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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY



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March overview

New Year; major challenges

1393 (21 March 2014 – 20 March 2015) will be an historical year in Iran. For President Rouhani, key challenges lie in the first six months. The Joint Plan of Action, implemented in January 2014, expires in June; time is short to find a comprehensive agreement. The new budget and the Targeted Subsidies Plan are now in place, meaning higher prices for utilities, which will not be popular among consumers or suppliers. And, all the while, hardliner opposition to Rouhani and the nuclear deal is growing.

Nuclear talks between Foreign Minister Mohammed Jawad Zarif and representatives of the E3+3 so far are reported to have been positive, but they have yet to focus on the main issues of contention. As Zarif told the IRNA on 19 March, negotiations on the main issues of contention for the nuclear accord will kick off in late April. Whether it is possible to find a deal that satisfies the West and that Rouhani can sell to Iran is far from certain, but is vital if the Iranian economy is to improve long-term.

Currently, in spite of the limited sanctions relief Iran has received to date and the efforts to attract international



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investment, the immediate economic outlook for Iran is uncertain. On the positive side, the open market exchange rate has stabilised, and the government's effort to bring down inflation is beginning to bear fruit. Oil exports are up, at least for now. Greater transparency and more sensible economic policymaking have resulted in slightly improved investor confidence. Rouhani's economic team, and the IMF (albeit cautiously), have suggested that the economy may yet return to limited growth this year. But, crucially, this has not yet translated into economic improvements on the ground in Iran. With the majority of international sanctions still in place, and the major socioeconomic problems that accumulated over the last few years persisting, the Iranian economy may still be contracting. The legacy of the Ahmadinejad years of economic mismanagement and nuclear-fuelled isolation will take years, not months, to clear.

Macro economic news

IMF Iran report released

The International Monetary Fund (IMF) has now completed its full report on the Iranian economy, based on their findings from their two week visit to Tehran in January-February 2014. The report will be published following the IMF Board discussions on 28 March.

As expected, the report focuses on the domestic economy and largely steers away from politically contentious issues such as the political system, its impact on economic policymaking, and the economic damage caused by politically-driven policies such as maintaining the huge state sector. It contains no big surprises, and is broadly in line with President Rouhani's administration on the prospects for the economy and economic policy priorities.

On sanctions, the report acknowledges that sanctions have contributed to economic contraction, but does not attempt to quantify the size of that contribution. In terms of outlook, the report presents scenarios on the likely medium-term (5 years) impact of sanctions easing and sanctions being sustained. In the scenario that sanctions ease, the IMF estimate a growth in real GDP of 4.2 – 5.7 percent per annum over 5 years (driven largely by a projected increase in oil output to 4.3 million bpd); in the alternative scenario that sanctions are sustained, the IMF estimate a growth in real GDP of 2.3 percent per annum over 5 years. Unfortunately, there is little explanation of how the IMF arrive at these estimates, and so it is difficult to assess their credibility. No attempt is made to estimate the impact of an intensification of sanctions, perhaps because of the political implications of a neutral UN body presenting a scenario that would inevitably make a clear economic case for Iran to agree a comprehensive nuclear deal.

On the labour market, the IMF assess that under current conditions, with no sanctions lift or reform of the labour market, unemployment will rise from the current 12.2 percent (which is nearly 2 percent higher than the most recent Iranian government estimate) to nearer 20 percent by 2018. Underemployment, which the Iranian government estimates at nearly 10 percent, should be added to this calculation.

In spite of the best efforts of the IMF to remain diplomatic, it is clear that there are some points in the report that are likely to attract controversy inside Iran. For example, there are some fairly thinly veiled criticisms of President Ahmadinejad's policies and support for economic reforms. The call for a major liberalisation of the labour market to promote employment growth could concern the large numbers of workers employed in state enterprises. And the call for state enterprises to be integrated into the government's budget may also be seen as a threat to the continued funding of some of the government's loss making enterprises.

Overall, though, investors will welcome the publication of the report. It will provide an important baseline, the first since 2011, for investors to analyse what is happening inside Iran, and the likely direction of future economic policy under Rouhani.



Iranian government plans to end tax exemptions for Bonyads

VERITY's sources have revealed that the Iranian government is planning to end the tax exemptions that Iranian Bonyads have enjoyed in Iran since before the revolution. There are over 100 major Bonyads, or charitable trusts, currently in Iran.

Answerable directly to the Supreme Leader, Bonyads are involved in every sector of the Iranian economy, from hotels to shipping lines. Among the most prominent of the Bonyads is the Bonyad-e Mostazafen va Janbazan (Foundation for the Oppressed and Disabled), which is reported to control substantial portions of Iran's textile, soft drink, glass, tiles, chemicals, tires and foodstuff production. Critics of the Bonyads have argued that they lack accountability and operate outside government control. Bonyads are not subject to the General Accounting Law, and are therefore not subject to financial audits.

Estimates vary as to the extent of the Iranian economy that is controlled by these entities. Previous estimates, dating from before President Ahmadinejad's administration, suggested that up to 20 percent of the Iranian economy was controlled by the Bonyads. VERITY's sources, however, now estimate that a figure in the region of 30 percent is a more accurate estimate.

The government's plans for reform of the Bonyads are likely to encounter significant opposition, not least from the Bonyads themselves. The Bonyads are believed to have numerous supporters within the Majles. Consequently, VERITY expects Rouhani's government will wait until after the next Majles election before attempting to introduce these reforms.

Privatisation plans suspended

On 11 March 2014, Oil Minister Bijan Namdar Zanganeh issued a decree effectively excluding ten oil and gas companies from the list of companies that have privatisation permits. This effectively suspends progress with the privatisation programme Rouhani's government inherited from the previous administration. Investors will note that this is not reflective of opposition to privatisation within the government, but rather a sign that the government intends to manage privatisation more carefully. In practice, Rouhani's government can be expected to re-start privatisation once processes are in place to ensure that assets are transferred to the genuine private sector rather than end up in the hands of the shadow state.

Inflation falls

According to official Iranian figures, inflation in Iran has fallen to approximately 25 percent, a drop of nearly 20 percent since mid-2013. Rouhani's government has been focussed on reducing inflation since coming to power. The stabilisation of the open market exchange rate, and the tight macro-economic policy the government has stuck to, have been contributory factors.

Banking news*Unfrozen JPA funds remain inaccessible*

VERITY has learned that much of the money released to Iran as part of the Geneva agreement remains inaccessible. Under the terms of the Joint Plan of Action (JPA), Iran is granted access to up to USD 4.2 billion of frozen revenue held in foreign bank accounts. The money is to be released to Iran in tranches of about USD 500 million; to date, USD 1.55 billion has been unfrozen. Further tranches are due to be released in April, May, June and July. According to VERITY's own sources, the money has been unfrozen and transferred to private banks nominated by Iran as part of



the JPA. However, the private banks have subsequently imposed their own restrictions on how the money can be accessed, likely due to an overzealous interpretation of sanctions. VERITY understands that Iran and the E3+3 are working to address the problems, and a solution is expected soon.

Oil and gas news

Oil exports increase in February

Iranian oil exports increased in February, according to press reporting. In total, February crude loadings by Iran's top buyers: China, India, Japan and South Korea, rose to over 1.1 million bpd, up from 995,000 bpd in January. Turkey's imports of Iranian oil in February were also up on January, rising to nearly 118,000 bpd in February. *Reuters* data revealed that this was the fourth month in a row that Iranian exports had exceeded 1 million bpd, the level at which exports are frozen by US sanctions. VERITY expects Iran's oil exports to fall in the coming months, as Iran's customers seek to ensure that their mean imports of Iranian oil over the 6 month waiver period remain within the limits set by the US government.

Iran Energy Exchange to start trading crude in April

On 19 March, Managing Director of the Iran Energy Exchange, Ali Hosseini, announced that the Exchange was ready to start trading crude on 6 April 2014. Private refineries would be able to purchase Iranian oil from the Exchange from this date. Hosseini said that Oil Minister, Bijan Namdar Zanganeh, supported the Exchange. The Exchange will start small; the National Iranian Oil Company (NIOC) has agreed to supply 3,000 bpd to get the Exchange started. The Oil Ministry will develop infrastructure at Esfahan and Bandar Abbas refineries to facilitate an expansion in trading.

Iran seeks to compete with Iraq for foreign investment

VERITY has learned that elements of the Iranian oil industry wanted to create a better environment within Iran and attract foreign investment in oil field development. The Iranian government planned to compete with regional countries, such as Iraq, for foreign investment in the crude oil sector and believed that with a relatively more stable security environment, Iran would be more attractive to foreign investors than Iraq in a short timeframe.

Iran and Oman agree natural gas export contract

On 12 March, during President Rouhani's visit to Oman, Iranian Oil Minister Zanganeh and his Omani counterpart, Mohammad bin Hamd al-Ramhi, announced the signing of an agreement to build a gas pipeline across the Strait of Hormuz. The planned pipeline will go from Iranshahr to Sohar port in north-east Oman. The countries agreed a 25 year deal to export USD 60 billion Iranian natural gas to Oman.

The pipeline will deliver 10 billion cubic metres of gas per year, mostly for re-export from Oman's liquid natural gas facility at Sur. It is due to come into commission in 2015, though experts in the region expect this date to be delayed, possibly to 2019-2020.

Other news

Workers protest outside Labour Ministry

According to Iranian media reporting, factory workers have staged protests outside the Iranian Labour Ministry on several occasions in the last two months. On 1 and 2 February, workers from a textile factory in Esfahan staged a 2-



day protest outside the Labour Ministry to protest against the Social Security Organisation's (SSO) refusal to grant them unemployment insurance. More recently, on 16 March, workers from a steel factory from Kordestan protested outside the Labour Ministry over the failure of their employers to pay their salaries for 8 months. The steel workers have also recently protested outside Iran's Parliament, and other government buildings in Tehran.

National health budget facing IRR 60 billion shortfall

On 2 March 2014, Minister of Health, Hassan Hashemi, announced that the national health budget has a shortfall of IRR 60 billion (about USD 2 million) this year. He stressed that the situation was inherited from President Ahmadinejad's administration.

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)

27 March 2014: 78619.4

Inflation

Official figure: c.25%

Unemployment

Official figure: 10.3%

Exchange Rates

USD : IRR

Currency Centre (CTC) rate: 25,402

Open Market rate: 30,450



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