

Nuclear Negotiations and Iran's Economic Developments

WWIC

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Agenda

- Discuss the latest economic indicators;
- Gauge the impact of sanctions on the Iranian economy;
- Take a closer look at the petroleum sector;
- Outlook;

Introductory Remarks

- There is no doubt that external sanctions have had a negative impact on the Iranian economy;
- The impact has even led to the creation of a new term in revolutionary Iran, i.e. **“Economy of Resistance”** (اقتصاد مقاومتی);
- Sanctions have had effects, but the question is whether they have been effective in the sense of changing the Iranian calculus?
- This question cannot be answered only in the economic realm as the actual deliberations in Iran deal with a multitude of political, regional, economic and international interests;
- Sanctions have been one of the phenomena that have changed the economic considerations. Other factors include subsidy reforms, mismanagement and corruption as well as the overall business confidence;
- This analysis will focus on economic and energy sector factors influencing decisions;

Snapshot of the Iranian Economy

Indicators	1390* (2011/12)	1391* (2012/13)
GDP growth (real in Rial)	3.8%	4.3%
GDP (nominal in US\$ at official exchange rate)	\$340.4 bn	355.1 bn
GDP per capita (in US\$)	\$4,488	\$4,680
GDP per capita (in US\$) growth (decline)	-18.6%	4.3%
Inflation Official (Unofficial)	19.2% (26.9%)	16.3% (32.1%)
Population (million)	75.9	77.0
Oil and gas exports	\$80.1 bn	\$77.4 bn
Trade Surplus	\$32.9 bn	\$30.7 bn
Unemployment Official (Unofficial)	14.4% (19.0%)	15.2% (19.5%)
Budget Deficit (as a % of GDP)	4.2%	4.9%
Exchange rate (IRR/US\$) - official	\$1=IRR12,260	\$1=IRR15,000
Exchange rate (IRR/US\$) - unofficial	\$1=IRR19,000	\$1=IRR16,000

Main source: *Iran Economics Magazine (Eghtessad-e Iran)*, April 2012 / * Projected

Note 1: The difference between official and unofficial inflation is explained through the fact that the government uses subsidized goods for its inflation calculation;

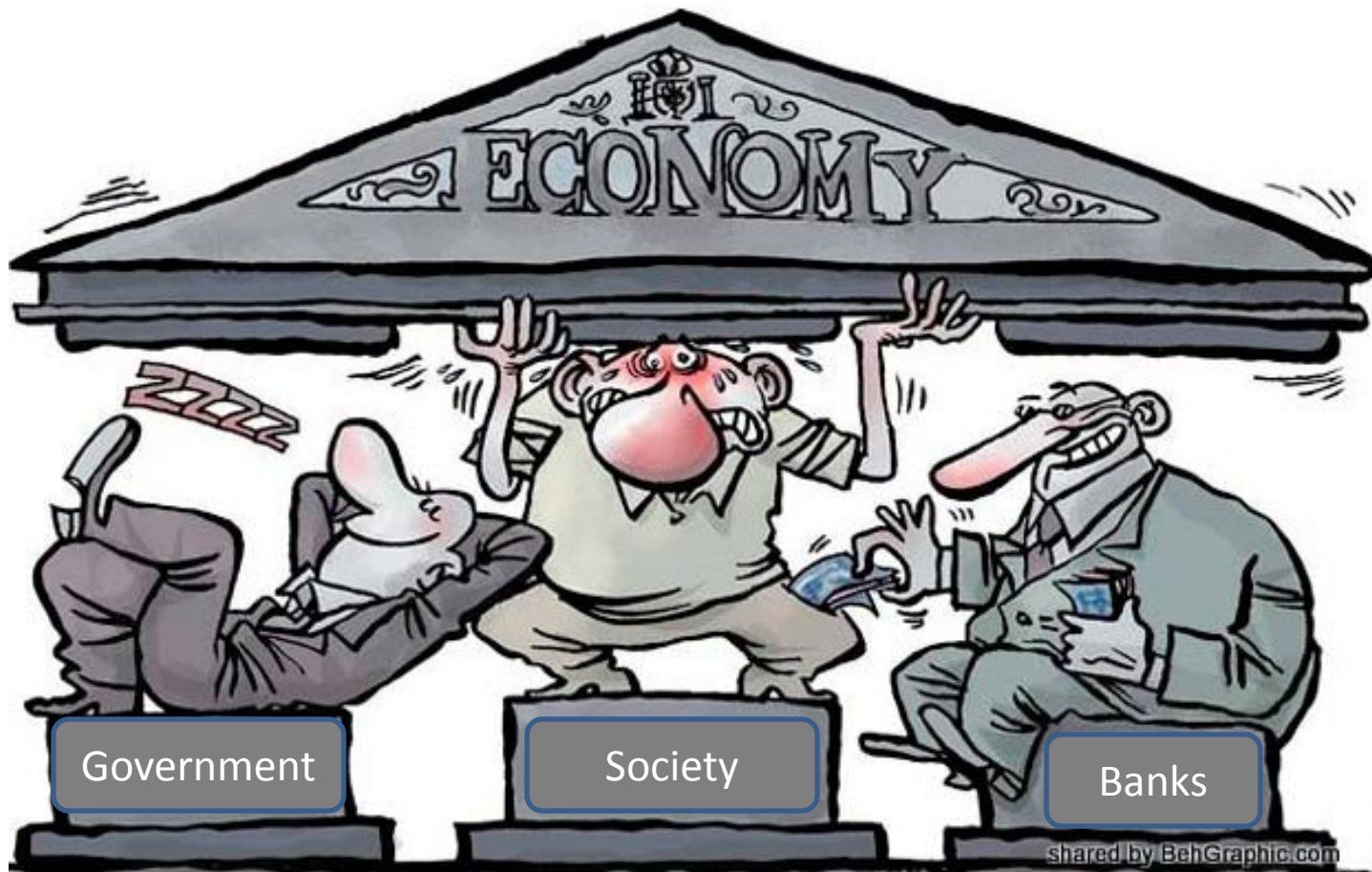
Note 2: Unofficial unemployment is higher due to the phenomenon of “underemployment” – mismatch between university graduates and expert jobs available in the market).

Some Other Economic Data

<i>Item</i>	<i>Latest Data</i>
Youth Unemployment (15-24 years old)	26.5%
Unemployment among females in the same age group compared to males	Usually 2 to 1
Sector contribution to jobs:	
Services	48%
Industries	33%
Agriculture	18%
Overall export performance in 2011 (WTO figures) - Rank 23 on an international scale.	US\$ 131.0
Overall import bill in 2011	US\$ 61.8
Top Trading Partners	China, Turkey, UAE, EU, India, Iraq (top market for non-oil Iranian exports)

Main source: *Atieh Bahar Consulting / Statistical Center of Iran*

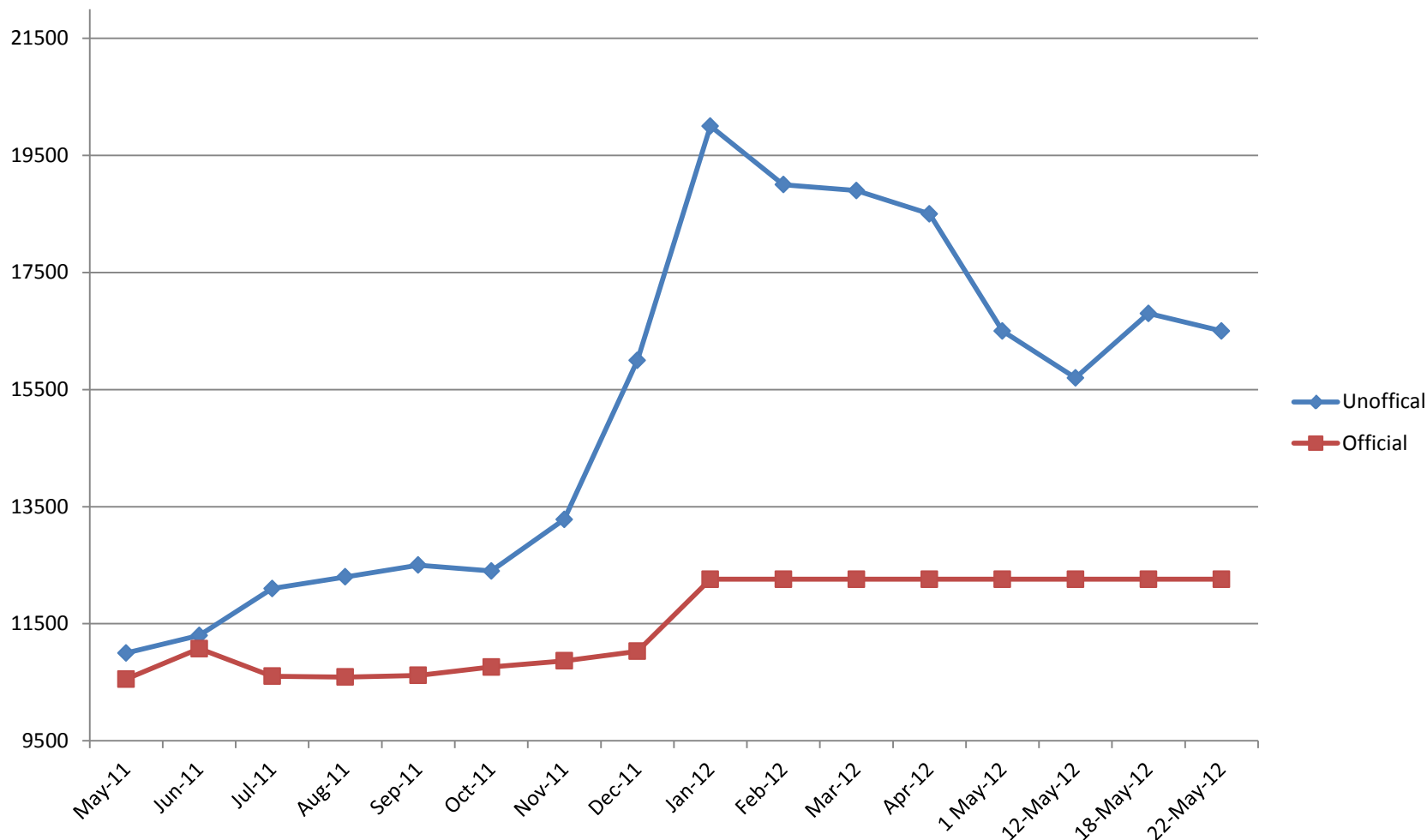
Cartoon describing the Iranian Economy





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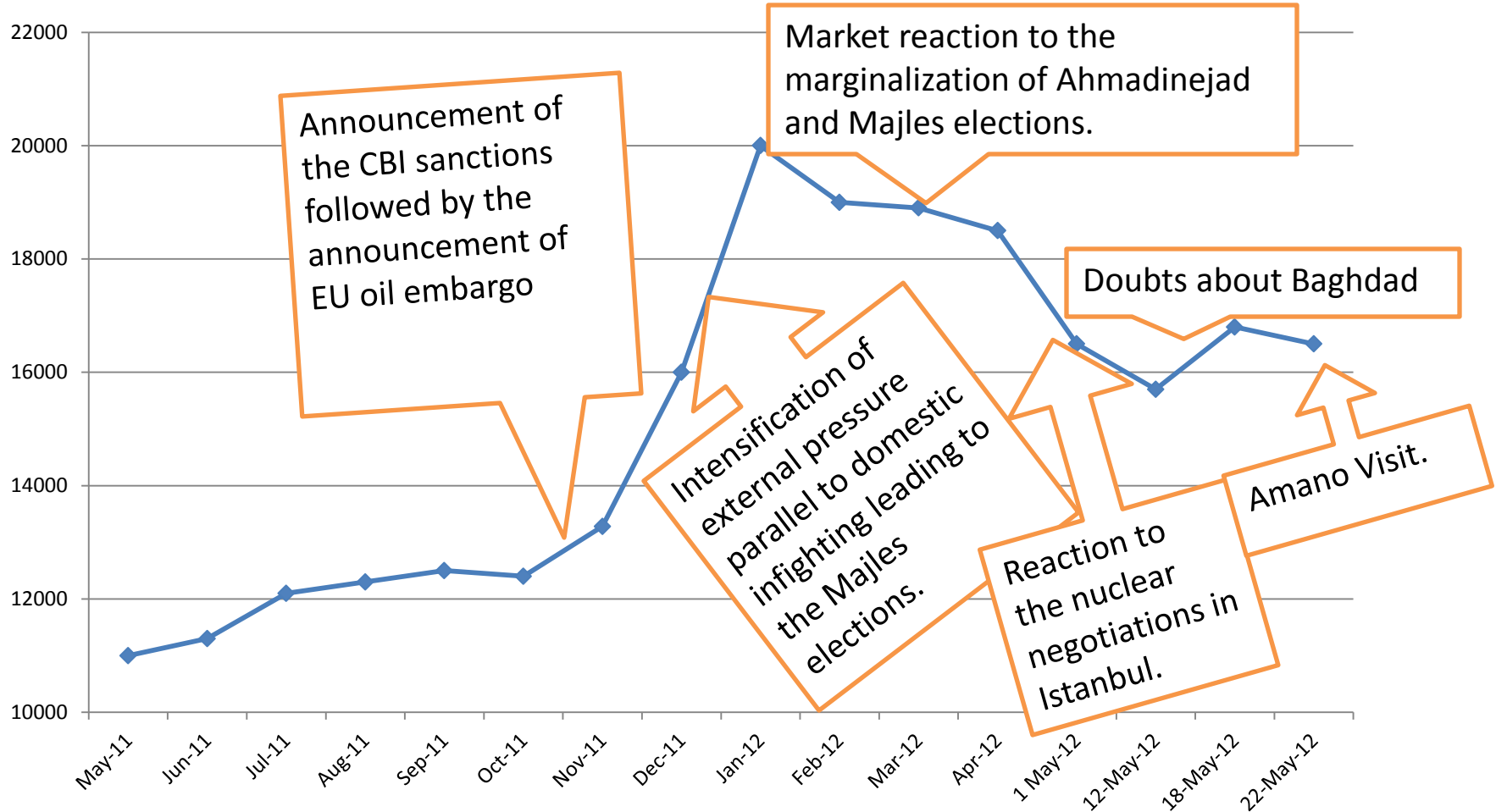
Official and Unofficial Exchange Rates



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Political Developments and the unofficial Exchange Rate

Unofficial



Impacts of Sanctions

- External pressure hand in hand with domestic irritations, have led to a low in business confidence – In my analysis, Iran's overall business confidence has not been this low since the final year of the Iran-Iraq war;
- Sanctions have also paved the way for shady business practices and for the operation of corrupt domestic as well as regional networks in the Iranian economy;
- Due to the opaque distribution of business interests in the economy, it is difficult to measure the direct impact of sanctions on various sector and industries. However, it is clear that the decline in oil production capacity is a consequence of sanctions over the past decade – a decline in oil production and oil income will eventually undermine all business sectors in Iran;
- Therefore, it is fair to state that economic stakeholders have lobbied for a de-escalation in foreign relations;

Quick Look at the Petroleum Sector

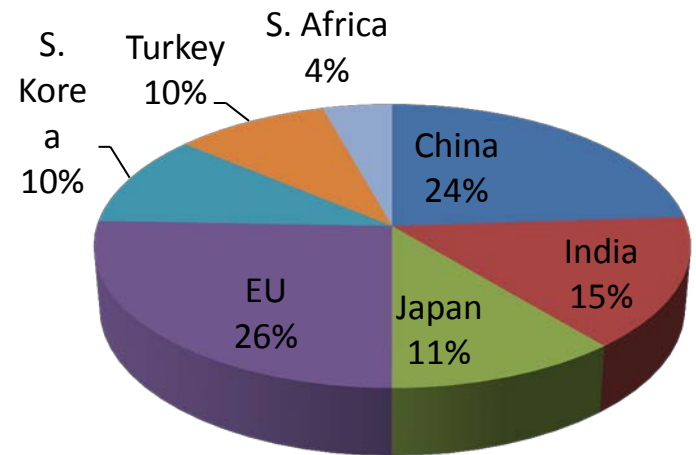
Current crude oil production	3.5 mbpd
Current natural gas production	530 mcm/d

- Iran's oil production capacity is in decline and it could drop to 3.1 mbpd by the end of 2013;
- Key issues right now are lack of investment and lack of appropriate technologies (mainly due to external sanctions);
- Gas production will grow gradually as new SP phases come on stream;
- Iran's energy savings from subsidy reforms (up to 100 mcm/d) could eventually help increase oil exports (through substitution and also through gas injections);
- The growth of the sector will make it also more vulnerable to political utilization of the petroleum sector, i.e. there will be more bargaining over interests in this sector (including lobbying on foreign policy decisions);
- The emergence of Iraq will work as a driver to improve the performance of the sector;

Impact of Oil Sanctions

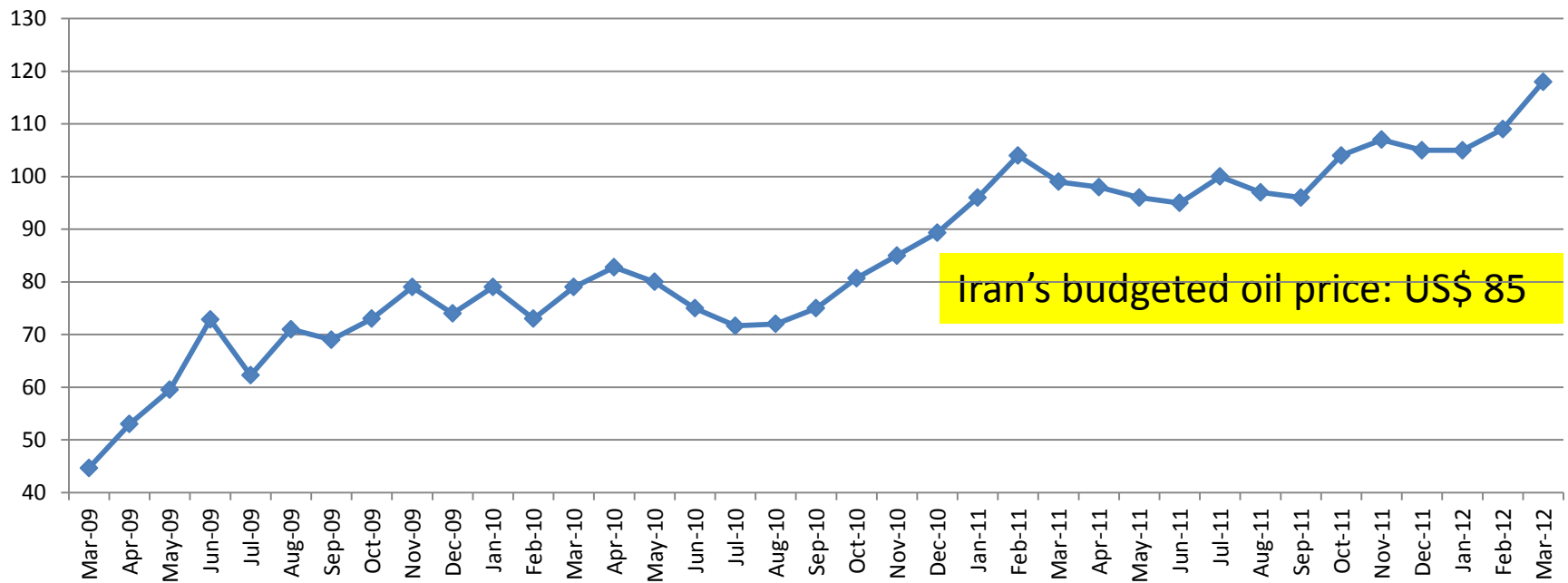
- EU's oil sanctions on Iran won't be the end of Iran's oil exports;
- In 2011, 26% of Iran's oil exports went to Europe;
- Iran can find substitutes, but it will eventually have to sell its oil on the spot market at lower prices;
- Some of the loss will be compensated through the higher oil price, but Iran will lose out financially;
- The main impact of the current sanctions is on the developments of the Iranian oil and gas sector – lack of technology and lack of new investments are undermining Iran's oil and gas production;
- Key stakeholders in Iran's petroleum sector know that the current situation is not sustainable and they will continue to lobby with key decision-makers;

Distribution of Iran's 2011 exports



Benefits from International Oil Price

Oil price (Iran Crude)

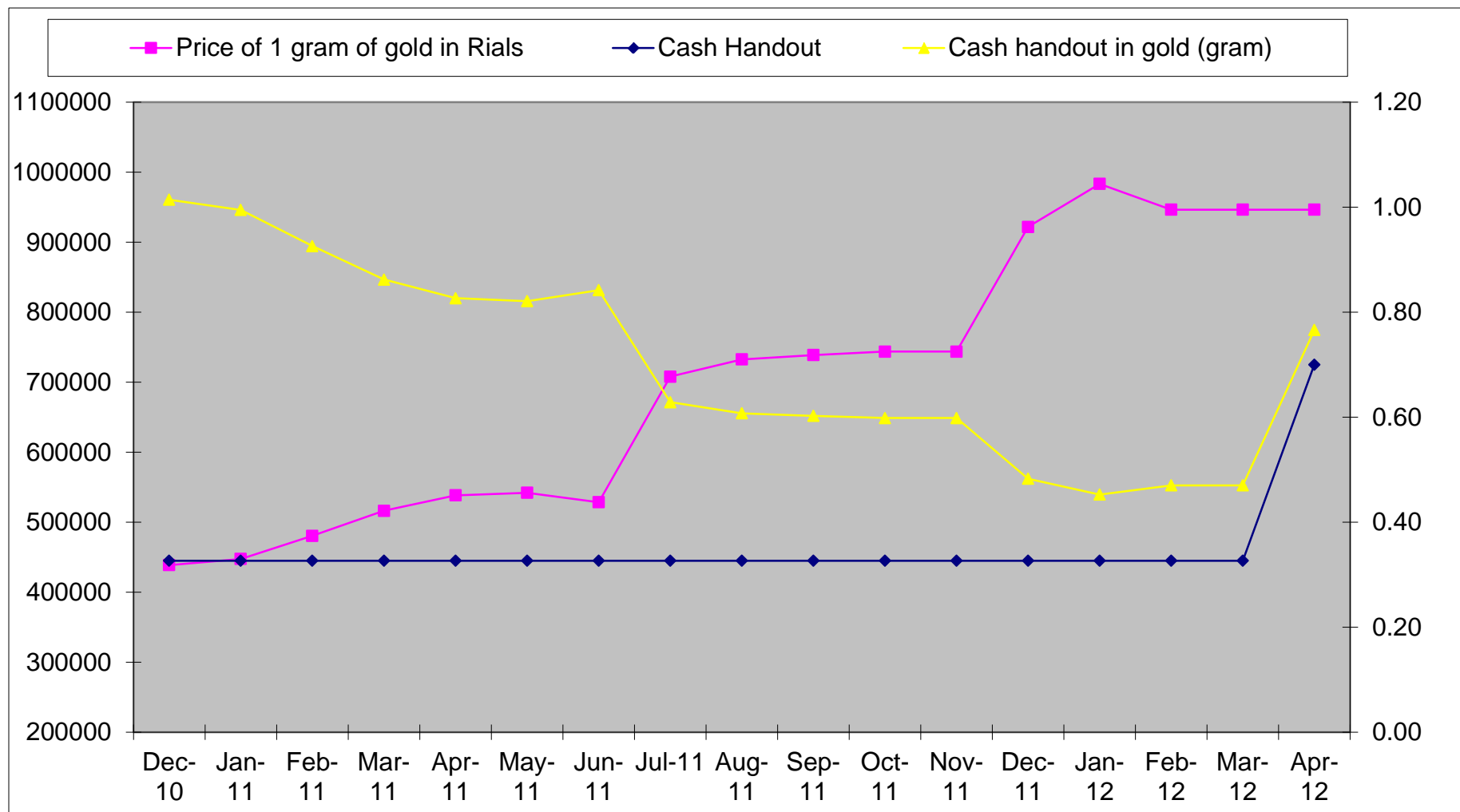


- The higher than expected oil price provides Iran with excess hard currency revenues that help smooth the financial situation.
- Currently Iran is exporting oil at about \$20 higher than budgeted which translates into an excess income of \$15 billion per annum;
- According to the IMF, Iran's foreign reserves stand at \$104 billion (historical record)

Subsidy Reforms

- From a socio-economic point of view, the subsidy reforms have been a disaster;
- The main losers have been the urban middle class;
- The Iranian industry is suffering and a large number of industrial units are going bankrupt in the absence of the planned government subsidies to the industry;
- In the absence of an exchange rate correction, the competitiveness of the Iranian industry, especially Iranian exporters will be undermined, as in the past low energy cost had acted as a competitive advantage;
- The situation is so serious that Ayatollah Khamenei declared the current Iranian year as the “Year of Domestic Production and Domestic Capital”;
- The negative impact on the industry will lead to further unemployment and economic decline;
- The Parliament has stopped the implementation of phase 2 of the subsidy reforms.

Diminishing Purchasing Power of Cash Handouts



Outlook

- Sanctions, subsidy reforms and continued budget deficit will all undermine the economic performance in the next 12 months – the Iranian economy will remain behind its actual potential;
- The higher than expected oil price will offer some leverage to the government, but the overall financial position will be critical;
- The Rial will have to be officially devalued to reduce the gap between official and unofficial rates and ease the pressure on the industry;
- The middle class are the main losers of the current subsidy reforms and economic misery and their situation will have a direct impact on the country's business interests;
- Therefore, economic interest groups (including the IRGC network) will continue to push for a moderation in politics to safeguard their interests;
- Economic, demographic and social phenomena will all push for a new constellation of power and more moderate policies;