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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY



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### November overview

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

#### *Four (more) days in Geneva*

After two further rounds of talks in Geneva in November, an agreement was reached between the E3+3 and Iran in the early hours of 24 November. The agreement on a Joint Action Plan sets out a first step, lasting six months (but renewable) in which Iran will take action against many of the E3+3's most pressing proliferation concerns, and will in return receive proportionate sanctions relief. The Plan also looks ahead to the final step of a comprehensive solution, in which all concerns about Iran's nuclear programme are fully resolved, and all international sanctions are lifted. The Plan implies in its preamble formal recognition that, in the event of a comprehensive solution, that Iran will have a (limited) enrichment programme. Full details can be found in a fact sheet on the US Department of State's website.

The agreement opens a window for Iran and the E3+3 to begin to plan a comprehensive solution to the nuclear programme. Once implemented, it will provide a little much needed oxygen for the Iranian economy. Details on the implementation of the deal are to be agreed over the next two months, with the deal expected to begin in earnest early in 2014. The State Department estimates the level of sanctions relief at approximately USD 7 billion in total, though



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other estimates vary. If Iran fails to meet its commitments, the E3+3 will revoke the sanctions relief.

Reactions to the deal have been largely positive, internationally and in Iran. The Supreme Leader issued a congratulatory message to the negotiation team on their return to Tehran. The efforts of a handful of hardliners in the Majles to criticise the ambiguous wording on Iran's right to enrich in the event of a comprehensive settlement were very much in the minority. Israel maintained their opposition to the agreement, criticising it as an 'historic mistake' and refusing to be bound by it. More significantly, some members of the US Congress believe that the concessions made to Iran outweigh the concessions obtained from Iran.

In Tehran the market reacted strongly to the news of the agreement. Already riding high following the Geneva talks in October, the Tehran Stock Exchange reached a succession of new highs in November. Barely registering the disappointment at the failure to reach an agreement at the first round of talks in November, the Stock Exchange rose to a new high above 82,000 after the announcement of the agreement on 24 November. According to VERITY's sources, the value of the Rial on the open market also strengthened following the announcement of the agreement, crossing to below 30,000 Rials to the US Dollar for the first time in months.

Reports have emerged since the agreement of attempts by Iran's Oil Ministry to attract US and European oil firms back into Iran. Oil Minister Bijan Namdah Zanganeh told London's Financial Times that Total, Royal Dutch Shell and Statoil were among the firms that he was reaching out to. Trade with Iran will be an enormously attractive prospect for many investors, particularly for those with interests in the energy markets.

Investors should remain wary of over-optimism. The structural problems that brought Iran to the negotiation table are still present (see below). The sanctions relief on offer at Geneva was limited. The majority of the sanctions architecture remains in place. The US and the EU have said that they will continue to enforce remaining sanctions rigorously. While the E3+3 have signed up to no new sanctions against Iran for the duration of the agreement, those breaking existing sanctions can still be designated. The US waiver system that has steadily reduced the quantity of Iranian crude that countries can import is frozen at its current levels, thereby preventing Iran from substantially increasing its exports.

Alongside monitoring companies trading with Iran, Iran itself will be monitored closely. Evidence that Iran is breaking sanctions or not sticking to the Geneva agreement will undermine the deal, and likely lead to its collapse.

The hardest part lies ahead. It took a great deal of work and difficult negotiations to bring both sides to an agreement effectively to pause current activity for six months. To bring about a comprehensive solution that allows Iran enough of a civil nuclear programme to satisfy an Iranian audience, but not so much of a programme to concern a Western audience, may ultimately prove unobtainable. By Rouhani's own admission, the Iranian economy remains in critical condition. The limited sanctions relief could yet be reversed, and sanctions could still be strengthened further. Over hasty investments could fast be exposed as reckless if the agreement collapses before a deal can be reached. Iran may face darker economic days ahead.

### *Rouhani's first 100 days*

On 26 November, President Rouhani marked his first 100 days in office with a televised speech and a flurry of messaging on social media. Focussing on the economy, Rouhani painted a picture of an economy still facing challenges beyond sanctions pressure. Many of the problems, he said, were caused by the mismanagement and profligacy of his predecessor, President Ahmadinejad. Referring to the previous Iranian year, Rouhani described the stagflation as unprecedented. The economy contracted by 6 percent, while inflation rose above 40 percent. Despite receiving USD 600 billion dollars in oil revenue in the eight years of his presidency, the legacy of Ahmadinejad's two



terms was a debt of around USD 67 billion.

Looking ahead, Rouhani said that reducing inflation would be a priority. The Government planned to reduce it to below 25 percent by the end of the following Iranian year. Government figures suggested inflation had fallen from 43 percent to 36 percent since Rouhani took office. Rouhani said that his Government would also reform the banking system, stabilise the currency, reduce unemployment, promote agriculture and reduce Iran's dependence on imports. The reform of Ahmadinejad's subsidy reform programme, however, will have to be postponed.

Rouhani will be judged by his record on the economy. His performance thus far has been positive. He has brought in experienced and capable ministers and managers and begun to address structural weaknesses. The stabilisation of the currency and the increased transparency in the budget has been particularly welcomed by investors. The rise and rise of the stock exchange is a sign of increasing confidence. But Rouhani and investors will know that sustained economic success is tied intrinsically to the successful resolution to the nuclear negotiations and the lifting of sanctions. By far Rouhani's biggest success has been to come to a first step agreement at Geneva without losing the support of the Supreme Leader or hardline factions. Failure to retain this support while searching for a comprehensive solution with the E3+3 would jeopardise progress across the board, and lead to severe contraction in the economy.

## 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

#### *Government stats show economic fundamentals in decline*

Iran's economic fundamentals have continued to decline, in spite of the optimism surrounding the granting of temporary sanctions relief at the talks in Geneva, according to VERITY's sources. Unofficial Government estimates of the rate of inflation are approaching 70 percent, and considerably higher for some goods. Oil sales have continued to fall as customers have sought to remain within limits imposed by the US waiver (India, China and South Korea will look to earn renewed waivers in early December). Accessible foreign reserves have decreased as the Government has had to pull on available pots of money to keep the Government functioning.

#### *Iranian Government requires USD 40 billion before year end*

VERITY has learned that the hole in the Iranian Government's finances is growing wider. It is now estimated that more than USD 40 billion will be required before the end of the financial year to enable the Government to finance its agreed spending. Some analysts are predicting energy shortages over the winter unless action is taken to plug the gap. As yet, however, there have been few indications that the Government's response has extended beyond the planning stage. Yet it is increasingly clear that an increase in domestic energy prices will be necessary to stave off possible shortages.

#### *Decline in foreign trade*

Iran's non-oil import and export trade declined in the first 7-months of the current Iranian year compared to the same period last year, according to Iranian customs data reported in the Tehran Times. Exports fell by 15 percent to USD 21 billion worth of goods, while imports were down by 25 percent to USD 24 billion. Iron ore concentrate, urea and methanol were the principal non-oil exports. Rice, soy meal and wheat were the principal imports. Iran exported most



non-oil products to China, Iraq and the UAE, and imported most products from UAE, China and India.

## Banking News

### *Bank Melli Iran in the UAE investigated for insolvency*

VERITY's sources in the UAE have revealed that Bank Melli Iran's UAE division is suspected of insolvency, and is the subject of an investigation by Emirati authorities. Bank Melli Iran in the UAE appears to be struggling under the weight of bad loans. Bank Melli Iran has been left exposed by the inability of other Iranian banks to repay loans. Sanctions imposed by the US and the EU have left it isolated.

### *Staff at Bank Tejarat call on President to take action against Bank Chief*

VERITY has learned that staff at Iran's Bank Tejarat have called on President Rouhani to take action against the Head of Bank Tejarat, Mohammed Reza Ranjbar Fallah. They have accused Ranjbar of nepotism and 'mafia-style' leadership at the bank, which has resulted in a loss of market share and low morale amongst staff. Ranjbar has prioritised spending on his own foreign trips, whilst cutting employee salaries and bonuses.

### *EU re-imposes sanctions on Iranian companies*

The EU has restored sanctions on several Iranian companies previously designated on suspicion of assisting Iran's nuclear programme, according to media reporting. The European Court had ordered the de-listing of the companies in September. The media reports listed the companies affected as follows: Post Bank, the Insurance Company of Iran, Good Luck Shipping Company, the Export Development Bank of Iran, Persia International Bank, Offshore Engineering and Infrastructure Construction Company, and the Workers Welfare Bank.

## Oil and gas news

### *Iranian to head GECF*

At a meeting in Tehran on 3 November, Mohammed Hussein Adeli, a former CBI Governor and diplomat, was elected to lead the Gas Exporting Countries Forum (GECF). The election of Adeli secures Iran an influential voice in the global gas market. It will provide Iran with access to government and industry leaders, and present crucial opportunities to attract investment and trade.

Iran, the world's third largest gas producer and with gas reserves believed to rival Russia's, is currently a net importer of gas, mostly from neighbouring Turkmenistan. Despite the absence of sanctions specifically prohibiting the export of Iranian natural gas, investors continue to be put off by Iran's history of nationalising oil and natural gas assets, and the fear of falling foul of international sanctions on Iran's banks.

### *NIGC bankruptcy denied*

Reports that the National Iranian Gas Company (NIGC) had declared bankruptcy were denied on 22 November by NIGC's CEO Hamid Reza Araghi. Without denying serious financial problems, Araghi emphasized that the NIGC was working with the Iranian Government and the Majles to resolve the problems.

The Iranian media had reported on 18 November that the NIGC had declared bankruptcy. NIGC debts were reported to total more than USD 4 billion. Oil Minister Zanganeh, who has ministerial responsibility for Iran's gas sector,



blamed the debts on the mismanagement of the subsidy payments set up by the previous administration.

## Other news

### *Iran's strategic reserves of bank notes declines to critically low-levels*

VERITY has learned that Iran's strategic reserves of bank notes have declined to critically low-levels as a result of international sanctions. The decline has reduced the CBI's ability to meet the domestic bank note needs of various organisations. Critically, it has also impacted on the bank note resources available to the CBI to control the currency rate

## Investment Focus

### *China's shale gas resources – impact on Iran's natural gas exports*

It has recently become apparent that China has shale oil and gas reserves almost as large as the US, according to research published in the US in June 2013. China's shale gas is located in more complex geological formations than that of the US, and while China does not yet possess the sophisticated technology needed to exploit it, this is a solvable engineering problem. It is only a matter of time before China develops its natural gas assets, fundamentally shifting the Asian natural gas market to lower prices, and posing a long-term challenge for Iran's natural gas sales.

Currently, prices for natural gas (sold as liquefied natural gas, or LNG) in Japan and South Korea are about twice that of Europe, justifying expensive LNG projects in Qatar and Australia. While such a project would be justifiable for Iran as well, sanctions would need to be lifted for Iran to obtain the required technology from the West. If sanctions were eased within months (not years), and that technology became available, an LNG project could be a viable means of utilizing Iran's natural gas assets. If not, investment in LNG-related companies should be avoided

## Statistics

### **GDP Annual Growth Rate**

2013: -5-8% (VERITY estimate for 2013)

-1.3% (IMF estimate for 2013)

-5.9% (CBI measurement for 4th quarter of 2012)

Tehran Stock Exchange Main Index (TEDPIX) 27 November 2013: 82129.8

### **Inflation**

Estimated at 60%+ across Iran

Vs. Official figure: 36%

### **Unemployment**

Between 30-35%

Vs. Official figure: 12.2%

### **Exchange Rates**

Rial : USD 1

Reference rate: 12,275

Currency Centre (CTC) rate: 24,794



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Open Market Rate: 29,600



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