Passport

Iran prepares for tightened sanctions

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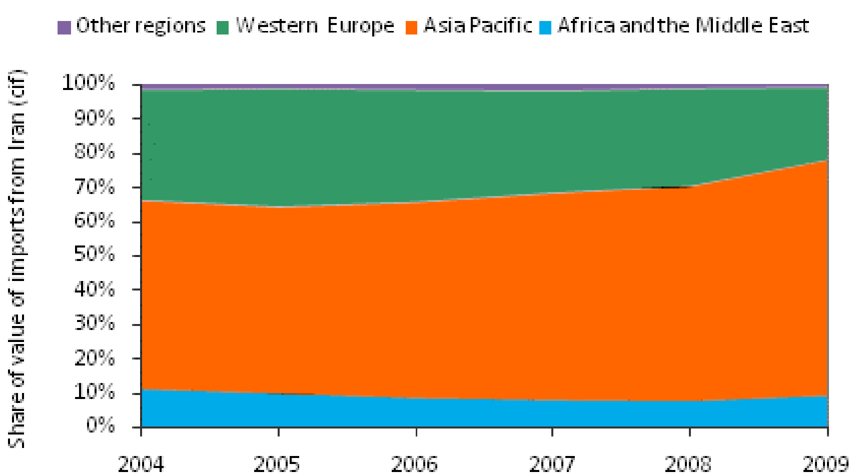
In June 2010 the United Nations agreed on sanctions against Iran, and in July 2010 the EU approved stricter controls to punish Iran for the nuclear program it claims is for peaceful purposes. EU sanctions prevent companies from investing in Iran's oil and gas sector and pressure banks to stop financing projects in the country. This will accelerate Iran's trade reorientation towards China and India, and may impact the domestic market as the government attempts to cut off energy subsidies.

- Western Europe's share of the world's imports from Iran dropped from 32.3% in 2004 to 21.2% in 2009, while Asia Pacific's share jumped from 55.0% to 68.7% over the same period. The sanctions will drive Iran further towards Asian companies for foreign investment and technology to boost oil and gas output;

Destination of imports from Iran: 2004-2009



% of total

Source: Euromonitor from trade sources/national statistics

- In 2000 Japan and South Korea were the largest recipients of Iranian imports in the world, but in 2009 China and India were the largest. In 2009 China and India accounted for 15.3% and 11.8% of Iran's exports;

- The sanctions are also designed to disrupt the shipping of Iranian oil and other goods by making payments more difficult and preventing European firms from insuring Iranian cargoes. Iran's economy is increasingly supported by oil and gas exports: the mining and quarrying sector was the largest contributor to GDP in 2009 at 27.4%.

Implications

- Although declining oil prices during the 2008-2009 global economic crisis decreased the value of Iranian exports, Iran's lower reliance on trade with Europe allowed it to maintain modest real GDP growth of 1.8% in 2009. While developed countries are experiencing economic stagnation, Iran's growing trade with China and India offer vast opportunities since they are the two most populated countries in the world and are generating rapid economic growth;

n Despite being the world's fourth largest crude oil exporter in 2009, Iran lacks sufficient refining capacity to meet domestic demand and relies upon imports for two fifths of its gasoline. Following UN sanctions in June 2010, gasoline imports began to decrease, which will put pressure on Iranian businesses and consumers;

n The Iranian government plans to phase out costly subsidies on food and energy in order to bring down spending and reduce domestic gasoline consumption. In July 2010 President Ahmedinejad announced that all energy subsidies would be phased out by March 2015;

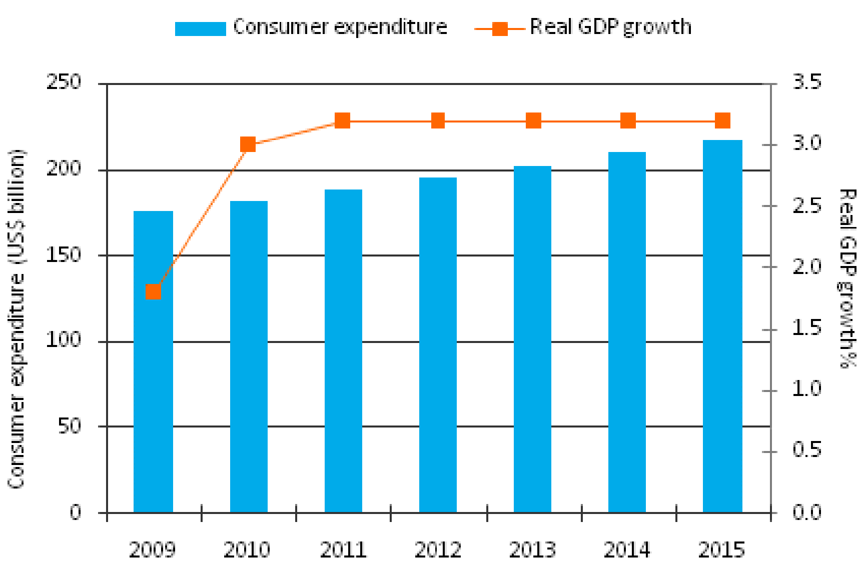
n Withdrawal of fuel subsidies would increase production costs of some Iranian businesses, leading to greater unemployment. Higher unemployment and inflation - which were already at 13.8% and 11.4% respectively in 2009 - would depress consumer expenditure.

Prospects

n Euromonitor International forecasts Iran's real GDP growth to jump from 1.8% in 2009 to 3.0% in 2010. This would help to spur domestic demand, with consumer expenditure expected to grow at an average annual rate of 3.6% from 2009-2015 in real terms. However, prospects could be jeopardized if sanctions make it difficult for Iran to import gasoline and the government cuts subsidies;

Real consumer expenditure and real GDP growth in Iran: 2009-2015

US$ billion at 2009 fixed exchange rates, constant 2009 prices / % annual growth



Source: Euromonitor International from International Monetary Fund (IMF), International Financial Statistics and World Economic Outlook/UN/National statistical offices/OECD/Eurostat

n If inflation and unemployment rise, there is the potential for civil unrest, especially in light of opposition to the government since the protests following the disputed June 2009 election;

n The government responded to the July 2010 EU sanctions by announcing their willingness to resume talks on a nuclear energy deal. However, Iran's trade will likely continue to move away from Europe. In July 2010 Iran and Turkey signed a US$1.3 billion deal for a pipeline to transfer natural gas to Turkey from Iran. There have also been indications that China intends to invest vast sums in Iran's oil industry.