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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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November summary: A return to relative calm; can it last?

By recent standards November was a quiet month for the Iranian economy with the Rial's value remaining steady for much of the month. Following the imposition of restrictions on the currency markets, foreign exchange volumes have fallen sharply allowing Government intervention to stabilise the thin remaining exchange market at c. IRR1:USD30,000. However, the thinness of the market is unsustainable in the medium term; the Government cannot afford to effectively subsidise the current level of imports at the official or intermediate rate indefinitely. VERITY therefore expects trade volumes to start increasing at the free market exchange rate from December onwards. This is likely to put severe pressure on the Government's ability to maintain the current exchange rate.

November also saw some limited good news in the oil markets for Iran. Oil exports to all of Iran's key South Asian buyers increased, with total exports reaching an average of around 1.3 mbpd compared with around 1.0 mbpd in September and October. The West concedes that the oil hungry nations of South Asia will continue to import Iran's oil in the near term while alternatives remain limited. Iran remains vulnerable however to further sanctions targeting its limited remaining banking options, as well as sanctions targeting the transportation of Iran's oil, including more robust sanctions targeting insurance provision.

While the current stand-off with the international community endures, VERITY sees little reason for optimism over the Iranian economy. VERITY predicts that Iran's budget for 1392 (beginning March 2013) will likely contain significant cuts to ministerial budgets in line with the fall in government revenues of up to 40 percent.

Fears of a run on banks mount with investor confidence fading fast

Following a surge in bank withdrawals over the past few months by investors converting their Rial holdings into safer assets such as foreign currency and gold, VERITY has learnt that officials fear that liquidity is dangerously low in a number of banks.

There are growing concerns about the possibility of wide-spread bank runs if depositors move to seek a safe haven for their savings. Iranian officials are attempting what amounts to a press blackout to ensure that the parlous state of the banks does not become public knowledge.

Limited options available to Iran to weather economic storm

The brief but dramatic crash experienced by the Iranian Rial in September has further exacerbated economic difficulties with import prices now rising by around 30 percent each month.

President Ahmadinejad continues to be the focus of rising anger at the economic situation from rival political factions who blame his lack of foresight and failure to prudently invest the vast sums accumulating to Iran from oil exports during his first term as President. The Supreme Leader recently had to intervene to prevent Parliament from calling Ahmadinejad to answer questions over his mismanagement of the economy.

Though officials continue to give mixed messages over the cause of the economic crisis, privately there is a growing acceptance that the crisis is inextricably linked to Iran's dispute with the international community over the purpose of its nuclear programme. Government experts have advised that, for the Iranian economy to survive let alone recover, it is imperative that sanctions be lifted allowing Iran to re-integrate into regional and international markets and financial systems.

However, VERITY understands that such views, though prevalent, have been edited from committee reports to the Supreme Leader by officials concerned that their expression would be badly received.

To convert or not to convert: A dilemma for investors

Economic pressure on Iran shows no signs of abating; no sooner had President Obama's re-election to the White House been confirmed than Congress was already debating further sanctions targeting the purchase of Iranian exports.

Holding on to investments in Iran at this present time in the expectation that the value of the Rial will recover holds a great deal of risk. Though the Rial has recovered some of the value it lost in September, this is largely as a result of the market being in effect dormant as traders are choosing to hold onto their Rials rather than offer them for exchange at the government decreed rate. The fact remains that, without a sudden influx of foreign currency, the Iranian government will ultimately be unable to sustain the current exchange rate of IRR30,000:USD1.

While investors will be understandably reluctant to realise significant losses by converting their holdings now that the Rial has partially devalued, VERITY urges prudent investors to take our advice and to **convert the maximum amount possible of their Rial holdings into safer, more reliable assets** now before the exchange rate worsens once more. VERITY understands that the Central Bank of Iran (CBI) is preparing for a further managed devaluation of the Rial to around IRR50,000:USD1 should forex reserves continue to deplete at their current rate.

Loss of revenue from oil exports greater than reported

VERITY understands that analysts in Iran have recently projected that Iran's oil sales for Persian year 1391 (20 March 2012 – 20 March 2013) will be as much as 50 percent lower by value than Iranian oil sales for the preceding year (1390). This estimate was based on the analyst's assessment that Iran's monthly sales would continue to decline or remain stagnant for the rest of the year, and that difficulties encountered in receiving funds would increase.

With the US set to demand further cuts in the amount of oil Iran's customers import in February 2013, prospects are looking increasingly bleak not only for the oil sector but for government revenues as a whole with some 50 percent of revenues dependent on the sale of oil.

It is as yet unclear how much of a reduction the US will demand with key South Asian importers neither willing nor able to tolerate further significant reductions. Of greater concern to Iran and investors however could be the restriction on foreign banks handling third country oil payments to Iran which will also come into effect in February and could reduce government revenues by a further USD 2-3 billion per month.

Statistics

GDP growth
-0.9% (IMF estimate for 2012)

Inflation
Estimated at around 50% and likely to climb sharply
vs. Official figure: 24.9%
vs. IMF estimate: 25.2%

Liquidity growth
Estimated to be 25%+ for 2012
vs. 21% (Official estimate)

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

Exchange Rates
Rial:USD
CBI figure: IRR12,260:USD1
vs. Unofficial rate: IRR30,000>:USD1
vs. Estimate for March 2013: IRR50,000>:USD1