

Iran Business Forecast Report Q4 2014

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Abstracts

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Core Views

Recent improvements in relations with the West bode well for the country's economy. That said, uncertainty over the outcome of negotiations over Iran's nuclear programme will ensure that risks to the outlook remain elevated.

The economy is set to return to growth in 2014, as improving relations with the West and better macroeconomic management, coupled with low base effects, will lead to an improved outlook for exports and increased business and consumer confidence. Despite some improvements, the Iranian rial will remain sensitive to developments in nuclear negotiations over the coming quarters.

Major Forecast Changes

We have revised our real GDP growth forecasts this quarter, and are projecting the economy to expand by 3.2% in real terms in 2014, up from our previous forecast of 2.8% growth.

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Nuclear Talks: Regional Implications

A breakdown or a breakthrough in nuclear talks between Iran and the P5+1 will have immense regional implications. Increased economic opportunities from a breakthrough would significantly benefit Gulf Cooperation Council states, although Saudi Arabia would see its geopolitical clout reduced. A positive conclusion of talks would also facilitate a political solution to the civil war in Syria over the next five to 10 years, with positive implications for stability in Lebanon and Iraq.

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Long-Term Political Outlook

Regime Change Likely By The Next Decade

Although Iran's Islamic regime has proved resilient in the face of tremendous domestic and external pressure, we believe that it cannot continue in its present form indefinitely. Consequently, we expect to see 'regime change' by the next decade, either through gradual reform or a popular uprising.

CHAPTER 2: ECONOMIC OUTLOOK

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Modest Expansion In 2014 And 2015

We forecast real GDP growth of 3.2% and 2.7% in 2014 and 2015 respectively, from a 2.9% contraction in 2013. The return to growth

will be the result of improving relations with the West, more effective macroeconomic management and low base effects. The lack of a breakthrough in nuclear talks will ensure that foreign direct investment - particularly by Western companies - remains limited.

Table: Possible Scenarios As Diplomacy Advances

Table: Economic Activity

Monetary Policy

Inflationary Environment Improving In 2014 And 2015

Inflationary pressure in Iran will be lower in H214 and 2015 compared to 2013. This will provide Iranian President Hassan Rouhani with the necessary public support to continue talks with the P5+1 countries on the Islamic Republic's nuclear programme.

Table: Monetary Policy

Banking Sector I

Reform Only In The Medium Term

Declining inflation and an improved macroeconomic environment will improve the outlook for Iranian banks in 2014. That said, risks to the stability of the industry will remain elevated this year. The government will seek to implement structural reform to the sector, which will decrease systemic risk over the next five years.

Banking Sector II

Negative Real Interest Rates Affecting Stability

Despite gradually declining price pressures in Iran, real interest rates will remain in negative territory until 2018, while the elevated nonperforming loan ratio will hinder borrowing. As a result, the banking sector will remain in a crisis situation despite the slowly improving macroeconomic environment.

CHAPTER 3: 10-YEAR FORECAST

The Iranian Economy To 2023

Significant Challenges Ahead

The inability of Iran to fully exploit its enormous oil & gas wealth will keep real GDP growth rates averaging 4.0% over the next 10 years, below the strong potential of the country's economy. Iran's youthful demographics mean that private consumption and investment will primarily drive this growth.

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