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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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Issue 17 – December 2012

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December overview: oil exports fall again; October/November spike likely to have been a one off

Iran's oil exports in December fell to an average of around 1 million barrels per day (mbpd) following a greater than anticipated rise in October/November which saw approximately 1.3 mbpd lifted. The reasons behind the movement in Iranian oil exports in the period August to December can be explained as follows:

The sudden drop in exports for August and September to between 800,000 – 900,000 bpd can largely be attributed to poor planning by the Iranian government. The effects on Iran's oil sales resulting from the June/July introduction of the US Significant Reductions Waivers, and the EU prohibition on the import of Iranian oil should have been better anticipated; however, the Iranian government seems to have been caught unawares of the loss of contracts resulting from these measures, and was forced to scramble for storage for its unsold oil, including taking around half of its tanker fleet out of action to store the oil. This led to deliveries of Iranian oil being significantly delayed, which resulted in dissatisfied customers cancelling future orders and the larger than expected drop in Iranian oil exports.

VERITY has learnt that by mid-October, Iran had largely rectified this situation by purchasing at least four Very Large Crude Containers (VLCCs) from China and by renewing the lease on several VLCCs which had expired in September. There was also a temporary spike in demand from both China and South Korea, both of whom had lifted amounts significantly below the US-set threshold under the terms of the Significant Reductions Waivers programme (in the case of South Korea, no Iranian oil was lifted at all). This led to an over-correction in October and November as China and South Korea were then able to lift above their monthly average under the waivers programme, resulting in a c. 500,000 bpd rise in Iranian exports.

In December, things have returned to normal with all of Iran's key customers lifting at around the mark set under the terms of the waivers programme.

In the near-term, 1 mbpd is about the maximum level that exports are likely to reach for Iran. Iranian Member Of

Parliament Gholamreza Mesbahi Moqaddam recently stated that ministerial budgets for Persian year 1392, beginning in March 2013, may assume monthly oil exports of 1 mbpd, meaning cuts averaging around 30 percent across all Ministries, as c 50 percent of government revenues are generated from oil sales. In VERITY's assessment, calculating next year's budgets on 1 mbpd may be too optimistic: although it is as yet unclear, given the risk of further upward movement in the oil price, what further reductions the US will demand of Iran's other key customers throughout 2013, VERITY understands that further significant cuts will continue to be required as the international community cranks up the pressure on the Iranian government to meet demands required under international law regarding its controversial nuclear programme.

In addition, well placed sources tell us that several of China's major oil companies are looking increasingly for alternatives to Iran, in particular the UAE, as they assess that over reliance on Iran to meet China's growing energy requirements is too risky a proposition.

Iranian economy vulnerable to drop in oil price in 2013

While the Iranian economy has undoubtedly been hit hard by a range of US and EU sanctions targeting its oil sector – the life-blood of its economy, the blow has been cushioned somewhat by historically high oil prices throughout 2012.

Most analysts agree that the current oil price is artificially high with supply significantly outstripping demand for several months. The fact that oil has remained at around USD 100 per barrel has been attributed, inevitably, to speculation amid rising conflict and uncertainty in the Middle East. Reacting to studies that blame speculation for raising global oil prices 25-50 percent, EU and US regulators are urgently researching measures to lower oil costs, and thereby help their struggling economies.

In the EU, Italy and other member states are seeking tough regulation of oil speculation in the futures markets. Italy has even asked the G-8 to reduce oil market speculation through global regulation. Meanwhile, US Senator Ron Wyden, the incoming chair of the energy and natural resources committee, has a similarly jaundiced view of the role of speculators in the market.

Senior European leaders, including the IMF's managing director, Christine Lagarde, have recommended that the EU establish its own commodity futures trading commission similar to the US model. The EU's desire to assert a regulatory role may even create a bidding war to develop the toughest approach to oil speculation.

The Iranian economy is extremely vulnerable to a shock resulting from a significant downward trend in the price of oil and it is difficult to see how its ministries could continue to meet the needs of the public should their budgets be slashed still further. The big drop in oil exports also means that Iran's influence in the OPEC cartel is equivalently diminishing, and Iran could find itself similarly vulnerable if proposals, likely led by Saudi Arabia, to bring the price of oil down to a more sustainable level of around USD 80-90 per barrel are accepted.

Danger of irreparable damage to Iranian banks

VERITY has learnt that, in a recent Central Bank of Iran (CBI) assessment, officials warn that the unprecedented pressure being exerted on the CBI to stabilise the Iranian economy while cash flow to the bank is severely restricted could cause irreparable damage to the bank's ability to manage foreign currency reserves and meet financial obligations.

Recent spikes in the Housing Market and on the Tehran Stock Exchange show that Iranian investors have responded to this danger, and to the negative real interest rates on offer, by reducing their Rial holdings and moving into safer assets.

VERITY stands by its prediction that the Rial will fall in value to c. IRR50,000:USD1 by the end of Persian year 1391 (March 2013). Considering the precarious situation, VERITY continues to urge against over-exposure, either through investment or deposits, to the Iranian banking system. Shares in companies exporting metals and petrochemicals have performed remarkably well since the fall of the Rial in September, as has the housing market. Investors should however remain vigilant to the risks of bubbles forming in these sectors and should ideally look to invest in a range of assets, including safe currencies (the Australian and Canadian dollar are both good bets) and gold.

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 30-35%
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