Euler Hermes Economic Research

Country Report

# Iran

## Potential still to be realised

## General Information

| | |
|---|---|
| **GDP** | USD415.339bn (World ranking 29, World Bank 2014) |
| **Population** | 78.47mn (World ranking 17, World Bank 2014) |
| **Form of state** | Theocratic Republic |
| **Head of state** | Supreme Leader Ayatollah Seyed Ali Khamenei |
| **Head of government** | President Hassan ROUHANI |
| **Next elections** | Legislative February 2016, Presidential June 2017 |

## Strengths

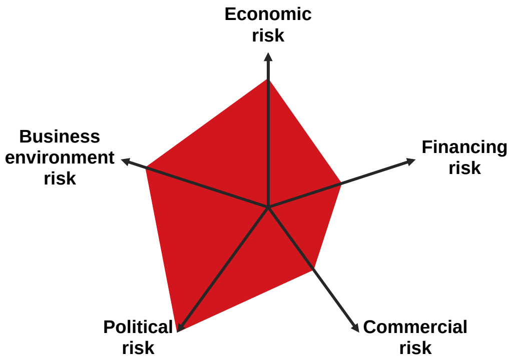
- World's largest known natural gas reserves and the fourth largest oil reserves.
- Oil and gas reserves will last over 100 years at current rates of extraction.
- Large domestic market.
- Current account surpluses.
- Large FX reserves (although now declining) and good (double digit) import cover.
- Very low external debt obligations.

## Weaknesses

- Occasional conflict between the twin pillars of power – the government and the theocracy. Other power bases include the Revolutionary Guards.
- Tehran's desire for Iran to be a regional and international power led to a build-up of a nuclear capability outside IAEA safeguards and this resulted in intense disagreements with the UN and the U.S., in particular, and international sanctions.
- Regional dynamics are negative. Neighbours include Iraq, Afghanistan and Pakistan. Sunni v. Shia divides and IS activities provide uncertainties. Moreover, Israel is perceived as a security threat.

## Country Rating

D4




Source: Euler Hermes

## Trade structure

By destination/origin (% of total)

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| China | 28% | 1 | 27% | United Arab Emirates |
| India | 15% | 2 | 15% | China |
| Turkey | 13% | 3 | 7% | Korea, Republic of |
| Korea, Republic of | 10% | 4 | 6% | Germany |
| Japan | 9% | 5 | 5% | Turkey |

By product (% of total)

| Exports | | Rank | | Imports |
|---|---|---|---|---|
| Petroleum, petroleum products and related materials | 67% | 1 | 13% | Iron and steel |
| Organic chemicals | 4% | 2 | 7% | Road vehicles |
| Gas, natural and manufactured | 3% | 3 | 7% | Other industrial machinery and parts |
| Metalliferous ores and metal scrap | 3% | 4 | 5% | Specialised machinery |
| Plastics in primary forms | 3% | 5 | 5% | Electrical machinery, apparatus and appliances, n.e.s. |

*Source: UNCTAD*

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## Economic Overview

Iran is classified as an upper-middle income economy, with annual GNI per capita of around USD5,780, although with marked regional and urban/rural divergences. The economy is dependent on oil and gas for around 20% of GDP, 60% of government revenues and over 70% of export receipts.

### GDP growth tends to be volatile, reflecting developments in international oil markets and the impact of sanctions…

GDP growth tends to be volatile (see chart), largely reflecting demand and price movements in international oil markets. However, since 2011, the GDP trajectory became disengaged from that of other leading oil suppliers and from the Middle East region as a whole. This is partly because domestic political factors and international diplomacy also weigh on the Iranian economy. GDP is estimated to have contracted by -6.6% in real terms in 2012, reflecting the impact of sanctions, which curtailed oil exports and (through restrictions imposed on the financial sector) limited other commercial transactions. Perceived policy mismanagement in the President Ahmadi-Nejad era further added to the weak economic environment in 2011-13. President Hassan Rouhani only took office in August 2013, so those policies continued to weigh against expansion that year. EH estimates that (modest) corrective measures by the current government enabled GDP to expand by +1.5% in 2014.

### …and, although the economy moved out of recession in 2014, those factors continue to weigh on the growth outlook

The outlook for growth in 2015 and 2016 is for moderate expansion relative to development needs and to potential. EH expects GDP will increase by around +2% and +3.5%, respectively, in real terms but there are considerable upside and downside risks to this outlook. Much will depend on the course of oil prices. EH's central scenario is for oil prices to strengthen only marginally next year but this is from a current position where benchmark prices in early September 2015 (below USD50/barrel) are down by over -50% y/y. Oil markets will continue to reflect weak demand relative to output gains from North American shale reserves and from OPEC. However, Iran's GDP growth could rebound more strongly if there is easing of sanctions (and they are not re-imposed) and if further domestic reforms are implemented. If sanctions are lifted in 2016, GDP growth could rise to around +4%.

### Post sanctions?

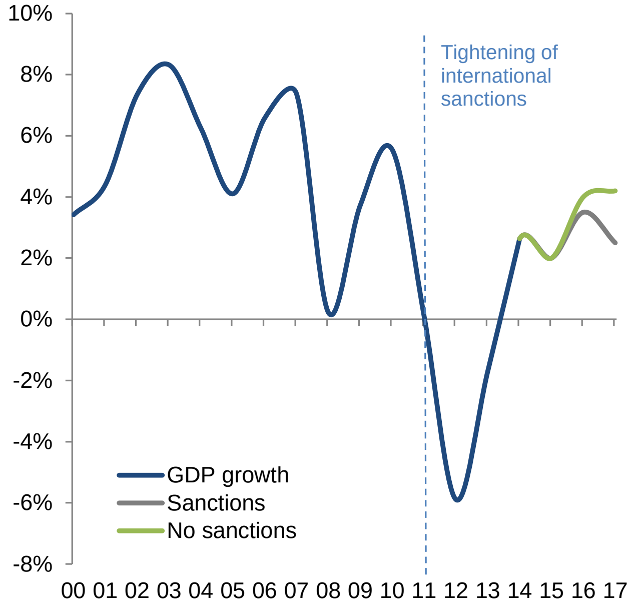
Reports suggest that global commercial interest in Iranian markets (including the energy sector, tourism, consumer goods, construction and automobiles) is already deepening. The sanctions (particularly those affecting Iran's access to financial and energy markets and that freeze assets held overseas) will be repealed following verification by the international nuclear watchdog, the IAEA, that Tehran is abiding by the restrictions on its nuclear activities. This could take until the end of 2015, so the main economic boost for Iran will come from 2016, although domestic consumer and investor confidence will receive a short-term impetus. Much could still go wrong but if the agreement holds commercial opportunities will emerge in the energy, civil aviation and automobile sectors, with openings in tourism and retail sectors likely to follow as Iran's re-assimilation consolidates.

**Key economic forecasts**

| | 2013 | 2014 | 2015f | 2016f |
|---|---|---|---|---|
| GDP growth (% change) | -1.9 | 1.5 | 2.0 | 3.5 |
| Inflation (%, end-year) | 29.6 | 16.7 | 11.7 | 11.3 |
| Fiscal balance (% of GDP) | -0.9 | -3.0 | -4.5 | -4.7 |
| Public debt (% of GDP) | n.a. | n.a. | n.a. | n.a. |
| Current account (% of GDP) | 8.6 | 9.1 | 5.8 | 7.2 |
| External debt (% of GDP) | 2.4 | 2.2 | 2.4 | 2.2 |

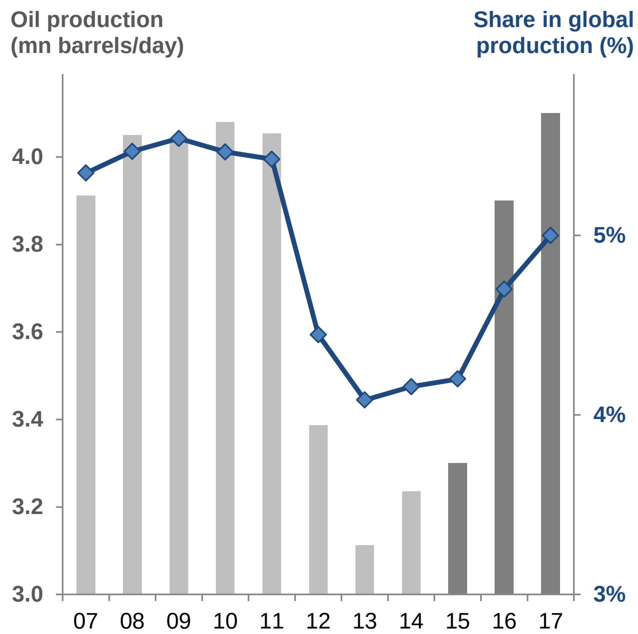
Sources: IHS, national sources, Euler Hermes

**GDP growth profile (y/y %)**




Sources: IHS, Euler Hermes

**Oil output (assuming relief from sanctions)**




Sources: BP, Euler Hermes

## External accounts remain strong

The strength of the external accounts continues to depend on internationally-determined oil prices and the country's associated revenue generating capacity. Crude oil and gas and related products account for over 70% of Iran's total export receipts. Strong current account surpluses were recorded in 2011-14, when oil prices were high (indicative average benchmark prices of >USD100/barrel). The recent peak for current account surpluses was +11.8% of GDP in 2011. Despite current weakness in oil prices, EH expects current account surpluses will continue, but at lower levels.

Hard currency foreign exchange reserves are currently around USD70 bn, down from over USD80 bn at end-2012, partly reflecting their use to stem a too rapid depreciation of the IRR. At current levels, FX reserves provide an import cover of around 12 months, compared with an internationally-accepted comfort level of three months. EH expects FX reserves and import cover will be further depleted, but overall external liquidity will not be at risk.

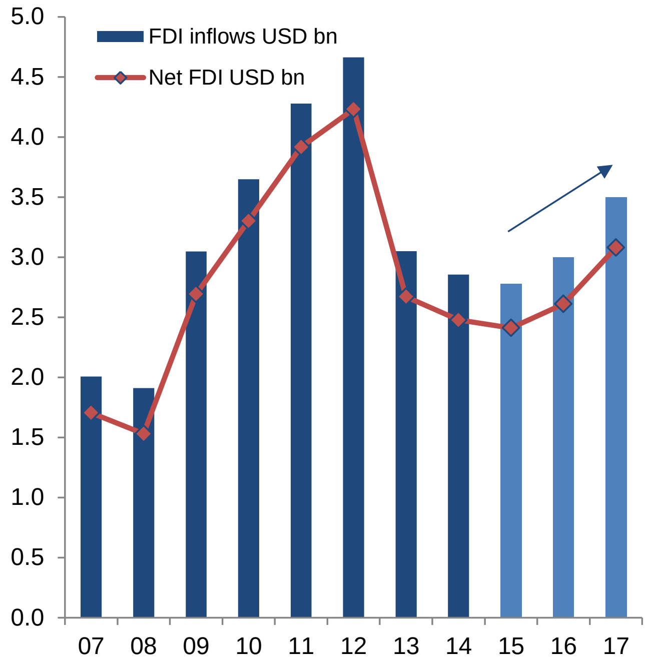
## External debt levels and servicing of obligations are comfortable

Partly as a result of Iran's partial ostracism from full involvement in international diplomatic and economic relations, external debt ratios are relatively low, with total foreign debt stock at <3% of GDP and around 10% of total export earnings and the debt service ratio on existing obligations is under 1% of total export receipts. As a result, external payments of debt obligations (and, by association, settlement of trade payments, where these do not contravene sanctions) should not be problematic.

## Policy

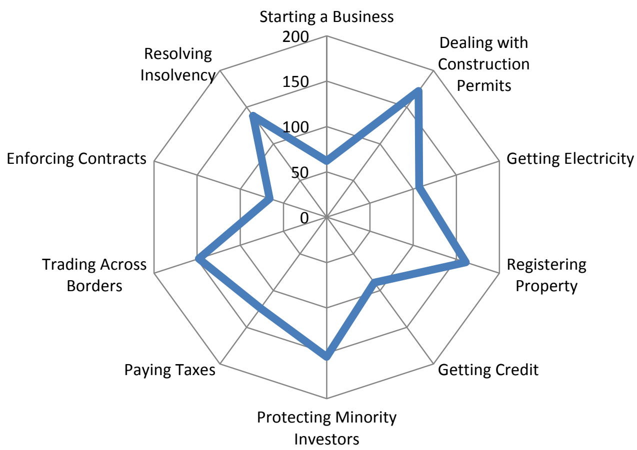
Overall economic strategy is laid down in five-year development plans but there were perceptions that the previous regime overlaid such planning with short-term policies with a distinct political agenda. The Ahmadi-Nejad government increasingly turned away from foreign investment and attempted to make the economy more self-reliant. However, this inward direction and constrained ability to source capital goods or raw materials from abroad caused a miss-allocation of resources and limited overall growth. Incumbent President Hassan Rouhani was elected on a platform of improving economic management, including removal of international economic sanctions. Some measures have been adopted that have slowed inflationary pressures and supported the IRR. In addition, a tentative agreement was reached to terminate economic sanctions. It remains to be seen whether the accord will hold and sanctions will be lifted sometime in 2016. Initial signs are encouraging but significant challenges remain evident.

**FDI (%)**




Sources: IHS, Euler Hermes

**Doing Business Ratings (2015)**




Sources: World Bank, Euler Hermes



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