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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY



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## Issue 25 – August 2013

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### August overview

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

#### *New Cabinet*

On 15 August, the Majlis voted to approve 12 of Rouhani's 15 ministerial nominations. All key Cabinet posts were approved. Minister of Economy, Ali Tayyebnia, gained 274 positive votes out of 284 cast, the strongest of all the nominees. Oil Minister, Bijan Zanganeh won only 180 votes. With strong links to Rafsanjani, he previously served as Oil Minister under Khatami, and has no IRGC background, Zanganeh's appointment to the Oil Ministry was always likely to prove controversial among conservative hardliners. The Oil Ministry controls a significant source of Iran's wealth, and has recently been an IRGC stronghold.

With some notable exceptions, Rouhani's new Cabinet appears on the whole to be moderate and technocratic. Many of his ministers have experience of serving in ministerial positions under previous, reformist governments led by former Presidents Rafsanjani or Khatami. Others have strong academic private sector experience to bring to bear.



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Rouhani has also assembled a strong team of independently-minded and experienced advisors and Vice Presidents. His appointment on 26 August of Valiollah Seif to run the Central Bank adds another strong technocrat to his team. Associated Press reported that Seif, who ran Karafarin bank, is an advocate of an independent central bank and a floating exchange rate for the Rial.

Rouhani's economic team look well-placed to deliver greater competence in economic policy making, and to begin to address the needs of the private sector. The market has reacted well to Rouhani's victory, climbing steadily to a succession of new highs. But the challenges the team face are great. Powerful vested interests, including the IRGC, dominate large parts of the private sector and will be difficult to shift. Inflation and unemployment remain among the highest in the world, and there has been no let-up in sanctions. Moreover, the early indications are that Rouhani will be unwilling and/or unable to change the direction of travel on the nuclear issue. Public statements from Rouhani and key members of his team have emphasized Iran's right to enrichment and their refusal to give in to sanctions pressure. Without some form of a deal on the nuclear issue, VERITY judges that Rouhani will be unable to deliver significant improvements to Iran's economy.

#### *Iran faces budget shortfall of one third*

Reuters reported on 18 August that Iran faces a budget shortfall of one third in this year's budget, which runs until mid-March 2014. Lower than expected revenues and exceptionally optimistic spending plans formulated under the previous administration, mean that one of Rouhani's first tasks will be to re-write the budget. Rouhani has promised to present the new budget to the Majlis by 11 September.

Whatever plans to address falling revenue are included in the budget, it appears that Iran is facing a prolonged period of austerity. The Iranian people will have to get used to a period of lower government spending. There is an element to which the private sector can fill the gap; but with sanctions blocking foreign investment and the oil sector continuing to dominate the economy, it is far from clear that the private sector is capable of fully replacing state spending an investment. Rouhani's plan to reduce the dominance of the IRGC in the private sector is important in this regard. It may create the space for re-growth of a genuinely private sector in the Iranian economy.

#### *Reintroduction of 'reference' exchange rate*

On 19 August, new Iranian Minister for Industry, Mining and Commerce, Mohammed Reza Nematzadeh was quoted in Mehr News saying that the Cabinet had decided to reintroduce the 'reference' exchange rate for basic goods. It is unclear if this was an official announcement.

The reintroduction of the official exchange rate would be a surprising move for the Government, which has pledged itself to greater transparency and professionalism in economic policy-making. Removed in June 2013, the reference rate was open to abuse by corrupt government officials, and placed great strain of Iran's limited reserves of foreign exchange to maintain. To bring it back would therefore appear to be a retrograde step for the government. It will increase the prospects for arbitrage, and would not augur well for Rouhani's stated plans to tackle corruption and vested interests.

#### *Oil exports to India fall in July*

On 22 August, Reuters reported that India's oil imports from Iran fell by three quarters between June and July 2013, from 140,800 bpd to 35,500 bpd. Essar Oil, currently India's only active importer curbed their imports as a result of ongoing issues relating to the insurance of Iranian oil shipments.

Indian imports of Iranian oil are expected to increase in August. The fall in the value of the Rupee in recent weeks has



made the barter deals available to buyers of Iranian oil too good for Indian companies to resist. Industry pressure on the government appears to have resulted in agreement to establish a sovereign-backed Indian insurance pool of INR 2,000 crore (equivalent to about USD 294 million) to cover Indian refineries processing imported Iranian crude. India's Mangalore Refinery and Petrochemicals Limited (MRPL), previously India's largest importer of Iranian oil, announced on 20 August that it planned to re-start importing Iranian crude after a four month hiatus.

The expected increase in Indian imports of Iranian oil will be welcome relief to the new government in Tehran as it seeks to improve the economic conditions in Iran amid tight international sanctions. However, Indian willingness to import Iranian oil in spite of sanctions will have been tested by the detention by the IRGC on 12 August of an Indian tanker carrying 140,000 tonnes of Iraqi oil from Iraq to India. The tanker, Shipping Corp of India (SCI) vessel the *Desh Shanti*, was still detained as of 28 August, despite Indian demands for the unconditional release of the tanker. Iran claims that the vessel had caused pollution on a previous voyage; something that Indian Shipping Ministry officials have denied.

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## 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

*Vice President says economy shrank by 5 percent between 2012 and 2013*

On 22 August, Iran's Vice President for Strategic Planning, Mohammed Bagher Nowbakht, announced that the economy shrank by 5.4 percent between March 2012 and March 2013.

*Iranian government forecasts 50 percent reduction in oil revenues by March 2014*

Iranian government forecasts 50 percent reduction in oil revenues by March 2014 The Iranian Government forecasts that oil exports would be reduced by 50 percent between August 2013 and March 2014. In terms of revenue from the sales over the same period, the government estimated that revenues would fall to about USD 1.5 billion by early March 2014. The government further estimated that Iran would be able to repatriate only USD 1.4 billion in August 2013, falling to less than USD 1 billion by early 2014.

*Senior officials underplay impact of sanctions to Iranian public*

VERITY has learned that senior officials in the Iranian government have intentionally underplayed the effect of international sanctions in order to limit the public's impression of the severity of the impact of sanctions. Government officials calculated that Iranian oil revenues fell by more than 50 percent in 2012 as a result of sanctions. However, senior officials agreed to announce publicly that oil revenues had dropped, but at a much lower level than was officially recorded. Criticism of the manipulation of statistics under President Ahmadinejad was a prominent feature of the election campaign, and has been widely discussed in the Iranian media since. Newspapers from across the political spectrum have described the unreality of official statistics, and the erosion of public trust they caused. President Rouhani has promised greater transparency and professionalism, but it will take time for his Government to rebuild public faith in officially-published statistics.

*Bureaucratic process crippling economic policy making*



Senior Iranian Government officials say that economic officials' efforts are being crippled by the constant pressure of investigations and legal proceedings being conducted by other government entities. They add that the investigations are more harmful than sanctions to the Iranian government's economic policy making. It is unclear the extent to which the investigations are politically motivated, inspired by opponents of the previous administration. Investors, however, will welcome news of detailed and thorough investigations into Iranian economic policy making, and will be reassured by the greater transparency that results.

## **Banking news**

### *Government debt to the CBI exceeds USD 250 billion*

VERITY has learned that the Iranian Government's total debt to the CBI is the Rial equivalent of more than USD 250 billion (using the Open Market rate of USD 1 : IRR 31,500; or USD 320 billion using the Currency Trading Centre exchange rate of USD 1 : IRR 24,775).

### *Inaccessible foreign reserves total USD 100 billion*

The Director of Iran's respected Majlis Research Center, Kazem Jalali said in mid-August that more than USD 60 billion of Iran's oil revenue was frozen in foreign banks and out of the reach of the Iranian Government. According to VERITY's own sources the actual figure is somewhat higher. Iran has USD 130 billion in foreign currency reserves held in banks outside Iran; USD 100 billion of this is currently inaccessible. The vast majority of these reserves are held in China and India, Iran's two largest trade partners.

## **Oil and Gas News**

### *Turkengaz considers reducing supply to Iran in response to Iranian unpaid debts of EUR 900 million*

VERITY's sources have revealed that Iran had substantial unpaid debts with Turkmenistan-based gas supplier, Turkengaz. As of March 2013, Iran's total unpaid debt to Turkengaz exceeded EUR 900 million. In July 2013, Turkengaz was considering imposing a significant reduction in gas deliveries to Iran, until Iran had finally settled its debts.

### *Iran plans to close Hong Kong Intertrade Company*

VERITY has learned that Iran's National Iranian Oil Company (NIOC) is considering closing down the Hong Kong Intertrade Company (HKICO). Like its parent company, the Lausanne-based financial subsidiary, the Naftiran Intertrade Company (NICO), the HKICO is used by NIOC to secure financing for Iran's oil and gas infrastructure projects. HKICO was sanctioned by the US in July 2012, and by the EU in December 2012.

### *Oil Minister plans to raise oil production by 70 percent*

Oil Minister Zanganeh has publicly announced plans to raise oil production 70 percent to 4.2 million bpd in an effort to combat the effect of sanctions. Production has fallen recently to about 2.5 million bpd, as US pressure has caused Iran's major oil customers to reduce imports and find alternative supplies. US pressure appears unlikely to dissipate soon, so it is likely that Iran will have to find additional facilities to store its oil. Iran has recently added 7 new VLCCs to its tanker fleet.

### *Petropars replaces CNPC as NIOC's partner for South Pars development*



On 27 August, NIOC signed a USD 5 billion buy-back deal with Petropars Limited (PPL), for development of Phase 11 of the South Pars gas field. PPL, a subsidiary of NICO, itself a subsidiary of NIOC, replaces the Chinese National Petroleum Company (CNPC) as Iran's chosen partner for the development for what is reckoned to be the field's largest gas layer. The CNPC signed a USD 4.7 billion contract with NIOC in 2009, replacing France's Total.

## Other news

*Increasing percentage of oil sales used to fund Iranian defence procurement.*

VERITY has learned that an increasing percentage of the proceeds from Iran's oil sales is being used to fund defence procurement. The Iranian Ministry of Defence's (MOD) allocation of oil exports was set when the total volume of exports was more than double today's total of under 1 million bpd. As total oil exports have declined, however, the allocation allotted to the MOD has remained constant. This means that Iran may be able to continue to fund expensive defence procurement projects, possibly including projects associated with Iran's nuclear programme. But it also means that the amount of money from oil sales available to be recouped by the rest of the Iranian Government is likely to be considerably less than the volume of oil exports might otherwise suggest.

## 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: 11.5%

### Exchange Rates

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



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