect Rouhani's inner-circle, economic adviser Mohammed Bagher Nobakht, attempted to put a positive spin on the economy when asked to comment on 25 July. He said that he was optimistic about the outlook for the year after the budget bill for 2013-14 increased.

However, speaking on 7 July, Tehran Chamber of Commerce official Mohsen Bahrami Arz-Aqdas, had a different interpretation on the budget bill. Arz-Aqdas said that the budget bill faced a deficit the equivalent of about USD 32 billion. He said that this was due to failing to realise projected income from higher energy prices and customs duties. Former Deputy Oil Minister Akbar Torkan, who is currently serving as a co-ordinator between the incoming and outgoing administrations, appeared to support Arz-Aqdas's sentiments. Speaking about the economy generally, he described the situation as worse than had been thought.

More news

A round-up of news stories from VERITY's own sources that have passed under the news radar over the last month:

Macro economic news

Point-to-point inflation rises

Kazem Jalili, a leading member of the Majles Research Centre, said on 24 July that point-to-point annual inflation for food items had increased to 61 percent. The Majles Research Centre is generally recognised as one of the most authoritative Iranian sources of information on the Iranian economy. Their information on the rising cost of food items is much closer to the truth than the official rate of inflation figure of 45.1 percent reported by the CBI on 25 July. VERITY's own sources, however, show that inflation in Iran is close to 77 percent.

15 percent of Iranian companies forced to close

A recent Iranian publication has made critical findings about the state of the Iranian economy. It suggests that close to 15 percent of companies throughout Iran have had to close recently, and 30-50 percent of companies were operating at less than half capacity. Unemployment was rising as Iranian industry was contracting. Rises in energy prices would cause further unemployment. The assessment noted that industry had not received the 30% income that the 5th five-year development plan had promised would be generated under the targeted subsidies law. Confidence in the economy amongst entrepreneurs was low.

The publication paints a persuasive picture of the current state of Iran's economy. Earlier this year, the Majles Planning and Budget Committee said that most production units were operating at 30 percent capacity. With more than half of Iranian companies now operating at less than 50% capacity and inflation continuing to rise, the economy appears to be undergoing a sharp contraction.

Banking news

Bank Pasargad fails to pay Russian debts

Iranian Bank Pasargad has failed to meet its obligations to pay outstanding debt owed to Russian exporters. VERITY has learned that Bank Pasargad has been warned by its Russian creditors that its continuing failure to pay up may have serious implications for financial and commercial relationships between Russian firms and Iranian banks in the future. Coming on top of the news this month that the World Bank had criticised Iran for failing to make payments on its loan over the last six months, the news about Bank Pasargad will further dent Iran's credit-worthiness and the international credibility of its commercial banking sector.

Oil and gas news

Declining oil and gas revenue force cuts to oil and gas development projects

Officials from the National Iranian Oil Company (NIOC) have announced that over the past 3 years, about USD 46 billion have been spent on the development of the Iranian sectors of the South Pars gas field. The officials said that a further USD 16-17 billion would be required in mid-2014.

It is not clear, however, that Iran will be able to secure the additional funding. VERITY has discovered the extent to which Iran's total crude oil and natural gas revenue has declined over the last 2 years. Iran earned nearly USD 95 billion in the year ending in March 2012. By the end of the following year, ending in March 2013, Iran earned USD 57 billion dollars. Between March 2013 and June 2013, the Iranian Government has earned less than USD 7 billion. Assuming that this trend continues, overall oil and gas revenue for the year ending in March 2014 will be USD 28 billion.

So far in 2013, Iran has closed down a significant number of oil wells due to difficulties selling oil as a result of sanctions. Additionally, a number of oil well development projects have also been closed down due to problems securing appropriate payment.

China to rebuff Iranian attempts to increase crude oil purchases

Oil industry insiders have told VERITY that China will rebuff Iranian pressure to increase crude oil purchases from Iran. In the optimism following the result of the recent election, it has been argued that Rouhani's victory will lead to the lifting of sanctions, and the return of Western competition for Iranian oil. Chinese firms, however, remain sceptical and are reluctant to increase Iranian imports at the moment. China appear keen to avoid causing damage to relations with the US over oil imports from Iran. China are also reluctant to become too dependent on Iranian oil at a time when a conflict between Iran and the West remains a possibility.

India afforded extra concessions to import Iranian oil

Iranian Ministry of Petroleum officials are concerned that the disclosure by Indian Minister for Petroleum and Natural Gas, Veerappa Moily, regarding Indian purchases of Iranian oil at discounted prices may prompt other customers to request similar discounts. VERITY has learned that the actual discount given to Indian companies is greater than the USD 2 per barrel mentioned by Moily because of special concessions offered only to India and not to other customers.

Discounts available for Iranian petrochemical and crude products

VERITY has leaned that Iranian petrochemical manufacturers are prepared to sell urea at discounted rates below the market value to encourage sales and to try to mitigate the effect of sanctions. The market value of urea is about USD

30 per Metric Ton. Most financial transactions for petrochemical sales are conducted through UAE-based banks.

It remains to be seen how effectively the offer of discounted prices for urea can be. The acquisition of Iranian petrochemical products is covered by US sanctions. US legislation also allows the designation of individuals and organisations from providing material support to NIOC, and sanctions any bank which transacts with any entity identified as part of the Iranian Government. Hitherto, it has been rare for petrochemical producers and brokers to attempt to conceal the Iranian origin of exported petrochemical products. All Iranian petrochemical producers are, at least in part, state owned through significant share holdings by state pension funds. Discounts are therefore available, but only for those individuals and organisations prepared to face exclusion from US markets and transactions involving the US Dollar.

Other news

FOREX shortages create difficulties for Iranian imports of livestock feed

A lack of available foreign exchange is creating difficulties for Iranian importers of livestock feed who have been unable to purchase sufficient quantities in recent months. As a result, Iranian officials are predicting spikes in the cost of livestock feed, and resultant increases in the price of poultry and red meat. As regular Iran watchers will know, on previous occasions such as in the autumn of 2012 price increases resulted in protest and sporadic outbreaks of violence.

Statistics

GDP Growth
2013: -5-8% (VERITY estimate for 2013)
-1.3% (IMF estimate for 2013)

Inflation
Estimated at c.77% across Iran
Vs. Official figure: 45.1%

Unemployment
Between 30-35%
Vs. Official figure: 14.1%

Exchange Rates
Rial : USD
Currency Centre (CTC) rate: IRR 24,775 : USD 1
Vs Unofficial rate: IRR 31,500 : USD 1