

# VERITYIRAN.COM

LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY



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## Issue 26 – September 2013

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## September overview

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

### *Reasons for cautious optimism after Rouhani declared readiness to negotiate*

Two clear messages from President Rouhani over the last month; the economy is in dire straits, and he wants to negotiate. At the UN General Assembly on 24 September, Rouhani publicly declared that Iran did not want a nuclear weapon, and that his country was ready for negotiations.

Previously, on 10 September, President Hasan Rouhani had provided a situation report on the state of the country



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during a live televised interview in Iran. Recalling his campaign promise to bring greater transparency to government, Rouhani had laid bare some of the economic realities facing Iran. Iran is in an inflationary recession, he had said, with a negative growth rate. Point-to-point inflation was 44 percent (though VERITY suspects it to be far higher), and the budget deficit had reached 80,000 billion Tomans (approximately USD 25 billion). Rouhani had said that his government faced the impossible choice of raising taxes or cutting spending.

Turning to the nuclear issue, Rouhani had declared Iran to be absolutely ready for serious negotiations. The nuclear issue would be resolvable in the not too distant future, if the world's powers willed it to happen.

Unambiguously describing the dire state of the economy, and publicly declaring his readiness to negotiate on Iran's nuclear programme were bold steps from Rouhani. With his openness, he has undermined the credibility of hardliners who still propose the validity of a 'resistance economy'. His approach received a welcome endorsement on 18 September, when the Supreme Leader unexpectedly announced his support for 'heroic flexibility' in diplomacy.

The constructive tone emerging from Iran has begun a new dynamic in the international stand-off over Iran's nuclear programme. If genuine, it will weaken resolve and international consensus over pressure measures on Iran. Alongside his public statements, Rouhani has also successfully moved responsibility for negotiation on the nuclear file from the control of the hardliners on the Supreme National Security Council, to the Foreign Ministry, headed by Mohammed Javad Zarif, Rouhani's own appointment. There are grounds for cautious optimism.

#### *Market responds positively*

The market has responded positively to Rouhani's statements, in spite of the negative declarations about the state of the economy. The value of the Rial rose steadily during September; at the end of the month, some exchange houses were offering 29,600 Rials to the Dollar.

Although US President Barak Obama was ultimately unable to meet Rouhani in New York, Rouhani's statements have been welcomed by the US and their E3 allies. But the US and the E3 will expect significant compromises, such as on further enrichment and international inspection of their nuclear facilities, before agreeing to remove sanctions on Iran.

For investors, the recent developments pose something of a dilemma. If Rouhani has genuinely got the backing of the Supreme Leader, and he is able to reach an agreement with the E3+3, then there appears to be a realistic possibility of a sharp improvement in Iran's economy in 2014. Access to funds frozen in foreign bank accounts will inject significant capital into the Iran market. But, should Rouhani fail to secure an agreement, the economic consequences would be severe. The new optimism is already heavily priced into the market, leaving it vulnerable to delay or failure in future negotiations. The next few months will be critical; much depends on Rouhani's skill in negotiations, and whether he is given the freedom to compromise.

#### *Parliamentary debate on amended budget delayed by several weeks*

The government's efforts to introduce a new budget for the current Iranian year suffered a setback on 4 September, when a motion to make debate of the amended budget a priority failed to pass in the Majles. The bill, which attempts to reduce government expenditure by up to one third to take account of lower than expected government revenue and optimistic spending plans, was the first major piece of legislation submitted to the Majles by the new Government. Shargh newspaper reported that it may take a few weeks before the revised budget is presented to the Majles again.



## 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

#### *Iran's economy contracts between 2012 and 2013*

A report published by the respected Majles Research Centre in early September reported that Iran's growth rate fell in the last Iranian year (ending on 22 March 2013) to minus 5.4 percent. This seems to be a realistic estimate of the degree to which the economy contracted last year. VERITY's own estimate is that the economy experienced negative growth of between 5 and 8 percent in 2013. With Rouhani's new economic team adding professionalism to economic policy making in the country, there is scope for a slow-down of economic decline in the months ahead. However, without meaningful sanctions relief in the short-term, it is unlikely that the Iranian economy can return to anything other than anaemic growth, while continued recession remains the probability.

#### *Iran unable to access major part of its National Development Fund*

Eliyas Naderan MP, a member of the Majles Planning and Budget Committee, said on 9 September that a major part of Iran's National Development Fund (NDF) was frozen in banks overseas, and was therefore inaccessible to the Iranian Government. The NDF was established in 2011 as the replacement for the oil stabilization fund to transform oil and gas revenues to productive investment for future generations.

By one recent estimation, the NDF totalled approximately USD 50 billion, some of which was allocated to various development projects, including agriculture. The remaining funds were almost entirely held outside of Iran. As well as being denied access to these funds by international sanctions, Iran is being required to pay large fees to some of the banks holding the money, and is unable to earn interest on the frozen funds.

### Banking news

#### *Iranian Government deficit to CBI amounts to 10s of billions of dollars*

According to various sources, the Iranian Government's deficit to the CBI amounts to several tens of billions of dollars. Loans taken out by the previous administration before the election, in an attempt to portray Iran as more prosperous than reality dictated, had forced the CBI to take funds from all of its accounts, leaving Iran's banking system critically short of capital. Unless the Government is able to settle the deficit, Iran's banks will remain technically insolvent.

#### *Iran faced USD 32 million forex deficiency during July 2013*

In July 2013, the Iranian Government predicted that Iran would face a USD 32 million foreign exchange revenue deficiency during the month of July 2013. The Government planned to use existing foreign exchange reserves to cover this deficiency.

#### *Iran falls victim to depreciating Indian Rupee*

According to reports from New Delhi and Tehran, the decline in the value of the Indian Rupee has had serious consequences for Iran. Between March and September 2013, the Rupee depreciated about 20 percent against the



dollar. (Indian Government intervention is believed to have arrested the decline somewhat in September). The Iranian Government has substantial holdings of Rupees, the result of a payment mechanism that required India to pay for its imports of Iranian oil in a mixture of Rupees and Euros. With Iranian demand for Indian exports considerably lower than Indian demand for Iranian oil, billions of dollars worth of Iranian Rupee holdings have been accumulating in Indian banks, as VERITY has reported frequently. One recent Indian report estimated that Iran has USD 5 billion worth of Rupees trapped in India's UCO Bank. With a depreciation of 20 percent in the value of the Rupee, these Rupees will now be worth USD 1 billion less than when Iran sold the oil to India.

## Oil and Gas News

### *44 percent of Iran's crude oil income cannot be spent or repatriated*

*Associated Press*, quoting unnamed US officials, reported on 30 August that about USD 1.5 billion of Iran's crude oil revenues that is not being used to settle bilateral trade is piling up in restricted foreign accounts every month. With crude oil revenues averaging about USD 3.4 billion per month in the first half of 2013, about 44 percent of Iran's crude oil income cannot be spent or repatriated.

### *Dubai's non-oil trade with Iran falls 12 percent*

*Reuters* reported on 12 September that Dubai's non-oil trade with Iran fell by 12 percent during the first half of 2013. Two-way trade between Dubai and Iran, excluding oil, fell to USD 2.9 billion between January and June 2013. Despite a large Iranian ex-pat community in Dubai, Iran now accounts for 1.6 percent of Dubai's total non-oil trade.

### *South Korean imports fall in August*

*Reuters* reported on 16 September that South Korea's Iranian crude imports fell in August to one third of the imports in July. The fall in imports brings South Korea closer to the target of cutting their imports by 15% between June and November, in line with the US sanctions waiver. South Korea imported 64,336 bpd in August, down from 190,516 bpd in July. The decline in imports puts South Korea's average imports from Iran at 130,135 bpd between June and August, not far from the target average of 125,814 bpd South Korea needs to meet by November. South Korea imported 148,016 bpd between December 2012 and May 2013.

## Other news

### *Automobile industry breaking down*

Reports from Iran have suggested that the automobile industry is in a critical state. Three manufacturers, Rayen, Modiran Khodro and Kerman Motor, have stopped producing vehicles. Production is significantly reduced at others, including Bahman Group (down 75.3 percent), SAIPA (down 25.2 percent), Pars Khodro (down 71.9 percent) and Iran Khodro (down 22.2 percent).

Exports have suffered as a result of sanctions. Iranian automobile exports between April and September 2013 were valued at USD 11 million, compared to USD 145 million over the same period in 2012. At the same time, imports of automobiles increased in the last year to 34,000 vehicles, up from 15,000 in 2012. The small increase in the value of the import market, from USD 341 million to USD 351 million, suggests that the majority of the vehicles being imported are no longer high-end luxury vehicles. The Iranian automobile industry produced vehicles for low-budget and mid-range customers. For these customers now to be purchasing imported instead of Iranian-made vehicles suggests major problems for the Iranian industry.



*Iranian shipbuilding company lays off entire workforce*

According to Iranian media reports from 23 September, the Sadra Shipbuilding Company (also known as the Iran Marine Industrial Company) which operates in Bushehr Province, has been forced to lay off all 1,500 workers. The workers had been unpaid for 4 months, according to the Bushehr House of Workers. All manufacturing activities carried out by the Sadra Shipbuilding Company has now been stopped.

**Investment Focus***LNG provides Iran's best hope for sustained economic development*

To ensure sustained economic development, Iran could make better use of its large natural gas reserves; but pipelines are not the answer.

The largest increment of European natural gas imports are likely to come via the Trans-Anatolian Pipeline (TANAP), and from new Russia pipelines. While European natural gas imports are expected to rise substantially over the next twenty years, Azerbaijan (TANAP's operator and majority owner) and Russia will preferentially fill these pipeline increments with their own gas, or with gas from which they can extract maximum transit fees. This will exclude Iranian natural gas.

Iran looks to sell natural gas to Pakistan, India and, potentially, China, via a pipeline through Pakistan. No non-Pakistani sales have been consummated for this pipeline. While future sales to India are conceivable, Pakistan does not appear to be a reliable conduit.

Even though its natural gas prices are more than twice that of Europe, Asia cannot be reached via pipeline; liquefied natural gas (LNG) is needed. In addition to allowing access to the best current markets in Asia, LNG allows exporters to shift their focus as conditions change. Qatar is the model, with natural gas reserves similar to Iran's, and having built LNG facilities to serve the Asian market; other players are following suit.

Pipeline gas sales are currently limited. LNG would provide both a wider range of opportunities and the flexibility to respond to market changes. In both the medium and the long term, LNG appears to be a superior development strategy. But it is a strategy that will require a resolution to sanctions, and access to Western technology.

**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



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Reference rate: 12,275

Currency Centre (CTC) rate: IRR 24,970 : USD 1

Vs Unofficial rate: IRR 29,600 : USD 1



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