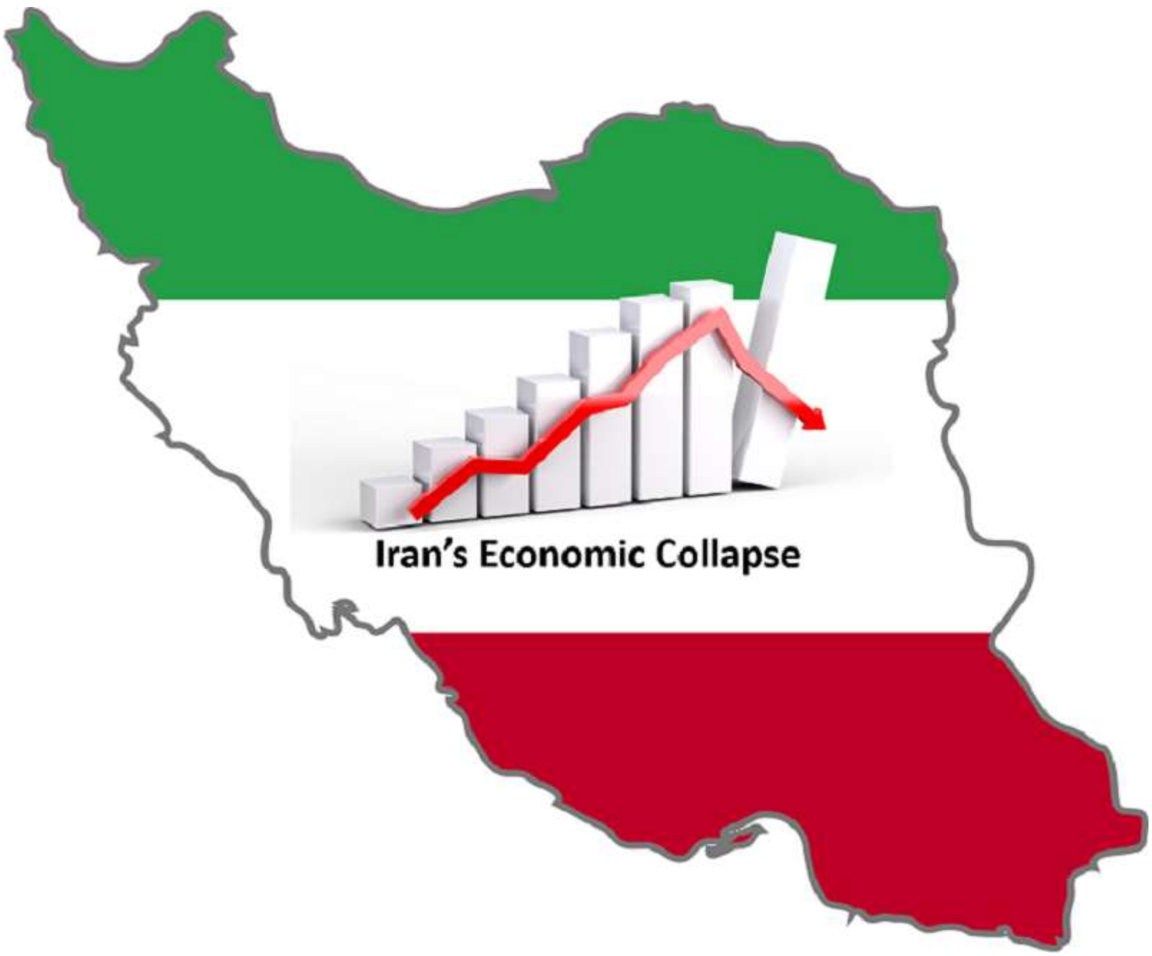
Economy of Iran



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Iran had an estimated Gross Domestic Product (GDP) in 2017 of US$447.7 billion, and a population of 80.6 million people. Iran's economy is characterized by the hydrocarbon sector, agriculture and services sectors, and a noticeable state presence in manufacturing and financial services. Iran ranks second in the world in natural gas reserves and fourth in proven crude oil reserves. Economic activity and government revenues still depend to a large extent on oil revenues and therefore remain volatile.

Iranian authorities have adopted a comprehensive strategy encompassing market-based reforms as reflected in the government's 20-year vision document and the sixth five-year development plan for the 2016-2021 period. The sixth five-year development plan is comprised of three pillars, namely, the development of a resilient economy, progress in science and technology, and the promotion of cultural excellence. On the economic front, the development plan envisages an annual economic growth rate of 8 percent and reforms of state-owned enterprises, the financial and banking sector, and the allocation and management of oil revenues among the main priorities of the government during the five-year period.

Iran's GDP growth in 2017/18 dropped to 3.8 percent as the effect of a large surge in oil revenues in the previous year dissipated. The overwhelming majority of growth came from the non-oil sectors out of which more than half can be attributed to services growing by 4.4 percent. Oil, agriculture and services sectors are now back above the levels of activity they were prior to sanctions in 2012/13. However, in the past two years, there has not been a strong bounce back in key sectors such as construction and trade, restaurant and hotel services following the stagnation in growth during the sanctions period and the overhang from the problems of the banking sector. The oil and gas sector witnessed a growth of 0.9 percent, limited by the OPEC+ quota for the agreed period. The unemployment rate remains high, at 12.1 percent as of Apr-Jun 2018, while it represents a moderate improvement compared to the same period of the previous year (12.6 percent). Male and female unemployment rates of 10.2 and 19.7 percent respectively, suggest continued gender gaps in the labor market. Youth (15-24 years) unemployment at 28.3 percent in June 2018 remains high compared to earlier periods and regional average. The labor force participation rate edged up to 41.1 percent in June quarter 2018, its highest level in more than 10 years. Female labor force participation rate continued to improve to around 19.8 percent in 2017/18. The country ranks among the top countries that improved the participation of females in the labor force, although considerable differences between male and female labor force indicators remain.

The fiscal deficit in 2017/18 reduced to 1.8 percent as a pick up in oil income led to government revenues growth outpacing the increase in expenditures. In 2017/18, Revenues accounted for 17 percent of GDP. Government debt issuances to finance gross borrowing requirements remained high as a share of revenues (13.9 percent) in 2017/18 but lower than the record level in the previous year (19 percent). Similar to the previous year, higher current expenditures came at the expense of lower capital expenditures (5.5 percent of GDP) in 2017/18.

The current account surplus fell from 3.9 percent of GDP in 2016/17 to 3.5 percent of GDP in 2017/18, as Iran's oil production initially slowed in 2018. Real export growth of goods and services was 1.8 percent in 2017/18, down from 41.3 percent, while real import growth was 13.4 percent in 2017/18. Iran's non-oil exports have risen in recent years from 6 percent of GDP in 2012/13 to 10 percent of GDP in 2017/18.

After months of turmoil in the exchange market, the government announced the unification of the official and parallel exchange rates in April 2018 but it failed to achieve its goals in calming the markets. The parallel market rate soared in anticipation of further dollar shortage as the US pulled out of the Joint Comprehensive Plan of Action (JCPOA) in May 2018. By August 2018, the rial had devalued by 172 percent over the past 12 months, rising above 100,000 rials per dollar. This has contributed to the measured inflation rate returning to 24 percent in August 2018, a rate last seen since 2013.

In the medium term, the economy is set to experience a downward trajectory as oil exports are expected to fall to half of their 2017/18 levels following the phased reintroduction of US sanctions culminating in November 2018. The economy is expected to contract by 1.4 percent on average between 2017/18-2020/21, experiencing a fall in exports and consumption on the demand side and a contraction of the industry sector on the supply side.

Higher import prices from the devaluation are expected to push inflation back above 30 percent in the coming years as inflationary expectations spiral and consumer sentiment falls leading to once again a period of stagflation for Iran. Despite the depreciation and drop in imports, the reduction in oil exports is estimated to almost eliminate the current account surplus, which is lower than the earlier sanctions episode as oil prices are almost half of the levels they were in 2012/13-2013/14. The economy's downward trajectory is also likely to put further pressure on the labor market and reverse recent job creation gains.

Poverty is estimated to have fallen from 13.1 percent to 8.1 percent between 2009 and 2013 (US$5.5 a day line in 2011 PPP). This was likely due to a universal cash transfer program in late 2010, which preceded the elimination of subsidies on energy and bread. The program appears to have more than compensated for the likely increase in energy expenditures of less-well-off households, thus contributing to positive consumption growth of the bottom 40 percent of the population, even though overall consumption growth between 2009 and 2013 was negative. However, poverty increased in 2014, which may have been associated with a declining social assistance in real terms due to inflation. Looking ahead, the falling real value of cash transfers due to inflation may counterbalance the positive impact on wellbeing from economic growth in 2016/17 and 2017/18 and exacerbate the impact of predicted negative growth after 2017/18.

Economy sectors of Iran

Oil and Natural Gas

These two resources are main natural income for Iran. After the end of the embargo the oil exports are expected to increase more. Investments are needed for the refineries in Iran and especially in upstream sector technology transfers that need to be updated. The production cannot meet the needs of the domestic demand but it keeps growing. Iran will offers significant opportunities for Turkish companies especially in the downstream sector.

Petrochemicals

This sector has a big contribution to Iranian economy. Especially in the last 15 years, even with the embargo, the production capacity reached 60 million tones. During the embargo, the exports used to be to the regions China and India. In the upcoming period, new ethylene production investments and the development of polymer production capacity are on the agenda of the Government. The growth of Iran sub-sectors such as plastics, rubber, fiber and packaging will also increase imports in terms of raw materials such as Turkey.

Tourism

For the last 30 years, the tourism sector was under the dominance of local hotels but now, it has attractred the international hotel chains with the rising visitor number. But there are some sets for this sector. The restriction of the alcoholic drinks and not available to pay with credit card can affect the growth. After the withdrawal of the regulations and the increase in the wealth, more tourists are coming to Turkey from Iran.

Construction and Infrastructure

Embargo has weakened the sector, as consumers have been suffered the impact on purchasing power and housing prices. There is a need of infrastructures and low-cost houses. With the Mehr project the government, which has built a large number of houses especially for the low-income group, has not received intense demand. With the signing of the JCPOA, Iran has signed agreements with foreign companies and some other countries to attract construction projects in the country. The leading projects will be airport, railway and subway modernization projects.

Textile

Turkey is coming after UAE and China as 3rd in exporting countries to Iran. In terms of Turkish textile producers, low tariffs on some textile products as a result of the Preferential Trade Agreement are the most important opportunities to increase exports in the short term. But, generally the custom tariffs in textile products are so high that it will be more logical to do the production in Iran.

Construction materials

Construction materials sector has a big share in Iranian economy. With the rich natural resources and cheap labor cost, Iran has very low production costs in cement and ceramic sectors comparing to other producers. Iran can be a strong competitor in the region for Turkey.

Energy

Iran produced 272 terawatt hours (tWs) of electricity in 2014/15 and is a net exporter if energy. The government is planning more than 800 projects for the next 20 years and is encouraging renewable energy investors to reach the target of 100 GW by 2021. In terms of Turkish investors, the average consumer price of electricity (Iran: about $ 8 / MWs, Turkey: $ 85 -144 / MWs) is the main investment opportunity.

Automotive

Iran has the biggest automotive industry in Middle East and ranked as the 20th biggest automobile manufacturer of the world. It is the second biggest sector of the country and represents 10% of gdp. It is expected that the sales can reach to 2 million in 2020. Local players (IKCO and Saipa), which own 90 percent of the domestic market, have partnerships with Chinese manufacturers. However, in the mid-term, the Iranian market can be an attractive market for Turkish automakers, also for spare parts and accessories.

Iran needs support of 250 billion $ foreign investment to achieve success in terms of economic growth and technology transfer, which is about.

It may be suggested that Turkey's logistics policies should be re-evaluated and Iran as an important regional player in order to increase the transit trade volume.

Conexio is a consulting firm in Turkey based in Istanbul that can provide you services and support you in your activities in the region both in Turkey and in Iran.

Sources :

https://www.worldbank.org

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