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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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January overview

The Geneva Agreement comes into force

On 20 January, the interim Joint Plan of Action that had been agreed between the E3+3 and Iran in November 2013, finally came into force. The implementation of the Joint Plan of Action is potentially a momentous step towards a comprehensive settlement of the Iranian nuclear issue. It presents a window of opportunity of six months, potentially renewable, for the E3+3 and Iran to agree on an acceptable end state.

Iran has temporarily suspended development of the controversial aspects of its nuclear programme, in exchange for some limited relief, valued by the US at USD 7 billion. Sanctions on oil-related insurance and transport costs, petrochemical exports, and imports of gold and precious metals have been suspended. The majority of the sanctions relief, some USD 4.2 billion, is to be provided from previously blocked overseas funds. The first instalment of these funds, reported to be USD 550 million, is expected to be made available to Iran on or shortly after 1 February. Subsequent instalments are contingent on Iran demonstrating it has kept to its side of the deal.

Negotiations on the comprehensive solution are expected to start on or around 20 February. These will be challenging. After weeks of talks about a first step, these negotiations will have to address all subsequent steps, and will need to find permanent solutions. To be successful, any comprehensive solution will need to address issues such as Iran's history of nuclear weapons development, as revealed in the IAEA's 2011 report on the possible military dimensions to Iran's nuclear programme. Iran will also have to satisfy the E3+3 on the future of the heavy water reactor at Arak, and the degree to which Iran is permitted to enrich uranium. VERITY expects that the six month window will be rolled over at least once to allow the negotiations to be completed.

In Iran, reactions to the deal have been mixed. Most Iranian media outlets have described the deal in positive terms, with some hailing the deal as a great agreement, and others expecting sanctions pressure to begin to ease with immediate effect. Rouhani has hailed the agreement as "the surrender of the great powers" and their acceptance (though not explicitly recognised) of Iran's right to enrich. But Rouhani has also been careful not to overstress the limited nature of sanctions relief on offer, not least because of the scale of the task he faces in rebuilding the Iranian economy. Some hardliners, however, have attacked the deal. IRGC Commander Jafari, a particularly vocal critic, has accused the Government of giving up too much for too little in return. Iran's Supreme Leader has adopted a more careful approach. While not attacking the deal directly, he has repeated previous warnings about the untrustworthiness of the US. Editorials in *Keyhan*, the Supreme Leader's unofficial mouthpiece, have criticised the secrecy surrounding the negotiations.

In the West, the US and the UK have publicly stated their intention to continue to enforce existing sanctions. In an interview with the BBC at the World Economic Forum in Davos, Switzerland, on 23 January, US Treasury Secretary Jack Lew urged companies to proceed with caution when dealing with Iran. In an unambiguous warning to companies, LEW said that the US will be monitoring and enforcing sanctions. The US and the UK will be concerned to avoid Iran extracting too much financial advantage from the deal, and thereby reducing the incentives of a comprehensive deal. With Iran continuing its efforts to attract new business, the US and UK will also be keen not to leave the deal vulnerable to attack from its opponents.

Investors now face a dilemma. The attractions of trade with Iran are obvious, made all the stronger both by Iran's efforts to reach out to new partners and the more predictable business environment under the Rouhani administration. However, the risks of over confidence and miscalculation could be severe. The US can be expected to meet its commitment to enforce sanctions. Individuals and businesses caught operating beyond the limits of trade permitted under the Geneva deal will face regulatory action.

Macro economic news

TEDPIX reaches new high, then declines 8,000 points

The main index of the Tehran stock exchange, the TEDPIX, reached an historic high of 89,500 on 5 January 2014. Thereafter, however, the index declined steadily, reaching 80,789 on 27 January. The market rallied slightly towards the end of the month. At time of writing, the index had reached 82797.7. It remains to be seen how the first instalment of the frozen revenues in early February will be received by the market, and whether or not Iran has been shielded from capital inflows and therefore is more immune than elsewhere in the developing world to the withdrawal of the US stimulus.

Banking news

Bad loans amount to USD 32 billion

On 8 January, CBI Governor Valiollah Seif announced that the amount of bad loans in the Iranian banking system totalled the equivalent of about USD 32 billion. Seif announced the formation of special committees to investigate the bad loans, and announced the government was committed to returning the sum to the banking system.

Infrastructure projects delayed by unavailability of Iranian funding

VERITY's sources in Iran have revealed that as of November 2013, Iranian infrastructure projects were being delayed as a result of difficulties arranging Iranian domestic funding. Difficulties associated with securing the rials necessary for deposits and initial financing, caused in part by the unwillingness of Iranian commercial banks to provide private financing, meant that many projects had yet to get off the ground. VERITY has learned that letters of credit for projects valued at more than USD 15 billion, had not been issued as a result of these difficulties.

Oil and gas news

Iran and Iraq co-operation to attract international investment

According to press reporting from 28 January, Iran and Iraq oil sectors are working together to attract international investment ahead of the possible removal of international sanctions against Iran. Iran is reported to be keen to share Iraqi experiences in rebuilding an economy heavily dependent on oil. In what many are seeing as a challenge to Saudi Arabia's dominance of OPEC, Iraq and Iran are both considering significant increases in crude production within the next few years. Combined, Iran and Iraq hold greater reserves of oil than Saudi Arabia. A significant increase in production would be likely to depress oil prices worldwide without a corresponding decrease in oil production by Saudi Arabia and/or other members of OPEC.

December crude exports remained at 1 million bpd

According to a report published by the International Energy Agency (IEA) on 21 January, Iranian exports of crude in December 2013 remained at a similar level to the previous month. The IEA reported that Iran exported 1.15 million bpd in December, compared to 1.1 million bpd in November 2013. Following the announcement of the Geneva agreement on 23 November, there had been some speculation that buyers of Iranian crude would be tempted to increase their purchases. Evidence to date, however, suggests that Iran's customers will continue to abide by the limits imposed by US sanctions.

Plans to increase crude production facing delays

VERITY has learned that Oil Ministry plans to increase crude production by the beginning of the next Iranian year (21 March 2014) are likely to be delayed. In spite of Iranian assurances about the absence of technical constraints to increasing production, VERITY understands that Western financial, managerial and technical assistance will be required to redevelop Iran's ageing oil infrastructure. With such assistance falling outside the remit of the Geneva agreement, any firm wishing to provide such assistance is likely to find themselves in breach of US sanctions.

NIOC threaten to halt supplies to Jebel Ali refinery unless ENOC settle debt

VERITY has learned that in December 2013, NIOC were calling on the Emirates National Oil Company (ENOC) to settle outstanding debts. ENOC's debts totalled more than USD 4.5 billion, which it claimed it had been unable to repay as a result of restrictions imposed by sanctions on trade with Iran. VERITY's sources have revealed that NIOC had threatened to halt supplies of condensate to the Jebel Ali refinery unless ENOC settled the debt.

Other news

Further decline in Iran's automobile industry

Figures released by Iran's Deputy Industry Minister, Mohsen Saleh-nia, have revealed a continuing decline in Iran's automobile industry, traditionally the second largest sector in the Iranian economy after energy. In the first nine months of the current Iranian year, Iran has produced 520,000 units, a reduction of nearly 25 percent compared to production in the year before. Output in 2012-2013 was already depressed as a result of international sanctions introduced in 2012. Based on current trends, Iranian car production in 2013-2014 is likely to be 693,000 units, a reduction of more than half compared to 2011-2012, before sanctions were introduced.

Statistics

GDP Annual Growth Rate
2014: 1.3% (IMF estimate for 2014)
2013: -1.5% (IMF estimate for 2013)

Tehran Stock Exchange Main Index (TEDPIX)
30 January 2014: 82797.7

Inflation
Official figure: 35.5%

Unemployment
Official figure: 12.6%

Exchange Rates
Rial : USD
Currency Centre (CTC) rate: 24,868
Open Market Rate: 29,700