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# Long term trajectory of Iran's economy: All to play for

*With the short term economic outlook looking dire, the longer term trajectory of the Iranian economy is as yet undecided. It will depend partly on the efforts of external partners in the cause of Iran's re-entry to the global economy, but mostly on the actions of the Iranian authorities. Three priorities stand out: clean up corruption and malpractice in financial services, redirect expenditures from external causes to domestic needs, and do not burn bridges on the nuclear deal.*

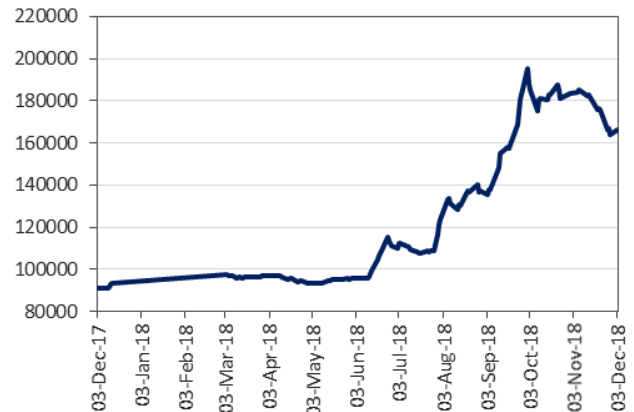
**The International Monetary Fund (IMF) dramatically revised downward its forecast for Iranian GDP growth last month.** The IMF now expects the economy to shrink by 1.5 percent in 2018, followed by a 3.6 percent contraction in 2019, wiping out last year's growth. Meanwhile, the Tehran stock exchange lost 12 percent of its value in the month of November, beginning to reverse the climb of the last six months (Fig 1).

**The Iranian rial's value has strengthened slightly since its September low point, but is still worth only one third of what it was six months ago (Fig 2).** The collapse in the rial is also echoed in ballooning prices. Inflation has risen to over 35 percent per annum, according to the Iranian Statistics Centre, and more than 50 percent for food, beverages and tobacco.

**Earlier hopes that the lack of an international coalition would mean US economic sanctions would be lack 'bite', now appear misplaced.** The US administration has toured the financial centres of Europe and Asia and been successful in discouraging international businesses and banks from pursuing trade and investment relationships with Iran. With or without a coalition, the threat of financial repercussions in the US has proven a powerful lever so far.

**But Iranian businesses are experienced and resilient to life under international sanctions.** The economic environment will most likely continue to worsen in the short to medium term, as investment slows and export revenues falter. But in the longer term, Iran's economy could go any number of ways. At one extreme, Iran could head backwards to a chaotic and corrupt model of governance, exacerbating inequality and poverty as Iran isolates itself from the global economy for a generation. In a more optimistic future, businesses see a steadier, more stable Iran emerge, with a more diversified economy and a more even

Fig 1. TEDPIX All Shares Stock Index (December 2017 to present)



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distribution of wealth, returning to a warmer international trading environment after a temporary diversion. The second route demands a degree of commitment from both external and internal stakeholders in the Iranian economy's success.

**Externally, the European Union's commitment to establishing a Special Purpose Vehicle (SPV) for payments is promising.** There are frustrations about how long the SPV is taking to materialise—recent reports suggest member states are reluctant to be the ones to host the mechanism. But such financial arrangements are legally complex, and EU member states and their High Representative for Foreign Affairs, Federica Mogherini, have been consistent in their support for a continued JCPOA agreement without the United States. So it still holds potential as a long term solution.

**Following the announcement by SWIFT, the global financial messaging service, that it will comply with US sanctions – the Central Bank of Iran claimed to have alternative messaging systems in development.** The CBI downplayed the significance of SWIFT's decision, saying it had been developing its own system with international partners during the pre-JCPOA era. The Russian President Putin also reminded the world of Russian intentions to develop its own alternative to SWIFT, this month.

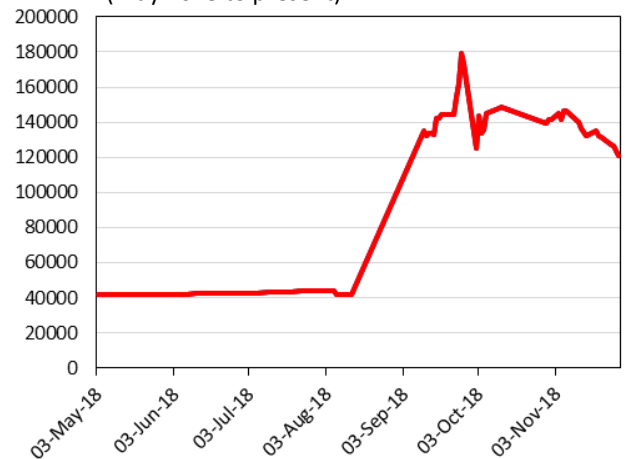
**In fact, the future path of the Iranian economy depends more than anything on the decisions of the Iranian authorities.** Under the Rouhani administration, the government has set in motion meaningful reforms in financial services, privatisation and governance. But a great deal remains to be done. These three priorities, and Iran's success in strengthening the financial sector, starving corruption and balancing the fiscal account will dictate Iran's options going forward.

**In finance, the government faces a battle to keep recently passed FATF legislation in place, in the face of pressure from wealthy special interests.** Iran's Foreign Minister Zarif was attacked by MPs for openly countenancing the "extensive money laundering" activities that take place at the highest levels of the Iranian economy. But his comments are highlighting a long-standing problem that will only become more acute under renewed sanctions. In the years ahead, foreign exchange will be increasingly scarce and the economy will flounder if legitimate businesses are unable to access funds whilst well-connected state owned enterprises plunder the system. The FATF legislation is a rare win for the government's more progressive policies to clean up governance and financial activity, and has long term benefits for the efficiency of the Iranian economy.

**The government's fiscal position will come under increasing pressure in the next two years as it makes big decisions on its spending priorities.** The public are increasingly aware of the many millions splurged on overseas military adventures. This scale of spending will be difficult to justify as more and more ordinary Iranian households fall into poverty, see their public services fail and struggle to access basic goods and services, including medical supplies. Iran's enormous overseas expenditures are typically justified in the name of regional security, but the opportunity cost of financing international wars will grow ever starker as the needs of the citizens deepen.

**Finally, the Iranian authorities must continue their compliance with the terms of the nuclear deal to keep alive the chances of a return to global markets.** Iran has regularly warned the world of its ability to restart its nuclear programme if the JCPOA collapses. In November, the Head of the Atomic Energy Organization of Iran (AEOI), Ali Akbar Salehi, reminded an international audience of Iran's capability to quickly restore 20 percent uranium enrichment if it falls apart. But in practice, Iran's adherence to the nuclear terms of the JCPOA has continued and AEOI's relationships with non-US nuclear authorities remain strong. If

**Fig 2. Rial to USD official exchange rate**  
(May 2018 to present)



there is one move sure to push Iran's economy on the long road to isolation and decline, it will be a reversal of this commitment to the nuclear deal, which will instantly and indefinitely burn the goodwill of its remaining European and Asian counterparts.



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