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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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February overview

Increasing signs of confidence, but still some way from business as usual

On 18 February, the first instalment of the sanctions relief promised to Iran under the Geneva deal was released by a Japanese bank. This represents the first tangible benefit to Iran of negotiating with the E3+3 on its nuclear programme. Considered together with the other positive news from Tehran, there are signs of increasing confidence in Tehran. Iran has been flooded with international trade delegations, seeking to re-establish ties with Iranian businesses. Oil exports increased slightly, according to figures released by the International Energy Agency. And, in a sign of the improvements President Rouhani has made in governance, the proposed budget for the next Iranian year was delivered and approved by the Majles on time.

However, it also became clear during February exactly how limited the benefits of the Geneva deal are. On 6 February, the US announced a number of new designations of Iranian and foreign individuals and entities it accused of having breached US sanctions on Iran. VERITY understands that the EU are also working up a number of designations of entities accused of breaching EU sanctions on providing support to the Iranian economy.

It is clear that it is not business as usual on Iran. While the visits of the numerous trade delegations were a sure sign of a thaw, the lack of firm deals being reached is evidence that the winter continues. The US government has clearly shown that they will sanction anyone who attempts to do business beyond the limits of what was agreed at Geneva. Investors need to proceed carefully. The Geneva deal provided some breathing space for businesses. By far the biggest benefit of Geneva was the pause on new pressure measures being introduced for the duration of the Geneva deal, initially six months. For the first time in years, there is now a short period of certainty in which companies can establish ties with Iranian businesses that can be operationalized when a comprehensive agreement is announced.

In practice, this means that we are seeing some stability in the Iranian market, and an increase in confidence. The Geneva deal has set the conditions in Iran for some growth (according to the IMF prediction, following their visit in February), or at least an easing of the recession and a return to a more even keel. But, equally, it is increasingly clear that without a comprehensive agreement on the Iranian nuclear issue, there will be no normalisation of trade. Without a normalisation of banking rules, oil exports and investments, the prospects for the Iranian economy are only positive in so far as the sharp contraction in the economy is averted for now. Trade beyond the six months of the Geneva deal are still prohibited. Investors will be following developments in Vienna, where the talks on a comprehensive agreement are taking place, because a huge amount rests on the outcome of those talks.

Macro economic news

Talks on a comprehensive nuclear settlement begin

The first talks on a comprehensive settlement on Iran's nuclear programme between Iran and the E3+3 were held in Vienna between 18 and 20 February. The details of the discussions remain confidential, but both the Iranians and the E3+3 representatives described the atmospherics as positive and constructive. It is early days, and the issues to resolve are large and complex, but investors will be encouraged to see the talks begin. The Iranian negotiators appear to have retained the support of the Supreme Leader, at least for now. The continued support of the Supreme Leader will be crucial if Iranian domestic opposition is to be kept in check, and the talks are to reach a successful conclusion.

US designations of foreign companies accused of providing support to Iran's nuclear programme

On 6 February, the US Treasury Department announced that it had placed sanctions on a range of Iranian and foreign individuals and companies it accused of providing support to Iran's nuclear programme. Iran immediately responded, publicly summoning the Swiss Ambassador, who represents US interests in Iran, to protest against the US sanctions.

The announcement marked the first set of sanctions to be introduced since the implementation of the Joint Plan of Action last month, and the first since the designations of Iranian entities in mid-December 2013. The list of those newly designated included non-Iranian individuals and entities, most notably German bank Deutsche Forfait, and Ulrich Wipperman, a board member at the bank. In a new initiative, implementing an executive order issued in 2012, the US Treasury also published a new list of foreign sanctions evaders. Those listed are excluded from the US financial and commercial systems, though assets haven't be seized. Three Georgia-based Iranians, Pourya Nayebi, Houshang Hosseinpour and Houshang Farsoudeh, and 8 companies they controlled, were added to the new list for facilitating transactions for people sanctioned by the US.

The US Treasury announcement was widely covered in the press. It followed months of consistent messaging by the US that they intended strictly to enforce sanctions. For the E3 and the US, determined to keep the economic pressure on Iran to negotiate a comprehensive agreement, sanctions enforcement plays a key part in ensuring that the sanctions relief offered at Geneva remains limited. Enforcement of existing sanctions provides the incentive for Iran to reach a comprehensive agreement with the E3+3. Faced with scepticism to the deal from Congress and Israel, VERITY expects the US to be paying close attention to businesses trading with Iran in the coming months; investors will be aware that those found to be doing deals beyond the scope of the Geneva agreement will be liable to regulatory action.

Iranian officials have expressed concern that the introduction of the US sanctions has caused confusion among investors. Iran has made considerable efforts since the signing of the Geneva agreement to reach out to companies around the world in an effort to attract new business. There have been more than 100 visits by commercial delegations to Iran since the inauguration of President Rouhani in August, including from France and Germany. However, the new designations have left companies unsure about what trade with Iran is permitted, Deputy Oil Minister Abbas Sha'ri told *The Financial Times*. Investors will be waiting for a clearer picture about the outcome of the negotiations on the comprehensive agreement to emerge before making investment decisions.

IMF returns from visit to Tehran

On 8 February, the International Monetary Fund (IMF) concluded their first visit to Tehran since mid-2011. In a press release on 12 February, they offered their interim conclusions; a substantive paper will follow by the end of March, for consideration by the IMF Board.

The press release focuses on the domestic economy, and shows support for Rouhani's reforms. While the IMF see the economy continuing to contract this year, with GDP down by about 1-2 percent, they forecast modest improvements in economic conditions for the next Iranian year (GDP up by 1-2 percent). Inflation, they suggest, will decrease by the end of this year, and again next year, to about 15-20 percent. The release supports the policy of raised domestic energy prices, if they can be introduced, and emphasizes the importance of labour market reforms to help stimulate employment.

While the press release appears to take account of the limited sanctions relief offered under the Geneva deal, it makes no assessment of the full difference the Geneva deal will make to the Iranian economy. Investors will note that the press release only briefly mentions sanctions, and the effect of external pressure on the Iranian economy. Most observers, however, including VERITY, consider sanctions to be the biggest single immediate obstacle to Iranian economic progress. There are also few indications in the press release to suggest that the IMF has taken into account the political context for economic policymaking in Iran, such as the huge state sector, the economic roles of the IRGC and the Majles, and the vetting of economic legislation by the Supreme Leader and the Guardian Council behind the scenes.

Majles approves next year's budget

On 18 February 2014, the Majles voted to approve the government's budget for the next Iranian year (starting 21 March), after it had been revised by the Guardian Council. 160 Majles members present voted in favour of the bill; only 4 voted against. Investors will welcome the Majles's approval of the draft budget. It promotes stability and continuity in economic policy making, which stands in stark contrast to the situation under President Ahmadinejad. Ahmadinejad's budget plans were often presented late, neglected to include key aspects of government spending, and on occasion failed to win approval even after the next financial year had begun.

Crucial aspects of the government's spending plans, however, remain uncertain. It is not clear how effectively Rouhani's subsidy reform plans will be implemented when they come into effect on 20 June. Government subsidies, for example, on fuel and food, are estimated to cost the government approximately USD 100 billion per year. However, reform is controversial as it will cause substantial price rises. Moreover, as VERITY has written before, government revenue from oil sales and taxation remains uncertain. Revenue shortfalls this year have slowed development spending. The availability of revenue will determine whether or not the government is able to meet its spending plans.

Iranian budget deficit exceeds USD 40 billion

VERITY has learned that Iran is currently running a budget deficit of more than USD 40 billion. This is estimated to be about 10 % of Iran's GDP, and is a sign that Iran's economy is still suffering from recession. The government is likely to be forced to cut back on spending this financial year, as it seeks to reduce the size of the deficit. The government's response will limit the amount the economy is able to benefit from the sanctions relief offered by the Geneva deal.

Banking news

Japanese Bank provides first instalment of sanctions relief

Reuters on 5 February reported that the first instalment of the USD 7 billion sanctions relief provided to Iran under the Geneva deal had been provided by the Bank of Japan. The instalment is believed to total USD 550 million. The next instalment of sanctions relief, which is likely to total USD 450 million is due to be released to Iran on or around 1 March.

Oil and gas news

Monthly oil exports rise

Figures released by the International Energy Agency (IEA) reveal that imports of Iranian crude rose by 100,000 bpd in January, to 1.32 million bpd. China, Japan and India imported more Iranian oil, according to the IEA, while imports by South Korea, Syria and Taiwan were reduced. Iran continued to hold an estimated 30 million barrels of crude oil on tankers, including 6 million barrels held off the coast of China.

Ministry of Oil likely to default on its debts

VERITY has learned that the Ministry of Oil is likely to default on its debts to the CBI within the next year. The CBI has provided more than USD 25 billion in foreign exchange to the Ministry of Oil over the last 4 years. The money was provided to help to fund oil industry development projects. However, a combination of existing international banking sanctions and lower than expected income as a result of international oil sanctions, mean that the Oil Ministry will be unable to repay its debts to the CBI next year.

Indian imports of Iranian urea decline

VERITY has learned that Iranian urea exports to India in the first half of 2013 had declined substantially. Production problems and a shortage of necessary spare parts contributed to the decline in exports. Indian customers were increasingly turning to Chinese producers to supply urea.

Iran to introduce new generation of oil contracts

Oil Ministry official Mahdi Hosseini, head of the contract revision committee, told the Associated Press in mid-February that Iran planned to introduce a new generation of oil contracts by June that would offer greater potential benefits to foreign investors in Iran's oil sector. No details have yet to be provided on the exact shape of the new contracts, but investors will welcome the recognition As part of Iran's planning for a post-sanction era, in which Iran hopes to raise production to 4 million bpd within 6 months of sanctions being lifted. Iran's plans require Iran to attract

USD 150 billion worth of investment for its energy sector over the next five years.

Other news

Majles report implicates Iranian police in corruption

A Majles report published in late January named the Iranian law enforcement forces in a list of individuals and companies that had sold Iranian oil but not returned the money to the Iranian treasury. Others included in the list include disgraced trader Babak Zanjani, who is currently in prison in Tehran. Iranian law enforcement were accused of owing the treasury the revenue from the sale of 1.6 million barrels of oil.

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)
26 February 2014: 79785.5

Inflation
Official figure: 35.5%

Unemployment
Official figure: 10.4%

Exchange Rates
Rial : USD
Currency Centre (CTC) rate: 24,896
Open Market Rate: 29,700