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Iran's response to any change in US policy will shape its relationship with the global economy

With businesses scrambling to announce as many deals as possible before the goal posts are shifted, there are clear signals that the world and Iran want to do business. In the coming months, Iran can commit to working pragmatically around the new dynamics of its relationship with the US or it can undo the hard work of the last four years and reverse into economic isolation. Next May's Iranian Presidential election will be crucial in defining Iran's place in the global economy.

The fate of the JCPOA in the "Trump era" is not yet known but there are signs that even if the US chooses to change course, Iran might adequately rely on its relationship with the rest of the world to continue the path of economic integration. Contrary to what the more hawkish opponents to the JCPOA might suggest, many analysts argue that the US authorities would not be able to simply "switch back on" the leverage they had mounted over Iran in 2013 when the core deal was struck. That was the result of years of incremental legal and diplomatic pressure, orchestrated by an international coalition that included the world's most important financial centres. Today the international context is different. The other parties to the deal are ostensibly happy with its progress following positive reports on compliance from the IAEA and strengthening trade and investment relationships. The UK Prime Minister said in a speech to the Gulf Cooperation Council in early December that the UK would regard itself bound by the JCPOA agreement, even if the US withdrew.

Foreign investors remain cautious about Iran on the whole, but some big players are sending a clear message that regardless of the politics, they want to do business. US aircraft manufacturer, Boeing, announced a US$16.6 billion deal with Iran Air to supply 80 new planes, with a plan to avoid routing money through the US financial system. A similar deal with Boeing's competitor, Airbus, is also anticipated in the coming weeks. Royal Dutch Shell announced a provisional agreement with the National Iranian Oil Company to develop two large oil fields. This follows hot on the heels of last

Fig 1. Tehran Stock exchange (TEDPIX All Shares Index) 21 March 2016 to present

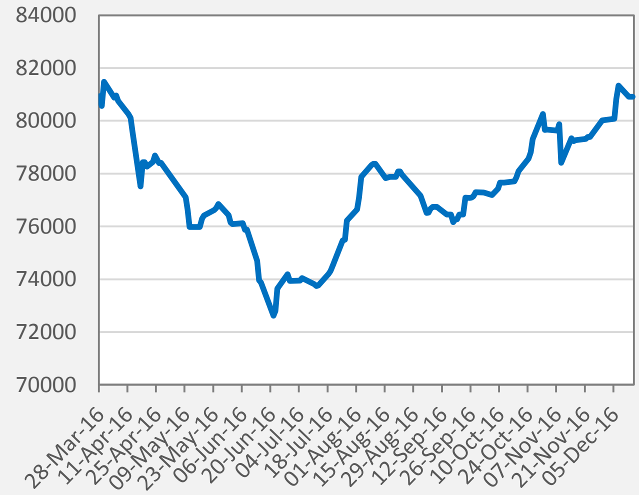
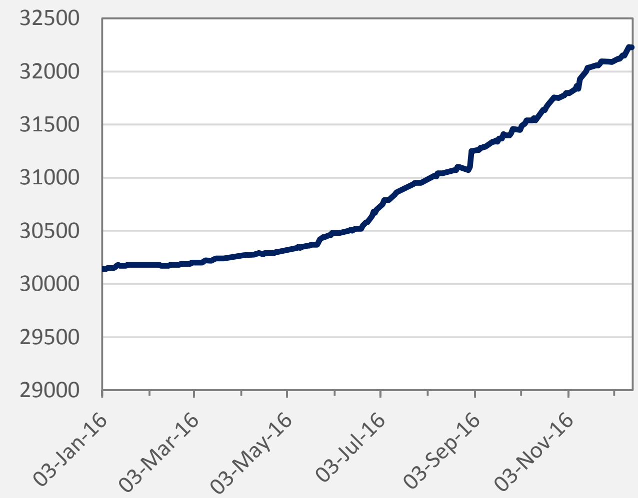


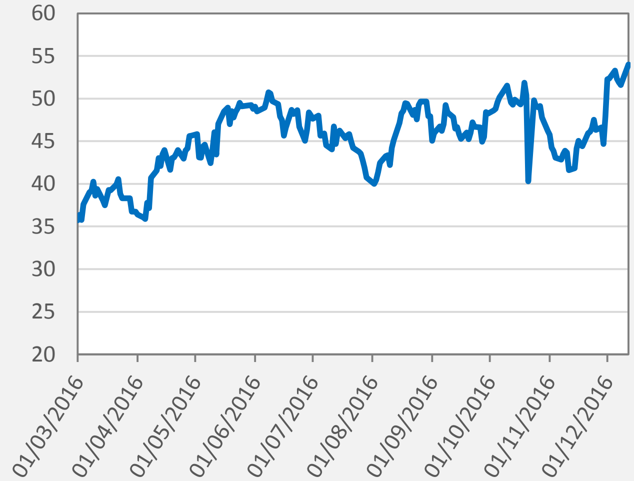
Fig. 2 Iranian Rial to USD, official exchange rate 1 January 2016 to present



month's agreement in principle with Total and CNPC to invest US$4.8 billion in the South Pars gas development. International oil majors are balancing off the risk of an uncertain US policy stance against the opportunity of long-lasting, low-cost oil and gas supplies that few other countries can offer. Russian companies also signed nine deals in Iran this month from energy to railways, worth US$10 billion.

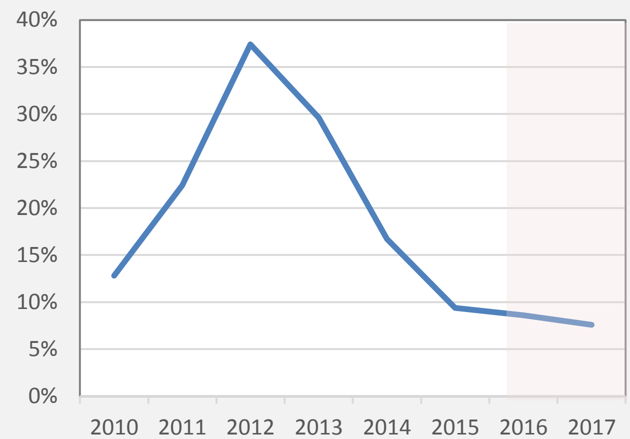
Just five months from the Iranian Presidential elections and only weeks away from political transition in the US, there is a sense that Iran is lining up as many deals as possible as insurance against a potentially less compliant atmosphere in the future. Iran needs to attract up to US$40 billion of investment per year in the oil and gas sector to restore its position as a leading oil producer and revive its economy – those resources are not available domestically. Iranian oil fields require sophisticated foreign technologies, not to mention advanced management practices, to compete with the efficiency of international operations.

Fig 3. Brent Crude Oil Price $/barrel
(March 2016 to present)



It is telling that whilst many agreements are signed in principle, few if any are finalised, and the five month run-in to the Iranian election will be a crucial test. There are forces at play that are outside Iran's control when it comes to attracting investment - such as the oil price or the policy tone in the US. But Iran's place in the global economy will largely depend on its response to those cross-winds in this unpredictable period. Iran's more sympathetic business partners are waiting to see it is committed to the path of the JCPOA and serious about cleaning up its business environment and ensuring the rule of law for foreign investors. Despite the US President-elect Trump's harsh rhetoric on the JCPOA deal, some analysts expect pragmatism from him on foreign policy. He himself publicly lamented the lack of US business in Iran in the wake of the nuclear deal, so a business-oriented solution to keeping the JCPOA alive may be a possibility. Even without it, non-US companies will have some room for manoeuvre if Iran can do more to lower the risks. On the other hand, an Iranian backlash against the Trump administration could lead to a downward spiral of retaliation that would be sure to put a halt to Iran's reintegration into the global economy.

Fig 4. Consumer Price Inflation (YOY % Change)
(2010 to 2017, projected)



In the meantime, the Rouhani administration continues to focus on the economy, submitting an expansionary budget bill to parliament at the beginning of December. Government spending is up almost 11% from this year, with predictions of 7.7% GDP growth and inflation of 7.6%. The government is optimistic about oil revenue growth, inward direct investment (projected to grow 12.3%) and the repatriation of overseas assets. The new sovereign bond market is also a key tenet of the budget plans, enabling the state to refinance around US$10 billion worth of debts to contractors, with provisions to issue a further US$1.5 billion to pay off bonds as they mature. Tax revenues are predicted to rise by 8.7% and revenue from crude oil exports to grow based on an assumption of US$55 per barrel and 2.42 million barrels per day exported.