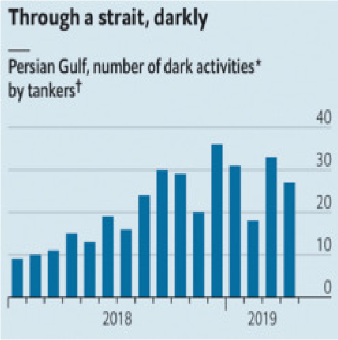
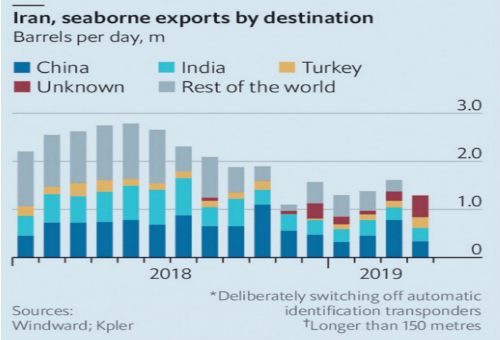
Iran Sanctions

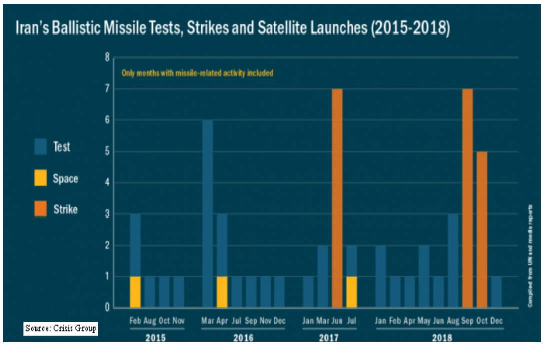
Road to War?

The drums of war are rolling; America is on the brink of sending 120000 troops to Iran after unspecified threats from them. John Bolton, the National Security Adviser said that any attack on America or its allies "will be met with unrelenting force." Meanwhile, in Tehran, President Hassan Rouhani said- Iran will no longer abide by the terms of the deal they signed with America and other world powers, whereby it agreed to strict limits on its nuclear programme in return for economic relief. Iran looks poised to steadily march towards building a nuclear bomb multiplying problems for the United States President – Donald Trump, who has been vocal against sending troops to fight wars overseas; this comes amidst the already deteriorating trade talks with China which are harming the U. S. economy.

Just four years ago, America and Iran came together, leading to a nuclear deal (Joint Comprehensive Plan of Action) that promised to set back the Iranian nuclear programme by more than a decade and possibly break the cycle of threat and counter-threat that have dogged relations since the Iranian Revolution 40 years ago. Iran had been complying, but critics were of the opinion that the temporary restrictions would legitimize the nuclear programme. Last year, President Trump pulled out of the deal, calling it a 'disaster'. Mr. Bolton and Mike Pompeo, the United States Secretary of State believe in using economic pressure to topple the Iranian regime and bombs to stop its nuclear programme. Internally, the mullahs and the Revolutionary Guards do not trust America; they are tightening their grip at home and lashing out abroad. In both countries, the policy is being dictated by intransigents, who risk the possibility of war.







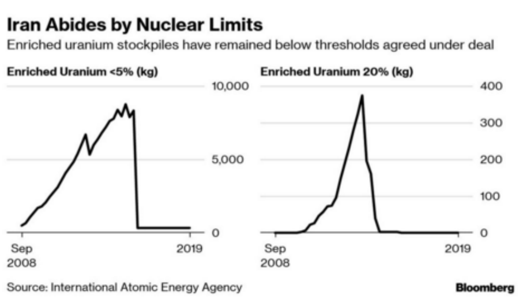
At the beginning of May 2019, America cancelled waivers that let some countries including India and China buy Iranian oil and now it is extending them to Iran's metals export. According to The Economist, Mr. Rouhani said on May 8, that Iran would begin stockpiling low enriched uranium and heavy water. He has 3 major audiences in mind- first, his own hardliners whom he seems to have appeased for now. Second, he is trying to get European companies to break with America which is something he will not succeed at and most important of them all, America, with whom he seems to be playing an old game- Iranian leaders have for long maintained that it is a peaceful regime and used the nuclear programme as a bargaining chip with the west.

Officials on both sides say their intent is peaceful, but who can believe them? America's accusations that Iran has been planning to attack American forces or its allies are suspiciously vague. Mr. Pompeo once suggested that he preferred American sorties to nuclear talks with Iran. In such a situation, violence by Iran's proxies may be just the push that leads America to launch a military strike. A military attack might not destroy Iranian nuclear know-how, but would drive it underground, making it impossible to monitor and thus, all the more dangerous. Mr. Trump, who is not a fan of foreign wars, needs to keep the likes of Mr. Bolton in check. He will no doubt face pressure from Middle East countries like Israel and Saudi Arabia but the only long term solution is renewed negotiations.

Sanctions

In an era that seems like a distant memory, the Joint Comprehensive Plan of Action (JCPOA) then received unanimous endorsement from the UN Security Council on the 20th of July 2015. It entered into force on 18th October and implementation was started on 16th January 2016 after the International Atomic Energy Agency (IAEA) certified Iran's fulfilment of its commitments thereby triggering sanctions relief. Donald Trump's election in November 2016 made matters far worse. As President, he took the first stab at the deal in October 2017 when he refused to certify it on the grounds that sanctions relief had been disproportionate to Iranian nuclear concessions. By January 2018, Trump indicated that he had run out of patience with his National Security team and Congress' reluctance to amend the deal. After several rounds of discussions between the United Kingdom, France, Germany & the United States, a mutually acceptable compromise seemed within reach but Trump deemed the progress insufficient and pulled out of the JCPOA on 8th May, 2018 starting the clock on U.S. sanctions.

Since January 2016, the IAEA has verified Iran's JCPOA compliance on 13 separate occasions, while the UN secretary general has attested 6 times that Iran is abiding by its JCPOA obligations. After the U.S. withdrew, Iran increased its co-operation with the IAEA- a clear attempt at depriving the U.S. of any pretext to shift the blame on Iran. Iran has kept a comfortable distance from the JCPOA's threshold for sensitive material- 130 metric tonnes for heavy water and 300 kg for low enriched uranium and was within its limit on the number of centrifuges that can be operated.



The sanctions were reinstated in two parts, first of which came into effect on August 7, 2018. It included restrictions on Iran's purchase of U.S. currency, trade in gold and other precious metals and sale of auto parts, commercial passenger aircraft and related parts and services to Iran. The second set of sanctions, which came into effect on November 4 of the same year, restricted sale of oil and petrochemicals from Iran. U.S. Secretary of State, Mike Pompeo laid out conditions that Iran must meet in order to ease the situation including ending destabilizing actions in the region, such as its support for Houthi rebels in Yemen and Hezbollah. Iranian officials, however, regard these demands as tantamount to seeking regime change.

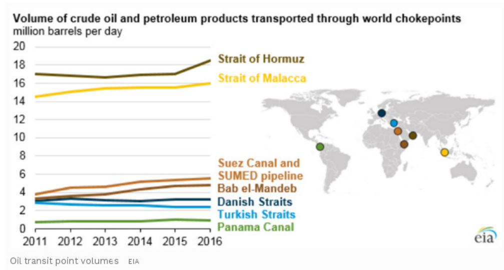
Role of Saudi Arabia & Israel

Saudi Arabia is eager for the United States to take military action against Iran in the wake that it will lead to a regime change in Tehran according to a Middle East news agency- AL Monitor. Saudi Arabia had called for an Arab summit in Mecca on May 30, 2019 to rally support against Iran. The Saudi government-controlled press is pushing for 'surgical strikes' by the U.S. against targets in Iran. One editorial said that such strikes are necessary because of the sabotage of Saudi oil tankers Fujairah in the United Arab Emirates and the Houthis' drone attack in the east-west oil pipeline in Saudi Arabia. Both of these attacks are blamed on Iran: the Saudi leadership has publicly blamed Iran for the drone attack, saying the Houthis are Tehran's puppets. Other opinion pieces argue that the Iranian military is weak and would be easily defeated by the United States' forces leading to the end of the clerical regime. According to Forbes, any conflict in the Strait of Hormuz, which sees roughly 18.5 million barrels of oil flow in and out each day could be catastrophic for the global economy.

There are multiple reasons why the Crown Prince Mohammed bin Salman would want the Americans to attack Iran. This attack could possibly end the tensions in Yemen which so far has proved to be a PR disaster for the Saudi Government and the Crown Prince himself who was the driver behind the kingdom's decision to go to war in Yemen four years ago as Defence

Minister. The result is an expensive quagmire for the kingdom and a humanitarian catastrophe for Yemen. A recent study commissioned by the United Nations estimates a quarter million Yemenis have died due to the war. The drones used last week demonstrated a significant improvement in Houthi capabilities. The Iranians and Hezbollah have provided expertise and equipment to help the Zaydi Shiite rebels but the Houthis are not Iranian pawns and make their own strategic decisions according to the same news article.

This month has seen huge fluctuations in oil prices as markets react to Trump tightening the Iran sanctions. However, the International Energy Agency (IEA) has announced a slowdown in oil demand which will help keep prices stable around $70/barrel to compensate for supply disruptions. OPEC has kept production at 30.2 million barrels per day (mbd) as it waits to see the full effects of the Iran sanctions. The impact on the Iranian production has been severe. In May of 2018 Iranian crude and condensate exports reached 3.5 mbd. In April 2019, oil shipments hit a five-year low at just under 1 mbd.



Israel President, Benjamin Netanyahu instructed the security branches to try to keep Israel out of this conflict. He knows that the chances of conflict avoidance are slim and that he has no chance whatsoever of keeping Israel off the list of Iran's top targets. A security source who asked not to be named, explained the prevailing assessment in Israel of the attacks on Saudi oil tankers- "The purpose of these attacks was to signal that Iran has the ability to interrupt the flow of oil from the Gulf and that it can force the US and its allies to pay a steep price." Israel says that Iran has avoided direct involvement in these attacks, preferring to use its local proxies instead. If, however, full-blown war breaks out, the Islamic Revolutionary Guard Corps will enter the picture. Should that happen, Israel believes that it would be in the top tier of Iranian targets according to news agency AL Monitor in May 2019.

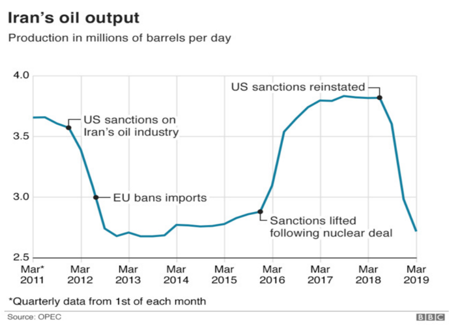
In late 2018, Benjamin Netanyahu claimed that there was an inspection crisis, which could put Iran in a spot of non-compliance if it were to deny UN inspectors access to 'suspect' sites. In April 2018, Netanyahu revealed 55,000 pages of documents and another 55,000 files on 183 CDs that Israeli intelligence operatives removed from a clandestine archive in Tehran in early 2018. In September 2018, he claimed the existence of another warehouse in Tehran containing "as much as 300 tons of nuclear-related equipment and material" in "15 shipping containers". He also alleged that the facility had held 15kg of radioactive material that Iran had since dispersed around Tehran. Netanyahu has been vocal against the IAEA not doing enough to follow up on Iran's past nuclear weapons work and called the Agency's Director-General to 'do the right thing'.

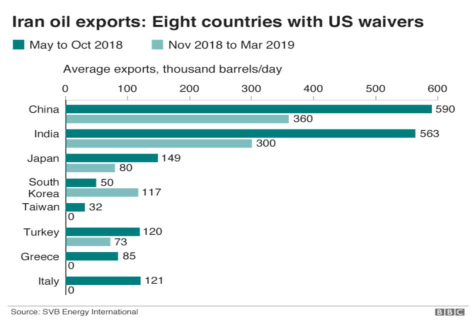
Why then has Netanyahu, taken a passive stance in such a short time? It was Netanyahu who appeared before a Congressional Committee in the days leading up to the invasion of Iraq to claim that Hussein was attempting to build nuclear weapons and that toppling the regime in Iraq would rein in Iran and create greater stability throughout the entire Middle East. History proved that, most of Netanyahu's predictions did not turn out to be right. No signs were found that Iraq was trying to develop nuclear weapons, while the removal of former Iraqi President Saddam Hussein triggered a chain reaction that set the entire region on fire. Now, Netanyahu is attempting to tone it down, so that he will not be thought of as the person pressuring the Americans to launch a military strike against Iran. It is not at all certain that he will succeed.

Effect of Sanctions

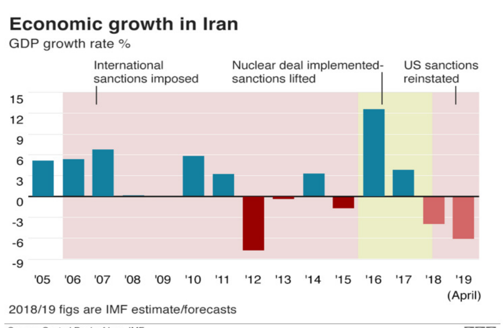
President Donald Trump reinstated the sanctions last year after abandoning the nuclear accord which he wants to renegotiate. In the face of the sanctions, Iranian leaders have remained defiant and vowed to overcome them but the substantial impact they have had on the country is clear. Iran's crude oil production reached 3.8 million barrels per day (mbd) at the start of 2018 out of which the country was exporting about 2.3 mbd according to OPEC. Most of it was bought by eight countries that were granted 6-month waivers by the U.S. when the sanctions on the Iranian energy sector took effect. These countries were allowed to do so as long as they reduced their purchases over that period. By March 2019, Iran's exports had fallen to 1.1 mbd on average according to consulting firm SVB Energy International. Taiwan, Greece and Italy halted imports altogether while its two biggest buyers- China and India, reduced their imports by 39% and 47% respectively, between November 2018 and March 2019. A U.S. official estimated that Iran's government had lost more than $10bn ($7.7bn) in revenue as a result. President Trump declared that he intended to bring Iran's oil supply down to zero when he decided not to renew the SRE (significant reduction exemptions) waivers in May 2019. However, it is not clear how much further could Iran's oil sales drop. China has said that its trade with Iran is perfectly legal and the United States has no right to interfere with it. Turkey has also said that it cannot cut ties with a neighbour.

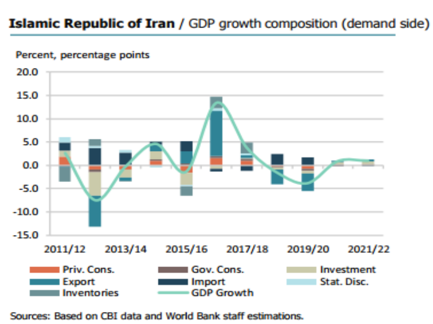
President Donald Trump's efforts to sink Iran's exports of oil will have a direct impact on India, the largest buyer of oil after China. Harsh Vardhan Shringla, the Indian Ambassador to the United States, said at a Carnegie Endowment event in April 2019. "We are apprehensive that that impact can translate into inflation, (and) higher oil prices," which could affect the common person in India, Shringla said. India's Petroleum and Natural Gas Minister Dharmendra Pradhan said in April 2019, that India will get additional supplies from other major oil-producing countries to compensate for the loss of Iranian crude.





In 2016, the year after the deal was implemented and the sanctions were lifted, Iran's GDP grew at 12.3% according to the Central Bank of Iran. Most of the growth was attributed to the oil and gas industry while the recoveries of the other sectors were not as significant as many Iranians would have hoped. The following year, it fell back to 3.7% on the back of threats from Donald Trump to walk away from the deal. This helped fuel the economic discontent that led to the biggest anti-government protests in almost a decade that December.

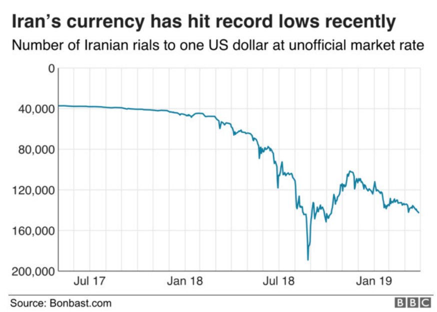




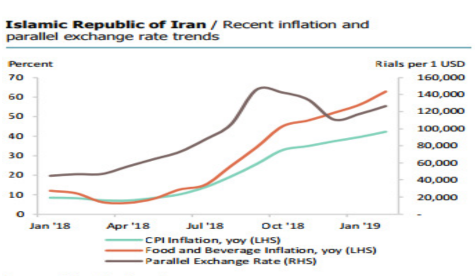
The reinstatement of US sanctions last year - particularly those imposed on the energy, shipping and financial sectors in November - caused foreign investment to dry up and hit oil exports. The sanctions not only bar US companies from trading with Iran, but also with foreign firms or countries that are dealing with Iran. As a result, Iran's GDP contracted by 3.9% in 2018, according to estimates from the International Monetary Fund (IMF). The IMF said in late April that it expected the Iranian economy to shrink by 6% in 2019. However, that projection preceded the expiration of the sanctions waivers.

President Rouhani kept the rial stable for almost four years but since the reinstatement of sanctions, it has lost almost 60% of its value against the U.S. dollar on the unofficial market. The fixed official rate of 42000 rials to the dollar is used for a limited range of transactions, so most Iranians rely on currency traders. Bombast.com, a foreign exchange website, reported that traders were offering 143000 rials to the dollar on April 30, 2019. The rial's slide has been attributed to Iran's economic problems and a high demand for foreign currency among ordinary Iranians who have seen the value of their savings eroded and worried that the situation will get worse. The rial has regained some of its value since September 2018, when the Central Bank of Iran released more dollars into the market and authorities cracked down on currency dealers as prices reached a record low of 190,000 to the dollar.

Source: xe.com

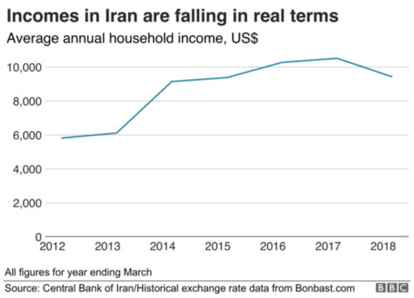


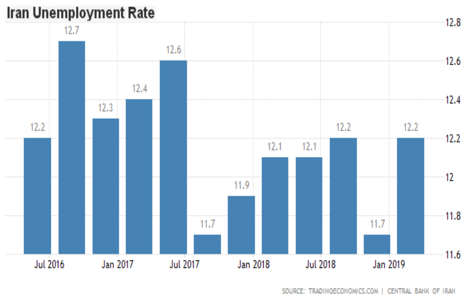
President Rouhani managed to get inflation down to 9% in 2017. But the IMF estimates that it soared to 31% in 2018 and predicts that it could reach 37% or more this year if oil exports continue to fall. The plunging value of the rial has affected not only the prices of imported goods but also of locally produced staples. Since May 2018, the cost of red meat and poultry has increased by 57%, milk, cheese and eggs by 37% and vegetables by 47%, according to the Statistical Centre of Iran. The increasing prices have made it extremely difficult for a large section of society to afford the basic necessities of life. In an attempt to lower prices, the government has banned livestock exports, flown in hundreds of thousands of cows and sheep from abroad. But analysts say some Iranian farmers are selling meat in neighbouring countries to obtain foreign hard currency. There is also a plan to introduce electronic coupons to help the poorest people obtain meat and other essential goods.



The really scary part for Iran is that the full brunt of U.S. sanctions has just begun to be felt with the removal of SRE waivers. The U.S. economic pressure is just adding to the years of corruption and economic mismanagement by Iran's leadership which has led to chronic inflation, unprecedented unemployment and ever-increasing budget deficits. Lower average oil prices now, than during the Obama administration, when the United States sharply limited Tehran's crude exports, means that it has less ability to absorb U.S. sanctions than in the past. Last year's budget deficit turned out to be twice the government forecast- and that was with higher than expected revenues from oil exports. What happened was that other sources of revenues fell short. Lower government revenues meant a bigger deficit, which in turn pushed down the value of the Iranian currency and made imports more expensive. This year's budget is even more worrisome, premised on the idea that Iran will export 1.5 million barrels of oil per day despite the U.S. sanctions- Exports have dropped from about 2.5 million barrels a day before sanctions to just over 1 million barrels a day currently.

The official unemployment rate reached 27 percent among young Iranians and over 40 percent among university graduates, says Omid Ali Parsai, Chairman of the Iranian Statistical Center in January 2019. The official Iranian figures seem barely convincing; Iran's methodology in estimating the number of people with jobs is to count one hour of work per week as employment. Parsai added that some 550 thousand jobs have been created in Iran during the first nine months of the current Iranian year which started on March 21, 2018. However, the country lags behind in terms of creating employment opportunities as the projected figure for the number of jobs needed annually is 900 thousand, said the Chief Statistician.





In addition to the economic effects, these sanctions have also crippled Hezbollah, the terrorist organization who allegedly get cash handouts from the Iranian regime. These were spent lavishly on benefits for its fighters, funding social services for its constituents and accumulating a formidable arsenal that has helped make the group a significant regional force, with troops in Syria and Iraq. In a major victory for the Trump organization, Iran's ability to finance allies such as Hezbollah has been curtailed. Hezbollah, the best funded and most senior of Tehran's proxies, has seen a sharp fall in its revenue and is being forced to make draconian cuts to its spending, according to Hezbollah officials, members and supporters Washington Post reported in May 2019. The official would not say how much Iran has cut its financing for Hezbollah or how big it used to be. U.S. Special Envoy Brian Hook told reporters in Washington in April that Iran in the past has sent Hezbollah up to $700 million a year, accounting for 70 percent of the group's revenue.

"The issue today is: What will be the price of continuing the sanctions and what will the collateral damage be?" Sami Nader, the Director of the Levant Institute for Strategic Affairs said. "There will be a lot of instability and hardship, and there could even be a new conflict." Although the sanctions appear to be working from the U.S. point of view, there is growing concern that the pain being inflicted on ordinary people, including within Iran, will further destabilize the already violence-racked region, heighten anti-American sentiments and increase pressure on Iran to retaliate.

Outlook

In the medium term, the economy is expected to undergo a period of stagflation until April 2020 as oil output continues to decline along with mounting external economic challenges. The economy is expected to contract by 1.6% in 2018/19 and almost 4% in 2019/20 before returning to a modest growth path albeit from a smaller base, according to World Bank. Inflation is projected to be at 30% in 2018/19 and increase further in the following year as the full effect of the exchange rate depreciation is passed on. The fiscal deficit is expected to widen as incomes continue to fall short of the previous years due to lower tax revenues and oil exports. On the external side, Iran's current account surplus is expected to decline to very low levels in the coming years as exports decline in goods and services category due to the imposition of the U.S. sanctions. The shrinking current account balance along with the expected rise in outward flows would make it difficult to manage the value of rial and inflation by the Central Bank of Iran.

A decline in real GDP per capita along with double-digit inflation is expected to have a negative impact on poverty through the labour markets and further erosion of the real value of cash transfers. The exact poverty trends will also depend on the public policy response of the government. Increasing the value of cash transfers, possibly along with introducing targeted mechanisms, may help the poor and vulnerable population cope with the social and economic shocks.

Islamic Republic of Iran / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2016/17	2017/18	2018/19 e	2019/20 f	2020/21 f	2021/22 f
Real GDP growth, at constant market prices	13.4	3.8	-1.6	-3.8	0.9	1.0
Private Consumption	3.8	2.5	-0.9	-1.9	-0.2	0.1
Government Consumption	3.7	3.9	-1.5	-4.0	2.4	2.6
Gross Fixed Capital Investment	-3.7	1.4	-2.2	-3.4	2.7	2.8
Exports, Goods and Services	41.3	1.8	-11.1	-15.0	1.6	2.0
Imports, Goods and Services	6.1	13.4	-27.1	-25.4	1.3	4.3
Real GDP growth, at constant factor prices	12.5	3.7	-1.5	-3.8	0.9	1.0
Agriculture	4.2	3.2	2.8	3.0	3.1	3.1
Industry	24.7	3.0	-6.8	-7.2	0.7	0.3
Services	3.7	4.5	2.9	-1.8	0.7	1.3
Inflation (Consumer Price Index)	9.0	9.6	29.9	39.2	24.6	22.0
Current Account Balance (% of GDP)	3.9	3.5	0.5	0.0	0.5	0.9
Fiscal Balance (% of GDP)	-1.9	-1.8	-4.8	-5.4	-5.5	-5.4
Gross Public Debt (% of GDP)	49.0	38.2	42.4	44.8	44.6	44.4
Primary Balance (% of GDP)	-1.8	-1.6	-4.5	-4.8	-3.9	-3.7
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	11.6	10.9	11.6	12.9	12.9	12.8

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on 2016-HEIS. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2016) with pass-through = 0.87 based on GDP per capita in constant LCU.

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