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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY



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### April overview

#### *President Rouhani enters defining period of his presidency*

April has marked the beginning of the make or break period for President Rouhani on the economy. The success or failure on three crucial issues will define the future of his presidency.

On the first issue, subsidy reform, Rouhani's government launched the 2<sup>nd</sup> phase of the Targeted Subsidies Programme on 21 April. The government is committed to reducing the drain of universal subsidy payments on the budget, but the risks of cutting subsidies are significant.

The second issue is the exchange rates, which the government has recently announced it plans to unify during the current Iranian year (ending March 2015). The plan makes eminent economic sense, but carries major risks. Implementation will be crucial to determining whether the plan is successful or not.

The third issue is the nuclear negotiations with the E3+3 that are continuing to take place in Vienna. Both sides are understandably reluctant to be drawn on the content of confidential exchanges. Some of the most contentious issues, such as the future of the heavy water reactor at Arak, have yet to be resolved. The drafting of the comprehensive



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agreement is due to begin in early May, and is expected to be a difficult process.

President Rouhani was elected on a wave of popular enthusiasm for his promises to improve the economy and end sanctions, and to relax state-imposed restrictions on society. Rouhani has prioritised economic improvement and sanctions, perhaps as a necessary precondition to increasing liberalism in society. The reality is that if he fails economically, or fails to reach a comprehensive agreement with the E3+3, his political appeal could fade quickly and his freedom to manoeuvre against conservative and hardline interests will be lost.

If Rouhani can secure the double bill of subsidy reform and a comprehensive agreement with the E3+3 on the nuclear issue, Iran's economic prospects will be transformed. Conversely, failure in Vienna will cause the economic prospects for Iran to deteriorate rapidly and will likely sink the Targeted Subsidies Programme. With it will go Iran's economic prospects, at least for the foreseeable future.

## Macro economic news

### *2<sup>nd</sup> phase of Targeted Subsidies Programme launched; fuel prices increase 75 percent*

On 21 April, the second phase of Iran's Targeted Subsidy Programme (TSP) was launched by the government. The TSP is a key plank of the government's plan to push domestic energy prices towards global market levels, whilst retaining compensation for the poorest citizens who are likely to be worst affected by raised energy prices.

Following weeks of speculation, on 25 April, the government set a new gasoline price, up 75 percent for purchases of ordinary semi-subsidized gasoline. Semi-subsidized diesel fuel rose 66 percent. The prices of water, electricity and natural gas for domestic use also rose in April, by between 20-30 percent.

The government attempted to reduce the number of citizens eligible for subsidies through a voluntary opt-out process, as reliable data that would allow the government to withdraw payments from high earners in a top-down way was unavailable. This process resulted in about 92 percent of Iranians re-registering for the subsidies, though exact information is unavailable at the time of writing. The government is likely to be disappointed with the result; it ran a very public campaign to encourage Iranians to opt out, and it was likely that they hoping for twice as many, at least, to forgo their payments voluntarily. Some ministers had suggested that the government needed to withdraw payments from the highest earning 20-30 percent of the population, to balance the budget of the TSP.

The previous attempt at subsidy reform, introduced by former President Ahmadinejad, was badly flawed in implementation. It was expensive to run and resulted in higher inflation. The revised proposals attempt to reduce costs by raising prices and cutting the number of monthly payments. The government opted not to do the alternative, to cut the level of individual payments (which remain at about USD 18 per person per month).

With so few opting out of the scheme, the government may now have to revisit its plans. Rouhani deserves credit for re-committing to subsidy reform, for trying to avoid past failures, and for being open about, and seeking a consensus on, the need to fund subsidies in a sustainable way. But it seems unlikely that the TSP will deliver the sustainable way forward the government was hoping for.

To balance the TSP, the government may have to remove citizens from the list of recipients. With inaccurate data, this will be difficult to do fairly. However, the alternatives, to raise energy prices further, or to cut the individual payments, are equally unattractive politically. To pay for the TSP, the government may have to continue to fund a substantial deficit in the TSP either from the National Development Fund (something which Ahmadinejad was much criticized for doing), or from the general budget. Both options carry the risks of raising inflation, which the government was just beginning to bring under control. It is likely that the TSP will remain a contentious issue, and a



thorn in Rouhani's side, for some time to come.

### *Iran to unify exchange rates*

Iranian Vice President for Planning and Strategic Supervision, Mohammed Baqer Nobakht, has announced that the government plans to unify the currency exchange rates during this Iranian calendar year (ending on 20 March 2015). Currently there are two exchange rates available in Iran. The official exchange rate (CTC rate) of about IRR 25,500 to USD 1 is set by the government, and used to set the prices of foodstuffs and other basic commodities. The free market rate, which is used for everything else, is currently available at about IRR 32,300 to USD 1.

The details of the unification of the exchange rates have yet to be announced. At first glance, the intention appears to be eminently sensible, reducing complexity, providing certainty for investments and significantly reducing the prospects for corruption in the currency markets. President Rouhani is to be lauded for trying to introduce necessary reforms. However, there are significant risks. The way that the unification is implemented will be crucial; in the short term, abandoning the CTC rate may result in higher price for foodstuffs and basic commodities. At the same time as ordinary Iranians are faced with increased energy and water prices associated with the implementation of the 2<sup>nd</sup> phase of the TSP, higher prices caused by the unification of exchange rates may increase the risk of popular unrest and protests.

### *Volatility on the stock market index*

The Tehran Stock Exchange experienced a volatile month, with the main index, the TEDPIX, falling from 78741.3 at the start of the month to a low of 73637.8 on 19 April. The market rebounded towards the end of the month, reaching 78,164.3 on 30 April. Analysts attributed the volatility to rising interest rates; uncertainty about progress in nuclear talks with the E3+3, and ambiguities about the implementation of the 2<sup>nd</sup> phase of the TSP. VERITY expects the volatility to continue as reaction to the TSP continues and Iran and the E3+3 begin discussions on the key issues of contention on the nuclear programme.

### **Banking news**

#### *Euro payments from Iran's oil sales to India remain unpaid*

VERITY has learned that portions of the Euro payments from Iran's oil sales to India remain unpaid. Following the termination of the Indian companies agreement between UCO Bank and the Central Bank of Iran (CBI), several Indian companies refused to deposit Euros into the CBI's accounts in foreign banks. Iranian officials were planning to raise this issue with their Indian counterparts.

### **Oil and gas news**

#### *US expects aggregate Iranian oil sales not to exceed target levels*

On 4 April, a senior US official told *Reuters* that the US expected that aggregate Iranian oil sales for the current waiver period would not exceed the targets set by the US. Iranian oil exports for the five month period before April 2014 had stayed above levels allowed under Western sanctions. The US official, however, said that the US had always expected fluctuations, and was focussed on aggregate not short-term data. Subsequently on 17 April, *Reuters* reported that India, one of the top importers of Iranian oil, had reduced its aggregate oil imports from Iran by about a fifth in the fiscal year that ended in March 2014. India's oil purchases dropped 16.5 percent to 222,000 bpd, according to tanker data seen by *Reuters*.



*Russia-Iran oil deal remains a long way off*

According to press reporting, Iran and Russia have made progress towards an oil-for-goods deal worth in the region of USD 20 billion. Russian sources have indicated that 500,000 bpd of Iranian oil would be exchanged for industrial goods including metal and food. Iranian officials have confirmed that negotiations are continuing, but said that a deal remains a long way off. Iran's Deputy Oil Minister for International Affairs and Trade said that Russia and Iran would struggle to reach a deal, as both countries are major exporters of oil. The US has made clear its opposition to the deal, which would go against the terms of the Joint Plan of Action. Investors will be watching closely for signs of the deal progressing, but with the US determined to continue to enforce existing sanctions, it seems unlikely that the deal will be confirmed before a comprehensive agreement on the nuclear deal is reached.

*Iranian government insist Zanjani case investigated in full*

VERITY has learned that debts owed to the Iranian Government by disgraced Iranian oil trader Babak Zanjani have yet to be settled. Following his arrest in late December 2013, conservative Iranian officials attempted to control the story of his arrest, and declared that his seized assets covered his debts to the Government. VERITY, however, understands that this is not the case. President Rouhani and the Oil Ministry are insisting that the Zanjani case be fully investigated, and the money owed by Zanjani be repaid in full.

**Other news***Iranian government debts to SSO total several billion US dollars*

VERITY has learned that the Iranian government's debts to the Iranian Social Security Organisation total several billion dollars, leaving a large black hole in the SSO budget. The debts are likely to have been caused by funds from the Iranian Government not being provided to the SSO. Alternatively, the government may have requisitioned funds from the SSO for other purposes. VERITY understands that the government is investigating the possibility of settling the debt, at least in part, through sales of Indian products purchased with Rupees from Iran's accounts in Indian banks. Iran has accumulated billions of dollars of Indian Rupees in Indian Bank Accounts from its oil sales to India since the introduction of sanctions. Iran is only able to use the money in these accounts for the purchase of Indian products, but has no large-scale requirements for these.

*Water shortages looming for 500 Iranian cities*

Iranian officials have warned that Iran is facing critical shortages of water in 500 towns and cities. In Tehran, water companies have said that water levels in the reservoirs serving the capital are at critical levels. Officials are considering rationing supply, scheduling water outages for high-consuming households and lowering water pressure in Tehran's pipeline network that serves an estimated 22 million people.

*Internet speeds to improve in Iran*

Iran is taking steps to improve internet speeds, according to press reporting. Ranked 170<sup>th</sup> in the world for internet speed in February 2014, Iran ranked behind Belize, Lebanon and Uzbekistan. The government planned to double average bandwidth by the end of March, though this has not been confirmed. Doubling the average bandwidth would leave Iran ranked 135<sup>th</sup> in the world. President Rouhani has promised to continue the work to improve internet speeds and access in Iran, partly as part of a drive to grow ecommerce. Investors will welcome signs that internet speeds are improving, and that government imposed filters are beginning to be removed. With a population of 76 million, Iran has by far the highest total number of internet users in the Middle East.



**Statistics**

**GDP Annual Growth Rate**

2015: 1.5% (IMF estimate for 2014-2015)

2014: -1.7% (IMF estimate for 2013-2014)

**Tehran Stock Exchange Main Index (TEDPIX)**

30 April 2014: 78164.3

**Inflation**

Official figure: c.25%

**Unemployment**

Official figure: 10.4%

**Exchange Rates**

USD : Rial

Currency Centre (CTC) rate: 25,518

Open Market Rate: 32,300

