The Economic Significance of the Nuclear Deal for Iran

Prepared for

Introduction

- Over the past decade, Iran’s economy has been undermined by populist policies, mismanagement, corruption, politicized decisions as well as sanctions;
- In the past 12 months, the collapse of the international oil price has further challenged the country’s economic development;
- However, the implementation of the Joint Plan of Action as well as rational policies of the Rohani government have induced some needed impetus;
- The country’s official response to external sanctions has focused on empowerment of the domestic industry and reforms under the so-called “Economy of Resistance”;
- The oil price drop has compelled the government and law makers to reduce dependency on oil export revenues and also reform the economy to pave the way for greater private sector activity;
- Tax reforms, privatization and a reform of cash handouts are already underway;
- Other reforms including a more investor-friendly business climate and legal frameworks for foreign investment will generate an economic momentum;
- The potential lifting of sanctions will boost the Iranian economy, but it is not the only factor that needs to be considered.
Factors Influencing the Iranian Economy

External Factors
- Sanctions
- Regional crises
- Oil price

Domestic political factors
- Factional infighting
- Competition between networks
- Majles pressure on government agencies

Governance issues
- Corruption
- Lack of a competitive environment
- Legal frameworks for private sector and foreign investment

Government policies
- Economic and trade policies
- Privatization and the approach to semi-state institutions
- Social and cultural policies

Foreign Policy
- Overall relations with key trading partners
- Regional relations
- Overlap between foreign relations and economic and trade necessities

Two Scenarios

<table>
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<tr>
<th>Scenario</th>
<th>Consequences</th>
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<td>The Parties sign a comprehensive deal in the summer of 2015</td>
<td>• A comprehensive Plan of Actions will be implemented including rolling back of the Iranian program and sanctions relief; • The process will take up to 2 years, but companies would engage Iran immediately; • The psychological impact would be immediate, but the actual economic and operational impacts will take a few months and will be felt in 2016 and beyond.</td>
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<td>The Parties don’t achieve a deal, but agree to freeze the status quo and NOT to escalate.</td>
<td>• The existing restrictions on Iran’s nuclear program remain in place and a number of sanctions remain suspended based on US and EU waivers; • Iran will try to improve ties with the EU and will still look for avenues to de-escalate ties with the US; • There may be future opportunities to achieve a nuclear deal; • Iran will expand relations with Russia, Asia and the regional players.</td>
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Oil export revenues

- Iranian officials believe that the country can increase production and exports by 1 million barrels per day (mbpd) after the lifting of sanctions but realistically, Iran can rehabilitate about 400,000 bpd of production relatively quickly (within months).
- Within 18 months after the lifting of sanctions, oil production capacity could go back to where it was in mid-2012;
- If current prices persist in the medium term and unconventional oil production declines, and if there is a comprehensive nuclear agreement, Iran could restore its pre-sanctions market share by 2017;

![Graph showing annual crude oil export revenue in billion US$](EconomicSignificanceOfTheNuclearDeal-2June2015.png)

Gas production

- Gas production will benefit from the availability of new technology and equipment from western companies.
- Iran has managed to increase gas production despite the sanctions regime, but a lifting of sanctions will accelerate the production increase.
- Higher gas production parallel to attempts to increase energy efficiency will create future potential for gas exports as well as investments in gas-based industries.

![Graph showing annual gas production in billion cubic meters](EconomicSignificanceOfTheNuclearDeal-2June2015.png)
Foreign Exchange Rate - 1

- The free market rate of the US$ has consolidated at Rial 33,000, while the forex chamber rate is tending towards Rial 29,000;
- If there is a nuclear deal, there will be a positive impact on the exchange rate;
- Some experts are proposing that the Central Bank (CBI) should use the potentially freed up hard currency to fortify the Rial
- It is more likely that the CBI would move towards unifying the exchange rates.

Economic Significance of the Nuclear Deal - 2 June 2015

Foreign Exchange Rate - 2

- If the negotiators fail to produce a comprehensive deal, there will be a negative psychological impact on the free market rate;
- The government and CBI will try to manage the negative impact, but their ability will depend on the availability of hard currency reserves;
- In this scenario, EU’s policy towards Iran will have a significant impact on the overall economic outlook in Iran.
**Inflation**

- The Rohani government has managed to contain the inflation efficiently;
- The impact of the nuclear deal on the inflation rates will be indirect, i.e. through the improvement of the government’s financial position as well as the exchange rate developments;
- However, no one predicts a single digit inflation in Iran in the next few years:

**Unemployment**

- The current administration has managed to reduce seasonal fluctuations in unemployment and also reduce the overall unemployment rate to about 10%.
- A comprehensive deal will generate a boost in new economic activity, especially through new investments by domestic and foreign private sector companies. In some sectors, the expectation of greater economic activity is already leading to job creation (eg. tourism);
- Nonetheless, demographic pressures will make it difficult to reduce unemployment below 8% in the next decade;
Trade Surplus

- There is no doubt that foreign trade will grow significantly after the listing of sanctions.
- Though there will be a push to import more, the overall import volume (about $60 billion) may not increase dramatically because some of the additional cost would be eliminated in a sanctions-free environment.
- However, Iranian exports will rise and will further consolidate the country’s economic future.

![Trade surplus graph](image)

GDP Growth

- Iran’s economic outlook will strongly depend on the outcome of the nuclear negotiations;
- The positive momentum from a comprehensive deal will accelerate the overall economic development;
- Even in the absence of a comprehensive deal, the economy will be on a growth path

![GDP growth graph](image)
Other Phenomena

- **The role of the Iranian Diaspora:** Should sanctions be lifted, the Iranian Diaspora will play an enormous role in investments and the transfer of technology. There is already some impact through programs such as support for IT entrepreneurship;

- **Gradual relaxation of social and cultural restrictions:** A nuclear deal will empower the moderate forces in Iran and it could potentially lead to some relaxation in cultural and social space;

- **Health sector reforms:** One of the major achievements of the Rohani government has been a reform of the health sector to reduce the health costs for average families. This process will continue and will be easier to administer, if sanctions are lifted and new technologies can be imported more feasibly;

- **Unblocking of Iran’s international assets:** A nuclear deal would unfreeze some significant Iranian assets. There is a debate on how the country should use those assets, but if they are invested internationally, Iran’s position in the global economy would be more consolidated;

- **The ownership of the Iranian economy:** Low oil price and the desire to reform the economy will reduce the government’s share of economic activity, but the main sector to gain will be the semi-state sector (see next slide).
Conclusions

• Sanctions are not the only problem in the Iranian economy (Some experts believe that only 20% of the country’s economic problems are related to sanctions), however, lifting of sanctions will accelerate the economic development in Iran;

• Other issues such as improved governance, political stability, investments in infrastructure and increased energy efficiency as well as modern banking solutions would also help the Iranian economy;

• The Iranian economy will grow in any of the scenarios, but a nuclear deal could elevate the growth potential to 7% p.a. – at the same time, Iran needs a 10% annual growth to address its unemployment issue in the next 5 years;

• A potential nuclear deal will have a positive impact on job creation because of growing private sector activity.

• However, unemployment figures will not drop significantly because of the negative impacts of demography, subsidy reforms, and privatization;

• Inflationary impacts remain and inflation will stabilize at about 10%-15% per annum with a falling trend;

• The value of the Rial against the US$ will consolidate around Rial 33,000 to the US$ in 2015 but will fall further because of inflationary effects, though at a slower pace, should there be a nuclear deal;