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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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Sanctions-relief the only stimulus for Iran's economy

The promise of "implementation day" came two steps closer this month with legal approval for the JCPOA framework achieved in Tehran and Washington DC. However, the short term pain in the Iranian economy is becoming increasingly hard to bear; President Rouhani has finally given in to the need for short term financial stimulus over his commitment to contain inflation. Only sanctions removal will deliver real relief to the Iranian economy in this harsh global economic environment.

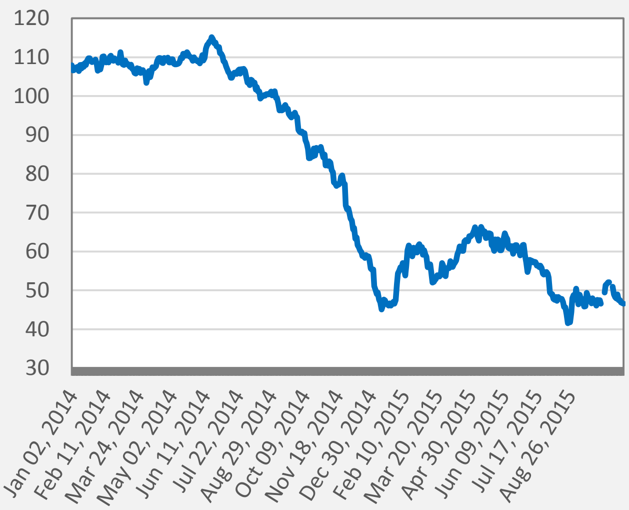
Fig 1. Iranian stock exchange (Tedpix All-share)
04-May-15 to present

After another month of political milestones, the long term implications of sanctions relief for the Iranian economy are as attractive as ever. The Tehran Stock Exchange finally showed signs of life with a 1% uptick on 14th October (see Fig 1) as the Iranian Majlis passed the JCPOA (Joint Comprehensive Plan of Action) Implementation Bill. Later that week, the US administration also approved the JCPOA conditional sanctions waivers, establishing the legal framework to lift extra-territorial financial and oil sanctions from Iranian entities. The implementation of these legal waivers will only come when the International Atomic Energy Agency (IAEA) confirms the Iranian authorities have taken the required steps to sufficiently dismantle their nuclear programme. The IAEA is due to issue its report on the possible military dimensions of Iran's nuclear programme by 15 December 2015.

Meanwhile, short-term economic pressures intensify and President Rouhani has bowed to pressure to loosen his anti-inflationary stance. A disappointing string of macroeconomic data and growing pressure from conservative commentators were compounded by an open letter to the President from four of his key ministers, including Tayebnia, the Minster for Economy and Finance, and Nematzadeh, the Minister for Industries and Commerce. The letter warned of a looming financial crisis should the Iranian economy be allowed to slip back into recession unchecked. The IMF's Tehran mission report suggested the economy may have contracted in the first half of 1394 (the year to March 2016) and would continue to do so in the second half unless sanctions were lifted very quickly. The Statistical Centre of Iran's own data revealed a 2% drop in industrial production in the first quarter of 2015, which supports the IMF's point of view. Stubbornly low oil (Fig 2) and iron ore (Fig 3) prices continue to squeeze the private sector and place a strain on government revenues. President Rouhani has responded with a "short term plan" to stave off recession in the second half of 1394 (the year to 22 March 2016). The stimulus plan includes a cut in the legal reserve requirements for commercial banks from 13% to 10% and a commitment to inject 75 trillion rials ($2.5 bn) into development projects.

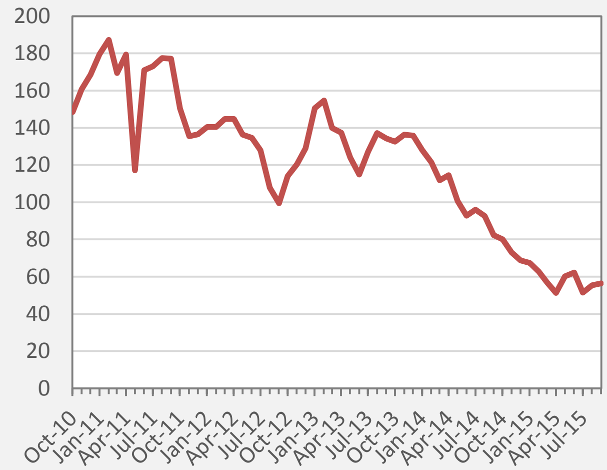
History will judge the wisdom of Rouhani's change of tack but many economists argue that the stimulus package fails to address the real drivers of Iran's slump. Verity-Iran analysts have long maintained that the short-term constraints on Iran's growth come from a) exogenous, international factors, such as the global economic slow-down and the drop in oil and minerals prices, as well as b) the collapse in domestic demand as consumers and businesses defer spending and investment decisions until after sanctions are lifted. Minister Nematzadeh has pointed to the seizing up of new car purchases and the 5-6% drop in purchases of white goods since the nuclear deal was announced. Similarly, many infrastructure projects have been delayed or suspended due to the dramatic shortfall in tax revenues this year.

Fig 2. Brent crude oil price (USD pb)
Jan 2014 to present



The stimulus most needed by the Iranian economy is the successful delivery of sanctions-relief and the long-awaited "implementation day" of the JCPOA agreement. Iranian ministers have reiterated their intention to boost Iranian crude production by 500kbpd as soon as sanctions are removed. Iran will receive a windfall of frozen funds and export revenues and an influx of foreign investment and high-quality goods and services that will provide the fuel for a short term lift. However, the recent IMF report also made clear the importance of deep-seated structural reforms to deliver Iran's economic potential. It concluded that if only mild-reforms were achieved, sanctions relief would have only a moderately positive impact on the economy. More assertive, deeper reforms would boost investor confidence and place Iran on a significantly higher growth trajectory.

Fig 3. Iron Ore price (USD pb)
Jan 2014 to present



Before any of this can be achieved, the Iranian authorities face the daunting task of delivering a menu of technically and logistically complex promises about its nuclear programme. This includes reducing the number of centrifuges used to enrich uranium and reducing the enriched uranium stockpile. President Rouhani has repeatedly stated his "end of 2015" ambition for "implementation day" but there remains a lot to do before the IAEA's conditions are met and it is conceivable that "implementation day" may not materialise until the middle of 2016.

Meanwhile, the US administration has impressed upon international business leaders and banks at the highest level the risks of dealing with Iran before sanctions are removed. The US State Department issued a demarche to its network of embassies to warn businesses and banks against premature engagement with designated entities. The authorities also held round-table discussions with oil industry executives and bankers in Washington and New York to reiterate that sanctions remain in effect. Nevertheless, legal processes are being put in place in the US and the EU to enable sanctions relief to take place. The global financial messaging service, SWIFT, announced that most Iranian banks will be able to reconnect to its financial transactions system as soon as economic sanctions are lifted, which would immediately loosen the constraints on Iranian businesses and kick-start the post-sanctions economic revival.