

## The long wait for sanctions relief

With the political process advancing as well as could be expected, international investors are feeling positive about the future prospects of the Iranian economy. But the long wait for sanctions relief leaves businesses on standby and is causing a drag on the economy. Investors are also increasingly aware of the complex legal terrain they will be trading when sanctions lift. Economic reforms are vital to the improve transparency and win the confidence of investors.

**The dismal performance of Iran's equity markets in recent months contrasts sharply with the positive progress being made towards finalising the deal.** The Tehran stock index has fallen to a 12 month low (see Fig 1), driven in part by sluggish demand, over-sized inventories, a depressed global outlook and weak oil prices. Total sales of publicly listed Iranian companies fell 12% over the year and total production 8%. The political milestones being reached in the nuclear negotiations are boosting investor confidence but only enough to offset these other negative dynamics. The Iranian rial also lost a further 1% in value against the dollar in the past month (see Fig 2), making that an almost 4% decline since the 14<sup>th</sup> July agreement was signed. Some market analysts blame a surge in demand for dollars in anticipation of the reopening of international banking and trading channels, plus feverish speculation in the black market.

**Of course, Iran's economic dip is consistent with the trajectory of other oil-dependent economies over the past 12 months.** Fig 3 shows the scale of the oil price shock that has hit the oil producers, which is particularly impactful given the lasting fundamental drivers behind it. Fig 4 shows how Iran's poor growth rate for 2015 still beats a number of other major oil producers.

**Iran's economic managers will be tempted to stimulate the economy but are more likely to maintain their grip on inflation for now.** President Rouhani is considering a substantial

**Fig 1. Iranian stock exchange (Tedpix All-share)**  
04-May-15 to present



**Fig 2. Iranian rial:USD exchange rate (market rate,**  
3-May-15 to present)



contraction in government spending next year as the government readjusts to much lower oil price expectations. The draft budget bill for the year to March 2017 is said to be crafted around an average oil price of \$42 to \$50, significantly lower than this year's \$72 per barrel. The Central Bank of Iran has confirmed its intentions to issue US\$600m of Islamic Treasury Bills, which will test the appetite for Iranian debt and may ultimately plug the spending gap.

**The time-lag between July's JCPOA agreement and the eventual lifting of sanctions appears to be placing a real strain on the economy.** Consumers are withholding purchases in anticipation of cheaper, more varied, higher quality foreign goods becoming available. Domestic producers are tightening their belts in fear of the competition that sanctions relief will bring. And even international investors who have long coveted the business prospects of an open Iranian economy are showing signs of cold feet. Trade delegations continue to arrive thick and fast, with new announcements and investment plans emerging from all sectors, but nothing is set in stone until "implementation day" for sanctions removal, leaving the Iranian economy in an uncomfortable limbo.

**Firms are increasingly aware of the ambiguous legal terrain they will be entering even after "implementation day" has passed.** Whilst around two-thirds of the 700 entities and individuals on the US sanctions list will be removed as part of the nuclear deal, many will remain and the list of designations is not standardised across European and US jurisdictions. US counter-terrorism sanctions will continue to prohibit business with subsidiaries or associates of the IRGC and given the hold the Guards have on the economy in crucial sectors, navigating a legal, risk free path will be complex and expensive for foreign investors. Certainly small and medium sized companies may find the costs prohibitive.

**International investors are undergoing a reality check on life after "implementation day" but the medium and long term prospects provided by the nuclear deal are undoubtedly positive.** Implementation day will bring a windfall of repatriated assets, new export markets, high quality intermediate goods and services and international expertise. But it will also risk undermining the competitiveness of Iranian firms and jobs and from a macro-perspective risk fuelling inflation. These are manageable risks but mean that as well adhering to a strict legal framework around the nuclear programme, the Iranian authorities have no time to waste in carrying out vital economic reforms. The oil sector has already developed a new legal framework for collaboration with foreign partners, which is a bold step towards improving the investment environment. The Finance Ministry has set out a blue print for banking reforms aimed at underwriting bad debts, improving competitiveness, better regulating in the banking sector and improving financial stability. The authorities will also be forced to address the role of the state in the economy, in order to provide the confidence and transparency foreign businesses need to invest in Iran's enormous economic potential.

