

## Update on Iran's Economy

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Prepared for:



### INTRODUCTION

- Iran's economic developments in the past few decades have been undermined by external sanctions, economic mismanagement and corruption;
- Post sanctions recovery has been below expectations, and the US withdrawal from the nuclear deal has further aggravated the situation;
- Iran's banking sector has not been able to reconnect with the global financial sector, partly due to the hesitation of international banks in re-engaging the Iranian market and partly due to domestic, regional and international tensions;
- Post JCPOA, the petroleum sector has managed to increase production efficiently which has helped Iran generate needed hard currency revenues;
- Foreign investment is flowing at the pace of about \$10 billion per annum which will help consolidate the growth path in the economy, but it is not enough to create the needed jobs;
- A recent loss in value of the Iranian currency underlined the continued prevalence of structural and economic imbalances in the country;
- One of the biggest risks over the next 2 years is the collapse of a number of banks that could have very negative consequences on the Iranian economy;
- The main impact of re-imposed US sanctions is that Iran will be deprived of the large multinational companies – most new investors in Iran will be European SMEs and large Russian and Chinese companies.

## KEY ECONOMIC DATA



Indicators	1395 (21.03.16 to 20.03.17)	1396* (21.03.17 to 20.03.18)
GDP growth (real in Rial)	4.6%	5.2%
GDP (nominal in US\$ at median exchange rate)	\$425 bn	\$464.3 bn
GDP per capita (nominal)	\$4,764	\$5,710
GDP per capita (PPP)	\$16,023	\$18,450
Inflation (Official)	7.2%	10.0%
Trade Surplus	\$19.3 bn	\$22.0 bn
<b>Unemployment Official</b>	<b>12.7%</b>	<b>11.8%</b>

- With the exception of unemployment, all key indicators in the Iranian economy are moving in the right direction;
- The recent devaluation of the Rial has already generated inflationary impacts and inflation will be 2-digit;
- Higher than expected oil price is generating more revenues, but there is a lot of uncertainty due to the US withdrawal from the nuclear deal;
- Nonetheless, if the EU continues its trade and investment in Iran, the economy will grow at about 4 to 5%;

Sources: Statistical Center of Iran, Central Bank of Iran, World Bank \* Projected  
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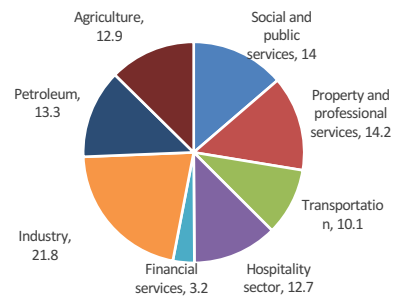
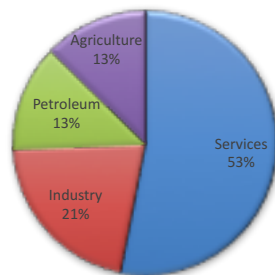
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## GDP COMPOSITION



Sectors' Contributions to GDP (%)  
(2017 figures)

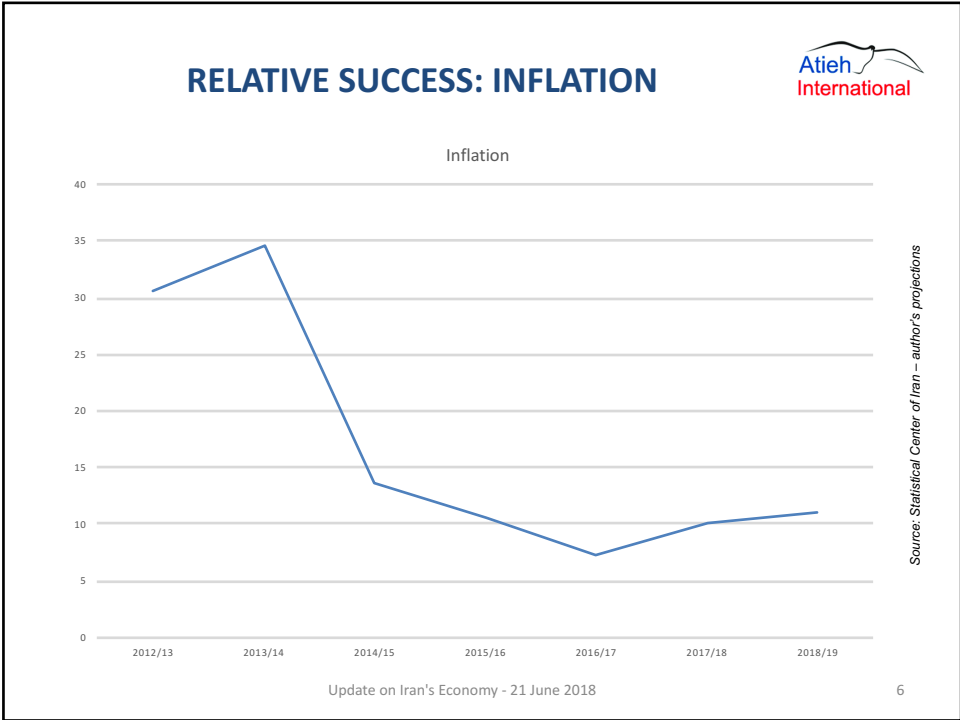
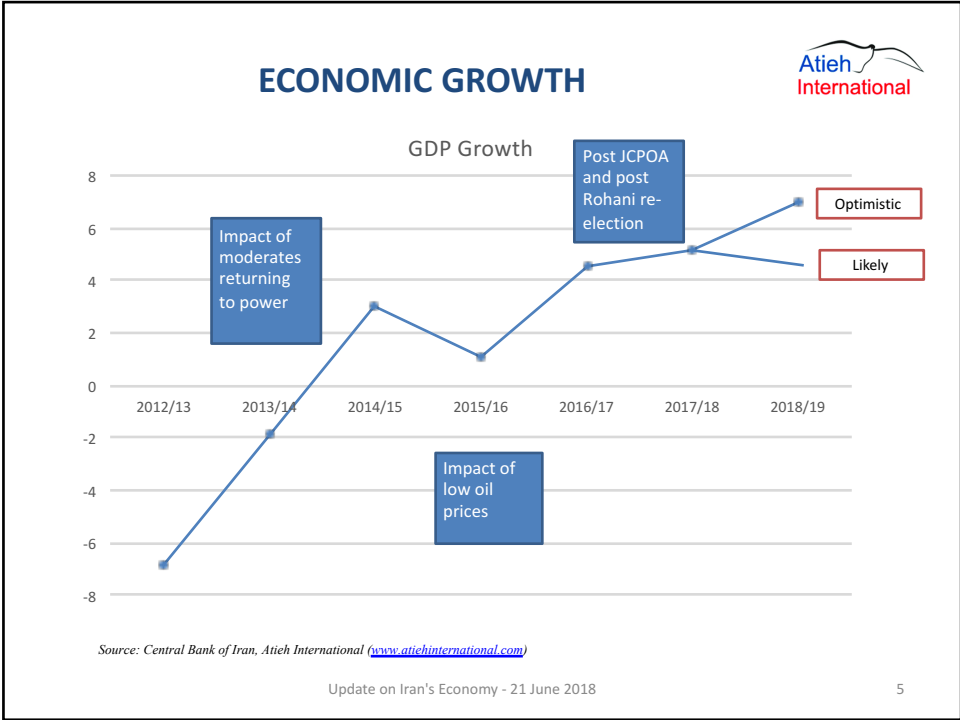
Sources: Statistical Center of Iran,



- Iran has a very diverse economy (the most diverse OPEC economy);
- At the same time, agriculture plays an over-proportional role in job creation (18% of total jobs);
- The GDP contribution and employment role of the service sector will increase in the next few years due to the growth of tourism.

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## KEY GROWTH SECTORS



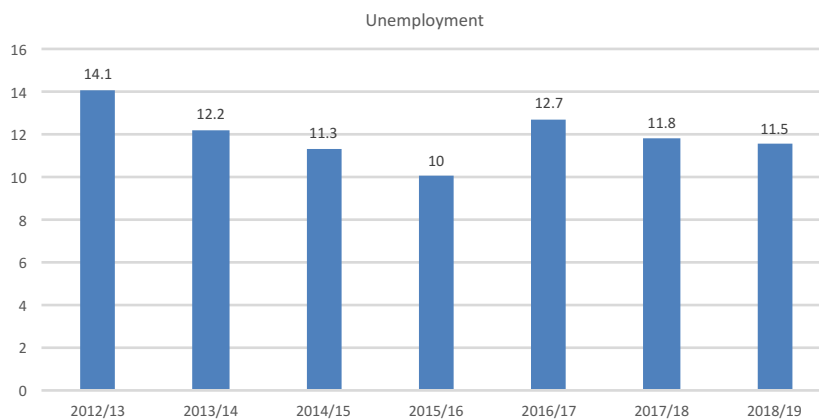
- Iran has ambitious plans to develop various economic sectors – some of these sectors offer potential due to existing natural and human resources and others offer positive prospects due to a growing domestic market, especially a growing middle class;
- The core need in all these industries is new technologies that can increase efficiencies in the relevant sectors. That is why western technology providers are essential to the Iranian growth strategy;
- There will be different degrees of negative impact by re-imposed US sanctions.

Sector	Comment
<b>Oil &amp; Gas</b>	<ul style="list-style-type: none"> <li>Huge oil and gas reserves / Growing production, especially in gas</li> <li>Highest negative impact of US sanctions / Majors will withdraw</li> </ul>
<b>Petro-chemicals</b>	<ul style="list-style-type: none"> <li>Major exporter of petrochemicals with current production of 44.5 MT and capacity of 60 MT / Solutions may be found through SMEs</li> </ul>
<b>Auto-motive</b>	<ul style="list-style-type: none"> <li>18th largest automaker in the world / Most significant foreign investment projects since JCPOA implementation</li> <li>Negative impacts, but solutions are available current technology.</li> </ul>
<b>Steel</b>	<ul style="list-style-type: none"> <li>14th largest global steel producer with production of 16.6 MT of steel and 16.8 MT of steel products</li> </ul>
<b>Agri-culture</b>	<ul style="list-style-type: none"> <li>Contributes 13% to GDP and employs 18% of labor force;</li> <li>Major potential for efficiency improvement</li> </ul>
<b>Telecom</b>	<ul style="list-style-type: none"> <li>Largest regional telecom market with the highest growth rate in the region with 110% mobile penetration</li> </ul>
<b>Aviation</b>	<ul style="list-style-type: none"> <li>The country needs 400 new planes in the next 10 years – most will be purchased from Russian companies</li> </ul>
<b>Tourism</b>	<ul style="list-style-type: none"> <li>Grew by 28% in 2016 compared to 2015;</li> <li>Need for massive investments in tourism infrastructure</li> </ul>

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## UNEMPLOYMENT



Source: Statistical Center of Iran – author's projections

- The country's young demography will continue to put pressure on the job market;
- There will be some 800,000 new entrants into the job market every year.

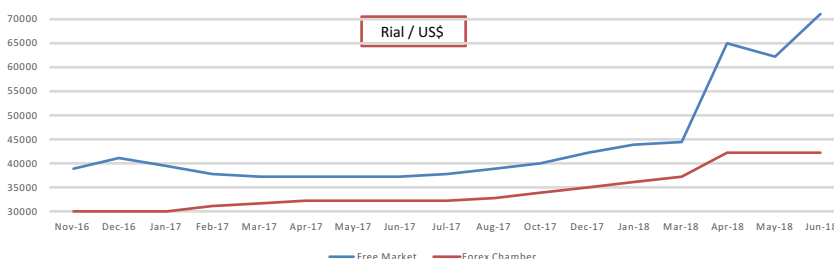
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## EXCHANGE RATES



- The Iranian Rial collapsed in value in March 2018, partly due to bottlenecks in transferring funds and partly due to the uncertainties emanating from US policy towards Iran and the consequent capital flight;
- The official rate was devalued by 13% in April 2018, while the government announced a “unification of exchange rates” – that unification has been a failure so far, as there is not enough hard currency available for all needs;
- The free market rate of the Iranian Rial has lost 58% in the past three months. On 17 June it stood at rail 71,000 to the US\$.
- The differential is a platform for corrupt dealings.



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## IRAN'S BANKING SECTOR



- Central Bank of Iran (CBI) is mid-way in a reform and restructuring process that is aimed at improving the conditions in the banking sector – including the passing of a bill to introduce transparency regulations;
- Iranian banks have enormous bad assets leading to a low capital adequacy ratio (CAR). In its Dec. 2017 report, the IMF underlined the need to “an asset quality review, related-party lending assessment, and a time-bound action plan to recapitalize banks and address non-performing loans should start immediately.”
- In March 2018, CBI instructed all banks that are listed on the Tehran Stock Exchange (TSE) to retain profits and increase their capital. However, the problem is that most banks are not making any profits.
- The recent turbulence in the country's foreign exchange market has further deepened the crisis in the banking sector, especially through the issuance of new bonds with a 20% annual interest in an effort to withdraw liquidity from the overheated foreign exchange market
- Iranian banks need to be capitalized (probably by issuance of government bonds) and a number of banks will be merged to create strong and reliable financial players
- In the meantime, trade financing has been a key bottleneck in trade with Iran, partly due to low compliance standards in Iran's banks. In order to reduce the impact of non-cooperation of first tier international banks a number of Iran's trading partners have signed various financing deals to promote Iran business;
- If the EU continues its cooperation with Iran, the country should be spared a financial collapse, but a logical process will dictate that the country's more than 30 banks will be merged into less than 10 banks that will in all likelihood be in a better financial and compliance position.

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## IRAN'S PETROLEUM SECTOR

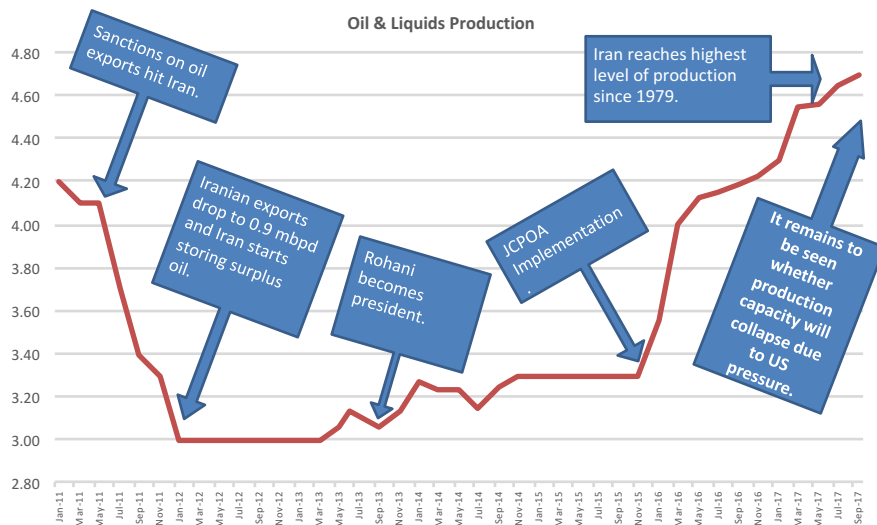


- In the past decade, Iran has gone from being a consumer of foreign technology and a pure exporter of oil to being an exporter of oil, gas and petroleum products as well as a hub for energy connectivity in the region;
- The initial lifting of sanctions shifted the attention to attracting foreign investment and technology in order to increase production. However, the re-imposition of US secondary sanctions means that large IOCs will stay away and that Iran will have to deal with European SMEs and Russian and Asian IOCs;
- The intensive sanctions regime of the past few years created a lot of headaches, but it also gave Iran the opportunity to optimize the utilization of its resources and create domestic capacities;
- Iran has successfully recaptured some of its lost market share in the international oil market and has also developed new markets. However, some of these markets will be lost due to US sanctions and we need to wait and see how the EU can protect Iranian interests;
- Iran will also invest heavily in producing more gas which will empower the country to export more oil and also promote gas-based industrial exports.
- In fact, the growing potential of gas will transform Iran and one should start looking at Iran as an exporter of energy in various forms;
- There is also a growing emphasis on value-add in the petroleum sector.

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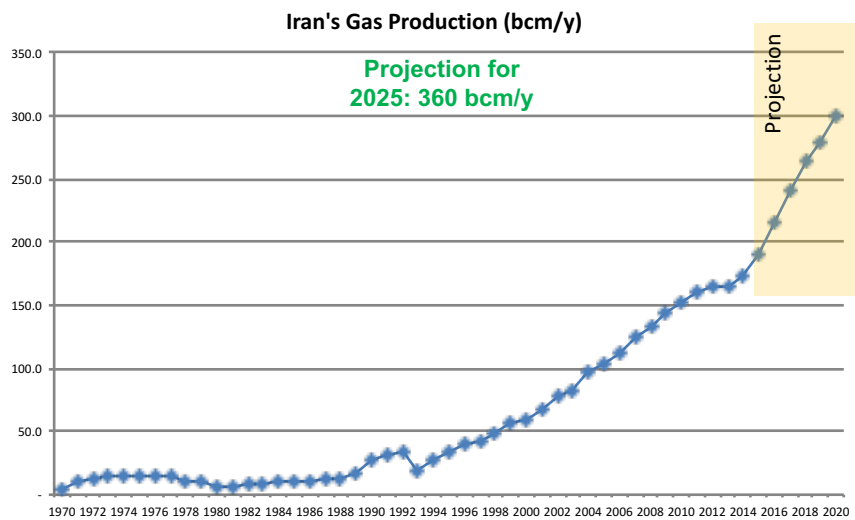
## IRAN'S OIL PRODUCTION



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## IRAN'S GAS PRODUCTION



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## ECONOMIC OUTLOOK



- Uncertainties will continue in Iran's overall development, but the country's economic players are all familiar with uncertain conditions;
- Considering the re-imposition of US secondary sanctions and the EU commitment to the nuclear deal, the Iranian economy will grow at a pace of 4 to 5% p.a.;
- The current 5-Year Plan which started on 21 March 2017 forecasts the creation of 950,000 jobs per year which is only feasible, if the GDP grows by a minimum 8% annual GDP growth;
- Annual investments needed for the above job creation would amount to \$48 billion – about \$30b coming from the government and the rest from the domestic and foreign private sectors.
- This can only be achieved, if the economy also experiences significant efficiency growth (the 6<sup>th</sup> Plan envisages 2.5% annual growth based on efficiency improvements);
- Job creation and efficiency growth both depend on the successful promotion of private sector and attraction of foreign investment;
- Consequently, the government will have to invest in the improvement of business climate where it is facing major push back from its opponents;
- Political and economic developments are paving the way for closer Iran-EU relations, though the biggest winners of US policies will be Russia and China;
- There could be two game changers for economic development and job creation:
  - Tourism (including health tourism) which will generate jobs and also economic impetus in provincial areas;
  - IT start-ups that would offer new opportunities to the educated youth.

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