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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

@VerityIran ContactUs@VerityIran.com

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In this issue:

- Limited progress as negotiations on nuclear deal enter crucial phase
- President Rouhani calls for patience as he reforms economy
- Iranian government calculations predict crippling budget deficit without sanctions relief
- Revised tax revenue estimates fall short of budget forecast
- CBI statistics show inflation is decreasing
- Bad debt in the Iranian banking system reaches critical level
- Iran to use stockpile of Euros in India to fund humanitarian purchases
- Iran to cancel USD 2.5 billion contract with CNPC
- Government statistics underplay unemployment
- Statistics

May overview

Limited progress as negotiations on nuclear deal enter crucial phase

The Joint Plan of Action is entering its crucial phase. Negotiations on a comprehensive agreement between Iran and the E3+3 are due to run until 20 July, the end of the 6-month period of sanctions relief. Reports from Vienna, where the talks are between the E3+3 and Iran are taking place, suggest some progress is being made, albeit slowly. Both the E3+3 and Iran are still publicly declaring that they are optimistic that a deal can be reached before the 20 July deadline. But, privately, officials from both sides are preparing to manage expectations in advance of a possible extension beyond 20 July.

Key issues, including on possible military dimensions.to the nuclear programme, permissible levels of research and development, and the future of the heavy water reactor at Arak, are now being discussed. Neither side has much room for manoeuvre, with powerful opponents from both sides watching closely. Yet Iran and the E3+3 may need to concede ground if a final agreement is to be struck on the size and scope of Iran's future nuclear programme.

Investors will be concerned at media reporting of a lack of tangible progress that emerged from the round of talks in mid-May. Reports of a falling-out between the E3+3 and Iran were subsequently denied,. The IAEA, tasked with monitoring the implementation of the interim deal in Iran, has subsequently announced that Iran is so far keeping to its agreements. But it noted that it is still not in a position to provide assurances on the absence of undeclared nuclear material and activities in Iran.

There is still time for a comprehensive agreement to be reached before 20 July. But, with much still to be agreed and the next round of talks not scheduled until 16-20 June, the possibility of an extension is looming ever larger. The terms of an extension will need to be worked out in advance, i.e. before 20 July, or risk suspended sanctions coming back into force. In reality, the window of opportunity post 20 July is likely only to remain open for a short period. At that stage pressure will begin to mount for additional sanctions measures to be levied on Iran.

As VERITY has frequently reported, a comprehensive settlement on the nuclear deal would go a long way to transforming Iran's economic prospects. International sanctions would start to lift, removing the biggest obstacles to economic improvements for Iran. Failure to reach a deal, however, will see Iran's economic prospects decline rapidly. But investors should not underestimate the impact of a failure in talks. The window for an agreement has become extremely short. If there is no deal by 20 July, or in the months that immediately follow, the prospects for the Iranian economy become grim indeed.

Macro economic news

President Rouhani calls for patience as he reforms economy

In a live interview on Iranian state TV, President Rouhani called for the public to be patient as his government sought to deliver on his election promises. He reiterated his pledge to reduce inflation to 25 percent before the end this Iranian year (March 21 2015). He said that his government had already started to control inflation, which had reduced from 43 percent to 35 percent over the previous year (ending 21 March 2014). The energy price rises announced last month (see VERITY 33) had been lower than had been reported, at 50 percent, and would add less than 6 percent to the current inflation rate.

Investors will welcome the concerted efforts by President Rouhani and his economics team to provide regular updates on the economy. Rouhani promised to report again on the economy in 3 months time.

Iranian government calculations predict crippling budget deficit without sanctions relief

VERITY has learned that internal Iranian government calculations suggest that without significant sanctions relief, Iran will face a crippling budget deficit this year. Oil and gas exports are increasing slightly, but there is little confidence in official circles that exports will rise sufficiently this year to start to significantly reduce the deficit. Moreover, without the removal of international sanctions, Iran's ability to recoup money from its oil sales will remain heavily restricted. Without a comprehensive agreement on the nuclear programme, VERITY expects Iran's economy to contract sharply this year.

Revised tax revenue estimates fall short of budget deficit

VERITY has learned that the Iranian government's revised estimates on tax revenue in the current Iranian year will fall some way short of the target included in the government's budget. As was widely reported, the budget estimated total tax revenue to be about IRR 680 trillion (about USD 27 billion at the official rate). Current forecasts, however, suggest that a significantly lower figure will be collected. The shortfall on tax income is likely to have a critical impact on the government's spending plans, as further government borrowing will negatively impact the government's plan to reduce inflation. VERITY expects the pressure on the Iranian negotiating team in Vienna to intensify as the government looks to find a way to remove the sanctions and permit an increase in trade to plug the hole in government revenue.

CBI statistics show inflation is decreasing

In an interview in Mehr News Agency on 21 May, CBI Governor Valiollah Seif provided a positive summary of current economic conditions in Iran. Seif said that the government had increased its foreign government revenues, which was enabling it to intervene and foster stability in the market. Seif said that the measurements of inflation also pointed to improved economic conditions.

Also in May, the CBI announced that inflation in May was 17.2 percent. Although this represented an increase of 0.7 percent compared to April 2014, the general trend was downwards. Compared to the previous year, the consumer prices index was down to 17.4 percent in April 2014, compared to 19.7 percent in March 2014. The index had measured 42.1 percent in the same period of 2013.

The figures for inflation announced by the CBI are similar to VERITY's own measurements. After years of falsification of statistics under President Ahmadinejad, investors will welcome the greater reliability and transparency brought by Rouhani's government to its estimates of inflation.

President Rouhani's government prioritised reducing inflation, and its policies appear to be bearing fruit. An inflation rate of 17.2 percent is still high and it is unclear the extent to which it takes account of the recent price rises associated with the second phase of the Targeted Subsidy Programme launched last month (see VERITY 33). But it is within the government's target for this Iranian year (25 percent). Moreover, it is a significant improvement on the assessments of inflation of upwards of 70 percent that were common before Rouhani took office last summer. The challenges for Rouhani's government now will be to sustain the improvements in inflation. Without progress on subsidy reform and a comprehensive nuclear settlement with the E3+3, Rouhani's government may have to borrow more or print new money to settle its debts.

Banking news

Bad debt in the Iranian banking system reaches critical level

Vice President Eshagh Jahangiri announced that the total value of non-performing bank loans in the Iranian banking system had reached the equivalent of USD 33 billion in May. This represents 15.6 percent of total bank loans according to the CBI. The government has handed the names of 575 of the biggest defaulters to the judiciary to try to recover as much of the bad debt is likely to hamper Rouhani's efforts to reform the economy, boost employment and raise living standards.

Iran to use stockpile of Euros in India to fund humanitarian purchases

Following last month's report that large portions of the Euro payments from Iran's oil sales to India remain unpaid (see VERITY 33), Iranian media reports that Iran will use the money to fund humanitarian purchases. Etemaad reported that Iran has asked India to settle some of Iran's debts to third countries for purchases in medicine and foodstuff in Euros. As a humanitarian transaction, this is likely to be permitted under the terms of the Joint Plan of Action. It will help India to pay down its debt to Iran of about USD 3.6 billion, which it owes for its purchase of crude oil.

Oil and gas news

Iran to cancel USD 2.5 billion contract with CNPC

On 29 April, Iranian Oil Minister Bijan Namdar Zanganeh announced that Iran had cancelled the contract with the

China National Petroleum Corporation (CNPC) for drilling wells in the South Azadegan oil field. The buy-back contract with CNPC was estimated to be worth approximately USD 2.5 billion. Iran claimed that the CNPC had failed to fulfill its commitments to drill a sufficient number of oil wells. Subsequently, on 21 May, the Managing Director of the National Iranian Oil Company Rokneddin Javadi said that the contracts for the South Azadegan oil fields will be offered to Iranian firms. This may be a sign of increasing self confidence by the Iranian oil industry. However, China remains an important partner for Iran's oil companies, and a key customer for Iranian oil. Behind the publicity, Iranian officials will be making efforts to avoid alienating the Chinese.

Other news

Government statistics underplay unemployment

VERITY has uncovered reliable information that shows that government statistics have considerably underplayed the scale of unemployment in Iran. VERITY's sources have revealed that the actual unemployment rate has risen far higher than the official rate of 10.4 percent. The rate is expected to increase further this year as numbers of school and college leavers enter the job market. The government's efforts to address unemployment have lacked cohesion and co-ordination. No ministry has assumed ownership of the problem. The government remains focused on reducing inflation rather than job creation. Employment opportunities have further been limited by an uncertain economic outlook, the legacy of historic under-investment in industry, and a lack of foreign investment. The government plans to improve the business environment and encourage growth in the private sector. However, meaningful progress is unlikely until the government can prioritise economic growth following the successful conclusion of the nuclear negotiations.

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)
29 May 2014: 76067.8

Inflation
Official figure: 17.2%

Unemployment
Official figure: 10.4%

Exchange Rates
USD : IRR
Currency Centre (CTC) rate: 25,582
Open Market Rate: 32,720