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# Iran

## Country Risk Report

Includes 10-year forecasts to 2028





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# Executive Summary

## Core Views

- We at Fitch Solutions assess that Iran is unlikely to drastically shift its strategy towards the US or the Middle East over the quarters ahead. Currently, there does not appear to be sufficient US pressure or incentive to bring Iran back into negotiations over a new deal, or to spur regime change. As such, Iran will probably adopt a wait-and-see approach, continuing its military activities in the region but with a view to avoid escalation.
- The Iranian economy looks set to slide deeper into recession: we forecast real GDP growth at -4.1% y-o-y in 2019, compared with -0.5% in 2018, as the re-imposition of US sanctions causes exports and foreign investment to fall. The resultant reduction in foreign currency inflows will result in persistent rial weakness and high inflation, weighing on domestic investment and consumption.

## Key Risks

- Drastically tighter international compliance with re-imposed US nuclear-related sanctions on Iran would exacerbate already-dire economic conditions inside the country. In turn, risks of internal political destabilisation would rise.
- Should Tehran decide to aggressively pursue a nuclear weapon, or take steps perceived as credible threats to Middle Eastern stability, then we could not rule out a US/Israeli military attack on Iranian territory.

# Country Risk Summary

## Economic Risk Index

Iran's economy will be weakened by the H218 re-imposition of US sanctions, which is hitting the country's oil exports and investment inflows. The rial will remain weak and inflation will stay elevated, weighing on domestic investment and consumption. With some trade with Asia and Russia still likely to be maintained, though, we maintain that a severe, multi-year economic depression is off the cards.

## Political Risk Index

Iran's political outlook appears uncertain, in the context of deteriorating economic conditions. High inflation and unemployment are key drivers of popular discontent, and core factors behind the frequent protests that have taken place across the country in recent quarters. We do not expect popular unrest to pose a national security threat in Iran any time soon: the political opposition in the country is heavily fragmented – and up against a strong and experienced establishment, backed by a powerful military. Nevertheless, should economic conditions continue to deteriorate for an extended period of time, an escalation of protest action could not be ruled out.

# SWOT

## Economic – SWOT Analysis

### Strengths

- Iran has the world's second largest proven oil reserves after Saudi Arabia, and the world's second largest proven gas reserves after Russia.
- Oil and gas aside, Iran is rich in other resources and has a strong agricultural sector.
- Iran benefits from favourable demographics. The population is large and relatively well educated.

### Weaknesses

- International sanctions heavily restrict trade.
- The banking sector is highly fragile, restricting credit availability.
- The military retains a large presence in the economy, making it difficult for private actors to compete.
- The regulatory environment remains highly challenging, deterring foreign investment.

### Opportunities

- The gas sector remains underdeveloped despite significant improvements in recent quarters, and there is considerable room to maximise this source of revenue.
- Iran represents a large consumer market, which foreign actors will be interested in penetrating should political and operating conditions improve.

### Threats

- Lower oil production will have a marked impact on the economy. Although an Oil Stabilisation Fund exists to protect the economy at times of weaker oil prices, it has increasingly been used to fund government overspending and could be close to empty.
- Should Iran decide to aggressively pursue a nuclear weapon following the US's withdrawal from the nuclear deal, then this could damage trade relations with China, Russia, India and others.



## Political – SWOT Analysis

### Strengths

- Trade relations are maintained with countries such as China, Russia, India and Turkey, helping to keep the economy afloat.
- The government remains able to subsidise basic goods imports and fund welfare programmes, reducing risks of widespread popular unrest.
- The Revolutionary Guard and Basij militia are fiercely loyal to the supreme leader, helping to maintain social stability.

### Weaknesses

- The country has one of the poorest human rights records in the region, and authorities do not hesitate to quell dissidents.
- While decision-making ultimately rests with the supreme leader, the regime is fragmented, and consensus is hard to reach.
- Widespread perceptions of electoral fraud during the course of June 2009's presidential elections have damaged the regime's legitimacy in the eyes of many Iranians.

### Opportunities

- The Majlis (parliament) is more than just a rubber stamp; the move by 150 parliamentarians (out of 290) to hold former president Mahmoud Ahmadinejad accountable for his handling of the economy in March 2012 is a positive indication that checks exist.
- The re-election of moderate cleric Hassan Rouhani in the presidential elections in May 2017 means that relations with some Western actors may remain cordial.
- Negotiations with the US may resume at some point down the line, improving political stability.

### Threats

- The prospect of further US and EU sanctions and the possibility of a military strike by the US or Israel cannot be dismissed.
- Youth unemployment looks set to remain high, continuing to fuel popular discontent.
- The strong influence of the Revolutionary Guards within the political and economic arena will continue to present a challenge to reform.

# Economic Outlook

## Economic Growth Outlook

### Iranian Economy To Slide Deeper Into Recession

#### Key View

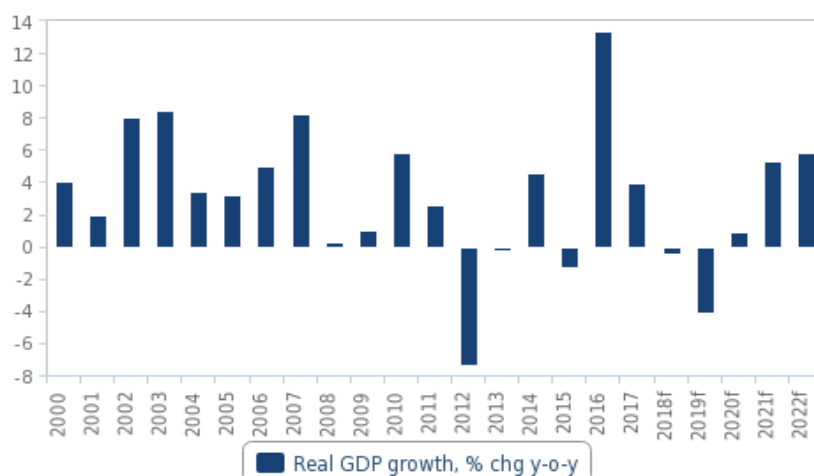
- We at Fitch Solutions forecast the Iranian economy to contract by 0.5% in 2018 and 4.1% in 2019.
- The re-imposition of US sanctions will cause exports and foreign investment to fall.
- Rial weakness and high inflation will weigh on domestic investment and consumption.
- Unemployment is likely to tick up, fuelling popular discontent and protest action.

We at Fitch Solutions expect the Iranian economy to slide deeper into recession in 2019 as the re-imposition of US sanctions causes exports and investment to fall, and subsequently, consumption to contract. We forecast real GDP growth at -4.1% in 2019, compared to -0.5% in 2018 (*for more on our upside and downside risk scenarios for growth see 'US Sanctions Re-Imposed: Scenarios & Implications For the Iranian Economy,' July 14*).

The latter represents a downward revision from our previous forecast of 1.8% growth for 2018 and comes on the back of recently released data which indicate weak economic performance even prior to the re-imposition of sanctions. According to the Central Bank of Iran (CBI), real GDP growth stood at just 1.8% y-o-y in Q1 of FY2018/19 (starting March 21), with non-oil activity expanding by only 0.7%. In 2020 we expect a return to real GDP expansion – albeit at modest rates.

#### Progress Since Nuclear Deal Derailed By Re-Imposition Of Sanctions

Real GDP Growth



f = Fitch Solutions forecast. Source: UN, CBI, Fitch Solutions

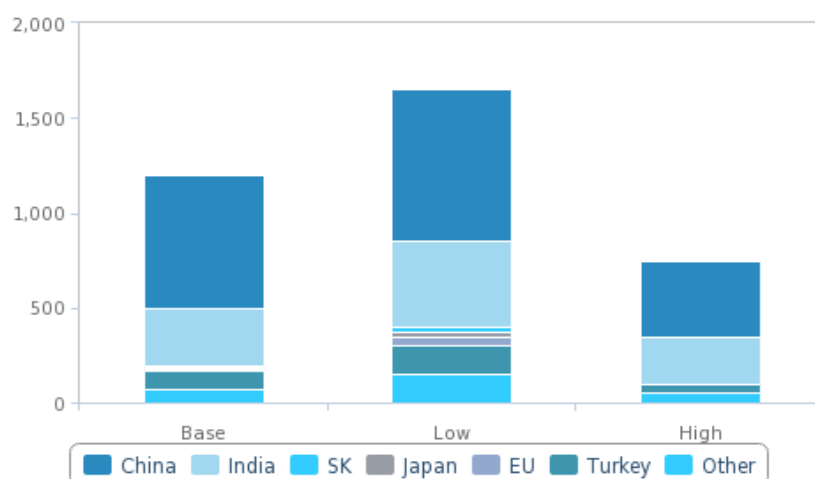
The renewed impact of US nuclear-related sanctions will sharply reduce Iranian oil exports. This trend is already playing out as importers of Iranian oil are complying with conditions for US sanctions waivers. In our view, it is likely that these conditions will

tighten further over 2019, leading to more reductions. Overall, our Oil & Gas team expects Iranian oil exports to decline from a peak of 2.5mn barrels per day (b/d) in April 2018 to around 1.2mn b/d by end 2019 (see *'Quick Update: Iranian Oil Sanctions More Bark Than Bite,'* November 5). We note that oil accounts for a majority share of Iranian exports, averaging between 55.0% and 85.0% of the total throughout the past decade.

Declining oil revenues will have a widespread impact on domestic demand and investment. Foreign currency inflows will fall, resulting in continued rial weakness. US restrictions on foreign investment and cross-border financial transactions will further contribute to this trend (see *'IRR: Multi-Tiered Exchange Rate System To Remain In Place,'* October 2). High import costs will keep inflation – which has risen to over 30.0% y-o-y in recent months – elevated. This, coupled with highly limited credit availability (see *'Iranian Banks To Face Isolation,'* October 16), will weigh on domestic investment and erode households' purchasing power. Although we do expect the government to continue to subsidise imports of basic goods and fund selected welfare schemes – helping to limit pressures on the population to some extent – we still expect private consumption to contract by around 1.4% in 2019.

## Core Scenario Envisions Sharp Reduction Of Iranian Oil Exports In 2019

Iran Crude Oil Export Scenarios, '000b/d



Note: Forecast export volumes by destination for end 2019. Low case = low impact from sanctions, high case = high impact. Source: Fitch Solutions

Unemployment is likely to edge back up, thus fuelling popular discontent. Following the initial lifting of US nuclear-related sanctions, Iranian job creation picked up – causing unemployment to moderate from a peak of 12.7% in 2016 to 12.1% in mid-2018. However, with conditions for Iranian businesses and government finances set to deteriorate, we now expect this trend to reverse. Gradually rising unemployment will feed into existing economic grievances among large elements of the Iranian population, and likely fuel sporadic protests in 2019 and beyond (see *'Protests Unlikely To Pose Existential Threat To Iranian Leadership,'* August 23).

## GDP By Expenditure Outlook

Iran's economy will be weakened by the re-imposition of US nuclear-related sanctions in H218. Even in the event that international sanctions compliance falters significantly, numerous, deep-rooted structural obstacles will still keep growth far below potential for the foreseeable future.

Iran's economy is dominated by private consumption, whose share of the total has remained fairly constant over the past decade. We expect this percentage to rise over the long term as the component eventually benefits from unwinding sanctions. Given the aforementioned weaknesses in Iran's business environment, we expect fixed investment to struggle throughout the coming decade. Government consumption will see limited growth as fiscal space remains tight. Net exports will see a rise in the long term (beyond 2020) as oil exports increase.

**Private Consumption Outlook:** The re-imposition of US sanctions will lead to declining foreign currency inflows and result in persistent rial weakness. In turn, inflation is likely to stay elevated, weighing on private business activity and consumption. Government revenues will also be negatively impacted by declining oil income, which in turn means that the government's ability to create jobs will be restricted. As such, unemployment is likely to remain elevated. This bodes poorly for Iran's private consumption outlook over the next few years. Over the longer term, it is likely, in our view, that sanctions will be relaxed again.

**TABLE: GDP GROWTH FORECASTS**

	2017e	2018e	2019f	2020f	2021f	2022f
Nominal GDP, IRRbn	16,345,159.7	20,327,599.8	25,221,118.8	29,849,966.4	34,957,378.4	39,478,867.7
Real GDP growth, % y-o-y	3.9	-0.5	-4.1	0.9	5.3	5.8
GDP per capita, IRR	192,106,058.0	247,862,087.5	304,526,509.4	357,111,994.7	414,638,732.0	464,556,659.9
	2023f	2024f	2025f	2026f	2027f	2028f
Nominal GDP, IRRbn	43,995,915.7	48,142,135.3	52,373,241.3	56,619,320.5	61,282,523.9	66,527,125.6
Real GDP growth, % y-o-y	4.3	3.6	3.5	3.5	3.6	3.8
GDP per capita, IRR	513,917,736.4	558,552,764.0	603,866,869.0	649,111,187.4	698,925,652.0	755,124,305.5

e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions

**TABLE: PRIVATE CONSUMPTION FORECASTS**

	2017e	2018e	2019f	2020f	2021f	2022f
Private final consumption, IRRbn	7,459,245.4	8,966,013.0	11,530,292.7	13,582,684.8	16,027,568.1	18,367,593.0
Private final consumption, % of GDP	45.6	44.1	45.7	45.5	45.8	46.5
Private final consumption, real growth % y-o-y	5.2	-0.8	-1.4	0.8	4.0	4.6
	2023f	2024f	2025f	2026f	2027f	2028f
Private final consumption, IRRbn	20,975,791.2	23,492,886.2	26,077,103.6	28,684,814.0	31,553,295.4	34,708,624.9
Private final consumption, % of GDP	47.7	48.8	49.8	50.7	51.5	52.2
Private final consumption, real growth % y-o-y	4.2	4.0	4.0	4.0	4.0	4.0

e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions

**TABLE: GOVERNMENT CONSUMPTION FORECASTS**

	2017e	2018e	2019f	2020f	2021f	2022f
Government final consumption, IRRbn	1,989,460.7	2,482,847.0	3,215,286.8	3,826,191.3	4,514,905.8	5,192,141.7
Government final consumption, % of GDP	12.2	12.2	12.7	12.8	12.9	13.2
Government final consumption, real growth % y-o-y	3.9	3.8	-0.5	2.0	4.0	5.0
	2023f	2024f	2025f	2026f	2027f	2028f
Government final consumption, IRRbn	5,919,041.5	6,593,812.2	7,286,162.5	7,978,347.9	8,776,182.7	9,697,681.9
Government final consumption, % of GDP	13.5	13.7	13.9	14.1	14.3	14.6
Government final consumption, real growth % y-o-y	4.0	3.4	3.5	3.5	4.0	4.5

e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions

Should this occur, then private consumption would be likely to gradually recover. Fundamentally, Iran benefits from a large and growing working-age population.

**Government Spending Outlook:** We forecast sustained fiscal deficits over the coming years, primarily on the back of lower oil revenues and gradually increasing spending. Should risks of widespread popular unrest elevate, then we could conceivably see a sharper increase in spending levels, in order to address some of the Iranian people's economic grievances, or fund military crackdowns.

**Fixed Investment Outlook:** Even with an eventual unwinding of sanctions against Iran, huge impediments remain to foreign companies looking to tap one of the Middle East's largest markets. Foreign companies in nearly every sector have recently expressed interest in returning to the Iranian market; however, the difficult operational environment – where corruption, bureaucracy and nepotism are rife – will, coupled with persistent political risks, ensure only a slow return of investment beyond the current political uncertainty.

**Net Exports Outlook:** Following sharp growth in the immediate aftermath of the Q116 lifting of sanctions, we expect Iranian hydrocarbon output gains to contract sharply in 2019 as US restrictions on Iranian oil imports are enacted. Beyond this, major investment and foreign expertise is required to develop the sector (accounting for the vast majority of Iranian exports) – which we believe is unlikely to be forthcoming on a large scale amid the current political and operational conditions.

TABLE: FIXED INVESTMENT FORECASTS

	2017e	2018e	2019f	2020f	2021f	2022f
Fixed capital formation, IRRbn	2,766,878.8	2,905,499.2	2,958,833.3	3,100,980.2	3,309,944.9	3,631,433.0
Fixed capital formation, % of GDP	16.9	14.3	11.7	10.4	9.5	9.2
Fixed capital formation, real growth % y-o-y	4.7	0.9	-2.0	1.0	3.0	6.0
	2023f	2024f	2025f	2026f	2027f	2028f
Fixed capital formation, IRRbn	3,960,812.3	4,307,257.3	4,665,968.1	5,049,782.0	5,460,312.3	5,899,271.1
Fixed capital formation, % of GDP	9.0	8.9	8.9	8.9	8.9	8.9
Fixed capital formation, real growth % y-o-y	5.5	5.3	5.0	5.0	5.0	5.0

e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions

TABLE: NET EXPORTS FORECASTS

	2017e	2018e	2019f	2020f	2021f	2022f
Net exports of goods and services, IRRbn	2,245,542.9	3,693,562.1	4,553,123.7	5,872,718.9	7,152,133.7	7,900,063.2
Net exports of goods and services, % of GDP	13.7	18.2	18.1	19.7	20.5	20.0
Net exports of goods and services, real growth % y-o-y	21.3	-3.2	-15.0	1.1	14.2	10.7
	2023f	2024f	2025f	2026f	2027f	2028f
Net exports of goods and services, IRRbn	8,278,769.1	8,429,697.0	8,546,860.9	8,610,675.9	8,617,828.3	8,672,901.8
Net exports of goods and services, % of GDP	18.8	17.5	16.3	15.2	14.1	13.0
Net exports of goods and services, real growth % y-o-y	5.0	2.7	1.7	1.7	1.7	1.7

e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions

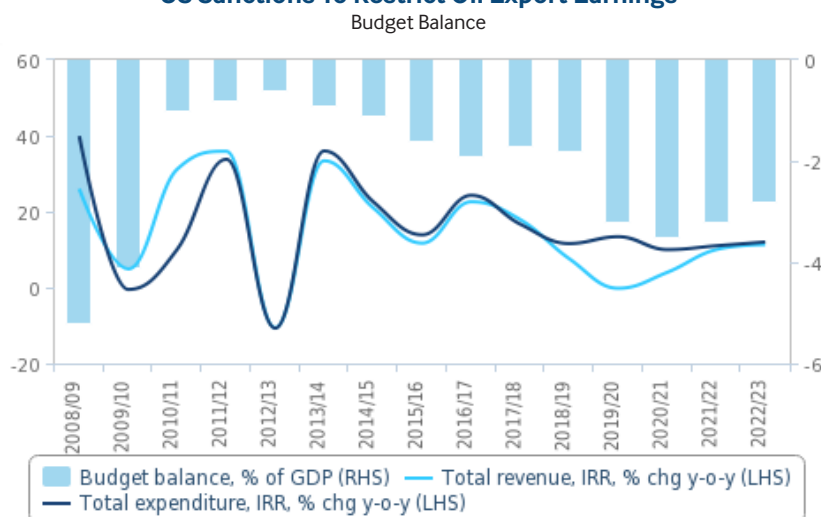
## Fiscal Policy And Public Debt Outlook

### Declining Oil Export Earnings To Weaken Iran's Fiscal Position

#### Key View

- US sanctions will reduce the Iranian government's oil export earnings, while elevated inflation and unemployment will limit the tax intake.
- Government spending will remain relatively high as elevated social discontent discourages large-scale subsidy and public sector wage bill cuts.
- Overall, we believe that the government's budget deficit will widen from 2.0% in FY2018/19 to 3.3% in FY2019/20.

#### US Sanctions To Restrict Oil Export Earnings



Note: 2018/19-2022/23 = Fitch Solutions forecast. Source: CBI, Fitch Solutions

The re-imposition of US sanctions will severely restrict Iranian oil exports and thus lead to a decline in government oil revenues. Our Oil & Gas team expects oil exports to reduce from a peak of 2.5mn barrels per day (b/d) in 2018 to about 1.2mn b/d in 2019 (see 'Quick Update: Iranian Oil Sanctions More Bark Than Bite,' November 5). Given that oil accounts for around 40% of total revenues, this will have a pronounced impact on the overall fiscal balance — particularly as oil price gains also look set to moderate (see 'Brent: OPEC Holds The Line For 2019,' December 11).

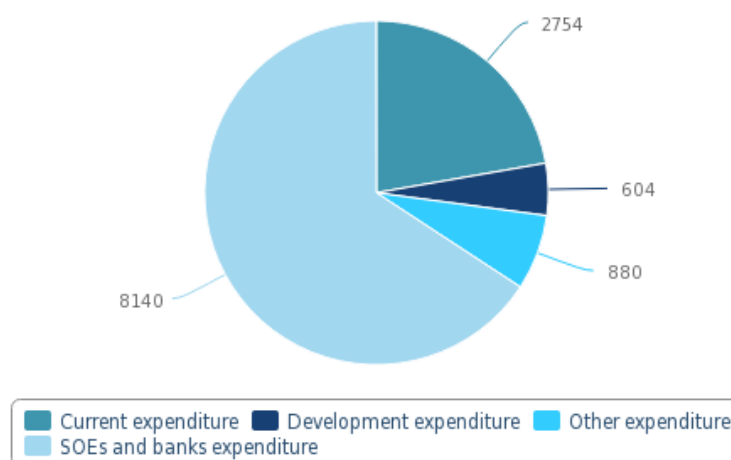
We expect non-oil revenue growth to remain flat. The budget proposal for FY2019/20 focuses on protecting low-income groups and limiting the impact of US sanctions on the Iranian population. This has become particularly important for the Rouhani administration (and the Iranian establishment at large) in light of the notable uptick in popular protest action over the course of 2018. As such, the budget does not contain any substantial tax increases. Households' and businesses' ability to pay taxes at current rates will also come under pressure amid elevated inflation and rising unemployment (see 'Iranian Economy To Slide Into Recession In 2019,' October 2).

We at Fitch Solutions believe that progress on the implementation of government spending cuts will prove limited. The Rouhani administration has included selected subsidy and public sector wage bill cuts in its budget proposal for FY2019/20. However, we

see a strong likelihood that a substantial share of these will be cancelled or significantly watered down by parliament, particularly as MPs begin to prepare for elections in early 2020. Cuts in capital spending are less socially sensitive and thus more likely to move forward. That said, with capex making up only a small share of overall spending, this will not have a strong impact on the overall fiscal deficit, which we forecast to widen to 3.3% in FY2019/20, compared with 2.0% in FY2018/19.

### Central Government Accounts For Only A Small Share Of Overall Spending

FY2018/19 Budget Expenditure Breakdown, IRRtrn



Source: Iranian government sources, Fitch Solutions

Public debt looks set to increase further. We believe that the government will continue to borrow domestically to fund its fiscal deficit, leading to an increase in the public debt burden. Although the central government's debt remains low relative to emerging market peers – estimated at about 38% of GDP in 2018 – we highlight that it is also liable for large amounts of debt and payment arrears accumulated by state-owned enterprises (SOEs). SOEs (linked, for example, to the military and clerical establishments) have long been – and still are – able to spend without central government oversight. The process of recognising and migrating some of this debt to the sovereign's balance sheet is ongoing; however, the overall amount owed by SOEs remains unknown.

## Currency Forecast

### Iranian Authorities Likely To Devalue Official Exchange Rate Or Cut Subsidised Imports In 2019

#### Key View

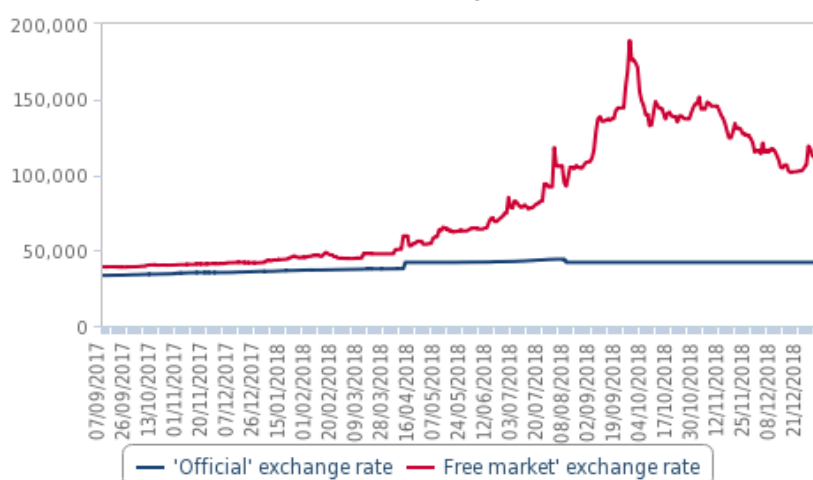
- We at Fitch Solutions believe that the Iranian authorities are likely to devalue the official exchange rate and/or narrow the definition of 'basic goods' that qualify for imports at the current rate in 2019, as US sanctions restrict foreign currency inflows into the Islamic Republic.
- Any devaluation of the official rate will probably be relatively limited in size in order to prevent a drastic acceleration in already-elevated inflation.

- Amid deteriorating trade dynamics, the appreciatory trend recorded in the free market rate in recent months appears unlikely to be sustained.
- Consequently, we view a unification of Iran's multiple exchange rates as off the cards in 2019.

We view it as likely that the Iranian authorities will devalue the official exchange rate and/or narrow the definition of 'basic goods' that qualify for imports at the current rate in 2019. The re-imposition and further tightening of US sanctions will drastically reduce oil export earnings and restrict cross-border financial transactions, leading to a sharp slowdown in foreign currency inflows into Iran (see *'Iranian Economy To Slide Deeper Into Recession,' December 28*). In turn, this will limit the authorities' ability to import basic goods and sell them at the official rate of IRR42,000/USD (versus a free market rate of IRR110,000/USD as of January 1). As such, the authorities may move to devalue the official rate, as they did under the previous round of nuclear-related sanctions (prior to the 2016 nuclear deal). The Rouhani administration's proposed budget for FY2019/20 (yet to be approved by parliament) references an exchange rate of IRR58,000/USD, suggesting a devaluation could be in the pipeline. Alternatively, we may see a reduction in the number of subsidised basic goods imports.

## Gap Between Official And Free Market Rates Remains Wide

'Official' & 'Free Market' Exchange Rates, IRR/USD



Source: TCMB, Bonbast, Fitch Solutions

We still believe that a unification of Iran's multiple exchange rates is off the cards. The Rouhani administration has previously made efforts to unify the exchange rate system, which in addition to the official and free market rates also includes a secondary market rate for transactions between licensed exporters and importers. However, with the gap between the official and free market rates now at 62%, unification appears unfeasible. Any devaluation of the official rate will likely be relatively limited in size in order to limit its inflationary impact and thus contain social discontent: we forecast the official rate to end 2019 around the IRR55,000/USD level. The appreciatory trend recorded in the free market rate in recent months is unlikely to be sustained amid deteriorating trade and investment dynamics, a subdued oil price outlook and elevated inflation.

The multiple exchange rate system will continue to create distortions in the economy, limiting the availability of some goods and facilitating profit-making in the free market by those receiving foreign currency at preferential rates. Private companies will also increasingly struggle to compete with establishment-linked counterparts that have access to subsidised goods imports, constraining overall private sector activity.



Political dynamics pose major upside and downside risks to the rial's trajectory. US sanctions, and US relations more broadly, are a key determinant of Iran's economic outlook and therefore a key driver of confidence and movements in the rial. While our core view is for no major shift in Iran-US relations over the quarters ahead as Iranian authorities look to 'wait out' the Trump administration, we cannot rule out either a resumption of negotiations or a drastic escalation of tensions (see '*US Sanctions Re-Imposed: Scenarios & Implications For the Iranian Economy*,' July 14).

Should there be a return to negotiations, resulting in improved confidence and loosened sanctions, then the rial would be likely to recover some of its losses. A drastic strengthening of international resolve to counter US sanctions, for example as a result of heightened trade tensions, could produce a similar outcome. Conversely, should Iran-US tensions escalate, resulting in tightening sanctions and rising risks of direct military confrontation, then the rial would almost certainly head lower. Pressure from such a development could also spur policy missteps inside Iran, for example in the form of drastically increased government borrowing from local banks, resulting in accelerating money supply and rial depreciation. Finally, although unlikely, we highlight another collapse in oil prices and a resultant reduction in foreign currency earnings as a key downside risk to the currency.

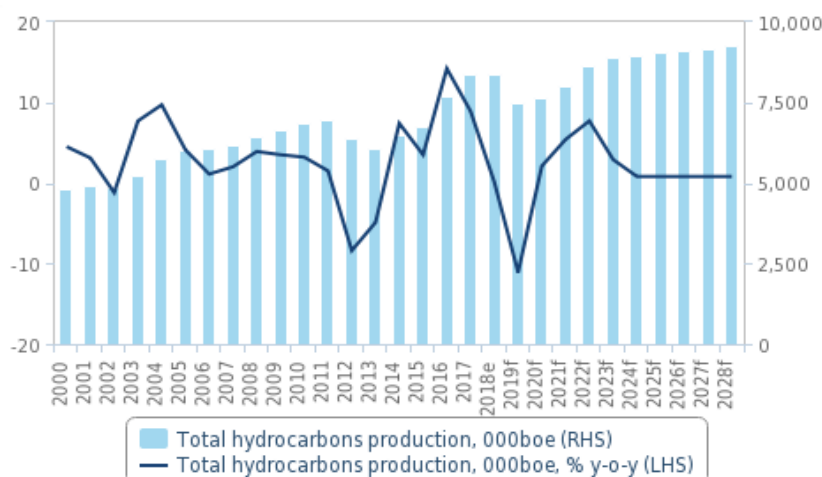
# 10-Year Forecast

## The Iranian Economy To 2028

### Potential For Regional Outperformance, Though Political Risks And Structural Obstacles To Persist

**Key View:** The Iranian economy has the potential to outperform the region in terms of growth over the coming decade, given its vast natural resource wealth and favourable demographics. However, political instability and tensions with the US look set to persist over the coming years. Coupled with major structural obstacles domestically, this will keep Iranian real GDP growth far below potential for the foreseeable future.

**Elevated Consumption Leading To Declining Exports**  
Energy Industry



e/f = Fitch Solutions estimate/forecast. Source: EIA, UN, Fitch Solutions

Even beyond an eventual relaxation of international sanctions, a failure to fully exploit its enormous oil and gas wealth and a challenging operational environment will result in slow expansion of Iran's economy over the coming decade. We project real GDP growth to average 3.2% over the 2019-2028 period, compared to 2.7% over 2006-2015.

**TABLE: LONG-TERM MACROECONOMIC FORECASTS**

	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Nominal GDP, USDbn	520.0	533.0	613.3	686.6	758.6	826.5	891.5	959.6	1,038.7	1,122.8
Real GDP growth, % y-o-y	-4.1	0.9	5.3	5.8	4.3	3.6	3.5	3.5	3.6	3.8
GDP per capita, USD	6,278	6,376	7,274	8,079	8,860	9,588	10,278	11,001	11,846	12,744
Population, mn	82.82	83.59	84.31	84.98	85.61	86.19	86.73	87.23	87.68	88.10
Consumer price inflation, % y-o-y, ave	30.0	17.0	14.0	10.0	10.0	8.0	7.0	6.0	6.0	6.0
Exchange rate IRR/USD, ave	48,500.00	56,000.00	57,000.00	57,500.00	58,000.00	58,250.00	58,750.00	59,000.00	59,000.00	59,250.00
Current account balance, % of GDP	0.6	1.0	1.5	1.5	1.8	2.0	2.2	2.4	2.5	2.5

f = Fitch Solutions forecast. Source: UN, CBI, Fitch Solutions

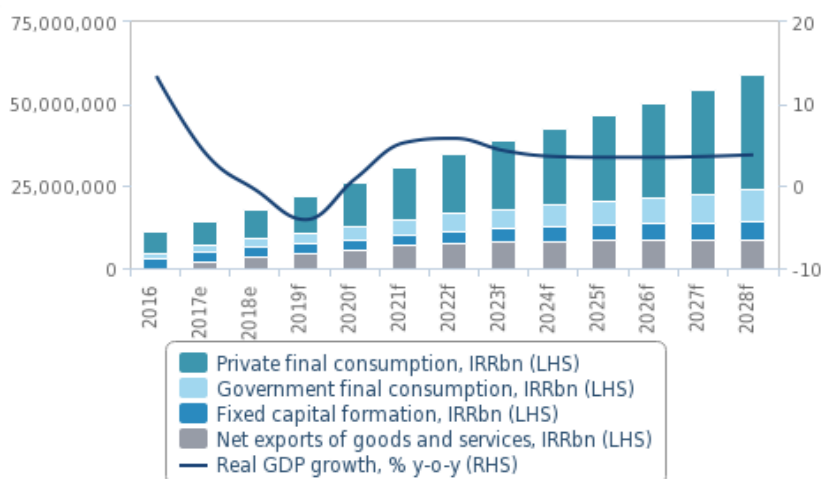
## Energy Sector: Great Potential, Low Expectations

Iran's oil and gas sector has enormous growth potential. Both its proven oil and gas reserves are the second largest in the world – 137.0bn barrels and 29.7trn cubic metres respectively, according to **BP**. However, oil production levels have plateaued since 2003.

In the longer term, our core view is for international sanctions on Iranian oil output to be relaxed, allowing for an increase back to 2017 levels. Beyond this though, further gains necessitate substantial foreign investment and technology transfer. Given the plethora of deep-rooted structural obstacles to foreign participation in Iran's hydrocarbon sector – including corruption, lack of transparency, weak regulations and an unfavourable investment framework – this is unlikely to materialise on a major scale for several years. As such, our long-term view is for a gradual expansion of Iranian hydrocarbon sector activity, rather than any sort of boom.

### Consumer To Drive Positive Growth Outlook

Macroeconomic Forecasts



e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions

## Political Risks To Remain Elevated

Iran's favourable demographics – the country has a large and expanding working-age population – will help to support real GDP growth throughout the next decade. That said, there are domestic political risks to our outlook. The mass protests in the aftermath of June 2009's presidential election, and in response to accelerating inflation and fiscal consolidation over 2018, have shown that there is considerable dissatisfaction with the authorities. That said, as long as the government continues to maintain the loyalty of the security services, it is unlikely to collapse. Nevertheless, an extended period of low oil prices could weaken this loyalty if the government were forced to cut back on payments to the military.

Our long-term macroeconomic forecasts are based on a variety of quantitative and qualitative factors. Our 10-year forecasts assume in most cases that growth eventually converges to a long-term trend, with economic potential being determined by factors such as capital investment, demographics and productivity growth. Because quantitative frameworks often fail to capture key dynamics behind long-term growth determinants, our forecasts also reflect analysts' in-depth knowledge of subjective factors such as institutional strength and political stability. We assess trends in the composition of the economy on a GDP by expenditure basis in order to determine the degree to which private and government consumption, fixed investment and the export sector will drive growth in the future. Taken together, these factors feed into our projections for exchange rates, external account balances and interest rates.

In addition, there is a chance that Supreme Leader Ayatollah Ali Khamenei (79) could pass over the coming decade. As the supreme leader is the true centre of power in Iran, Khamenei's successor will exert massive influence over Iran's future direction, adding to political uncertainty.



# Political Outlook

## Domestic Politics

### Iran Unlikely To Shift Foreign Policy Strategy In Near Term

#### Key View

- We at Fitch Solutions believe that Iran is unlikely to drastically shift its strategy towards the US or the Middle East over the quarters ahead.
- Currently, there does not appear to be sufficient US pressure or incentive to bring Iran back into negotiations over a new deal, or to spur 'regime change'.
- As such, Iran will probably adopt a wait-and-see approach, continuing its military activities in the region but with a view to avoiding escalation.

We believe that the Iranian leadership is unlikely to drastically shift its strategy towards the US or the Middle East region in the quarters ahead. The US Trump administration is, via its re-imposition of sanctions, increasing economic pressure on Iran in a bid to change

**TABLE: POLITICAL OVERVIEW**

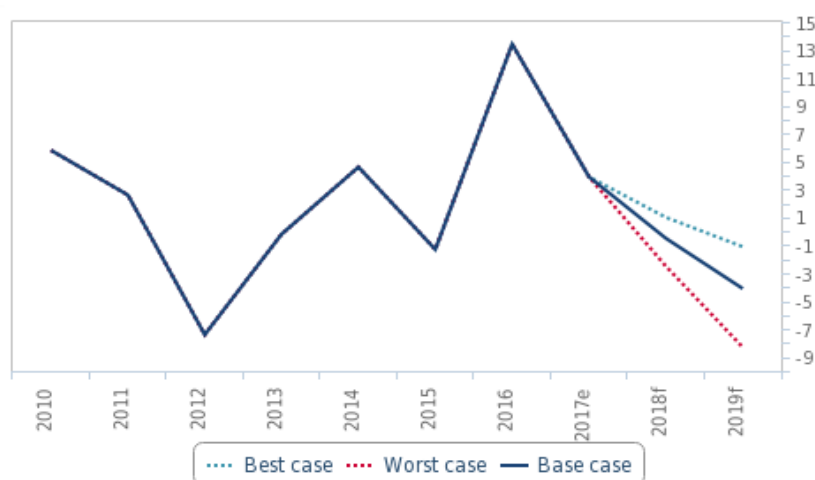
System of government	Islamic Republic based on the 1979 Constitution. Supreme Leader – life term, elected by Assembly of Experts. President – four-year terms, eligible for a second term and third non-consecutive term. Parliament (Majlis) – 290 members elected for four-year terms. Assembly of Experts – 86 clerics elected by direct public vote to eight-year terms
Head of state	Supreme Leader Ayatollah Ali Khamenei
Head of government	President Hassan Rouhani
Last election	Parliamentary – February 26 2016 Presidential – May 19 2017
Next election	Parliamentary – 2020 Presidential – 2021
Key figures	Mohammad-Ali Afshani (mayor of Tehran); Ali Larijani (speaker of parliament); Ahmad Jannati (chairman of the Assembly of Experts)
Main political coalitions	Ultra-conservatives: Generally Pro-Khamenei. Ayatollah Mesbah Yazdi, an ultra-conservative displaying a staunch anti-Western rhetoric, plays an important role. Moderate conservatives: Important members include Ali Larijani, Mohammad Bagher Ghalibaf and Mohsen Rezai; support moderate economic and political reforms but still favour current policy formation. Moderates: Led by Hassan Rouhani; support moderate economic and political reforms and favour a rapprochement with the West on the nuclear issue. Reformists: Made up of a number of factions with varying views, largely anti-government; favour political freedoms and more open policy formation.
Current parliamentary composition	Conservatives – 182 seats (62.7%), Reformists – 75 seats (25.9%), Independents – 19 seats (6.5%), Minority Religions – 14 seats (4.8%)
Ongoing disputes	US and EU (sanctions relating to terrorism and human rights abuses), Israel, UAE (Lesser and Greater Tunb), Azerbaijan and Turkmenistan (Caspian sea borders)
Key relations/treaties	WTO, Organisation of the Islamic Conference, increasing economic and political relations with Iraq, limited relations with GCC and member countries, strong alliances with Syria. Increasing relations with Russia and China. JCPOA
Short-Term Political Risk Index	59.6
Long-Term Political Risk Index	54.0

Source: Fitch Solutions

the behaviour of the Islamic Republic's leaders (or alternatively change the leadership itself). Specifically, the Trump administration is looking to compel its Iranian counterpart to participate in negotiations over a 'bigger and better' deal to replace that achieved under Obama, and/or to scale back its military presence in the region (including its long-range missile programme). However, the US administration's current approach of applying 'medium' economic pressure while putting forward maximalist political and military demands for a new deal is, in our view, unlikely to spur significant change in Iran's policies.

## Economic Pressure Severe, But Likely Manageable In The Near Term

Scenarios For Real GDP Growth, % chg y-o-y



e/f = Fitch Solutions estimate/forecast. Source: UN, Fitch Solutions

The current level of US pressure is unlikely to prove sufficient to bring Iran back to the negotiating table, or to spur 'regime change' over 2019. Although economic pressure emanating from sanctions is severe – we forecast Iranian real GDP to contract by 4.1% y-o-y in 2019 – it appears insufficient to spur a sustained depression on the kind of scale that would drastically raise risks of a popular uprising and thus compel the Iranian leadership to negotiate for sanctions relief. US sanctions waivers for Iranian oil importers will, in our view, most likely be renewed when they expire in Q219 so as to avoid an oil price shock and encourage continued international compliance (albeit with some cut-backs in import allocations). We therefore believe that Iran will maintain some level of oil exports, which will generate a base amount of foreign currency earnings that the leadership can use to subsidise goods imports and keep a lid on inflation. We also note that protest and opposition movements inside Iran remain fragmented and weak vis-à-vis a strong and relatively coherent leadership, backed up by powerful security forces. Popular protests are in this context unlikely to prove large enough to pose an existential threat to the leadership – particularly as the US may in large part be blamed for the downturn. The US's maximalist demands on Iran make it incredibly difficult for the Iranian leadership to enter into negotiations over a new deal without appearing existentially vulnerable to US pressure.

Iran will probably adopt a wait-and-see approach for now, continuing its military activities in the region but with a view to avoiding escalation. We believe that the Iranian leadership will most likely defer major strategic decisions related to the US until closer to, or after, the US presidential elections in 2020, which could potentially result in a more conciliatory policy toward Iran by the US. In the meantime, we expect Iran to continue its military activities in the Middle East, including its support for a large network of allied state and non-state actors, its maintenance of bases in the Levant, and its development of missile technology. These activities are central to the Iranian 'forward defence' strategy, which aims to create strategic depth and deter rivals from intervening inside Iranian territory. We highlight that such activities are not particularly resource-intensive, and thus are unlikely to be affected by the economic downturn.

However, we believe that the Iranian leadership will refrain from taking steps in the region that are perceived as highly destabilising by the wider international community, as this could prompt key trade partners such as China to also sever ties to the Islamic Republic, thus accelerating its economic deterioration. For that same reason, and also given the associated risk of US and/or Israeli strikes against its nuclear facilities, we further assess that the leadership is unlikely to aggressively pursue a nuclear weapon.

## Maximalist US Demands Leave Little Political Space For Iran's Leadership To Engage

Pompeo's 12 Demands On Iran

US Conditions On Iran For Removal Of US Sanctions (Issued May 21 2018)
Declare to IAEA a full account of prior military dimensions of its nuclear programme, and permanently and verifiably abandon such work
Stop enrichment and never pursue plutonium reprocessing; close its heavy water reactor
Provide IAEA with unqualified access to all sites throughout country
End proliferation of ballistic missiles, halt launching/development of nuclear-capable missiles
Release all US citizens and citizens of US partners and allies
End support to Middle East 'terrorist' groups, including Hizbullah, Hamas and Islamic Jihad
Respect Iraqi sovereignty, permit the disarming, demobilisation and reintegration of Shi'a militias
End military support for Houthi rebels, work towards a peaceful, political settlement in Yemen
Withdraw all forces under Iran's command throughout Syria
End support for Taliban and other 'terrorists' in Afghanistan and the region; cease harbouring senior al-Qaeda leaders
End the Quds Force's support for 'terrorists' and 'militant' partners around the world
End threatening behaviour against neighbours, including Israel, Saudi Arabia and the UAE; end threats to international shipping and destructive cyberattacks

Note: Demands as presented by Secretary of State Mike Pompeo in his May 21 speech at the Heritage Foundation.  
Source: FT, CNN, Fitch Solutions

Nevertheless, we highlight considerable risks to our core view, both to the upside and downside. It is not entirely inconceivable that Trump adopts a more conciliatory approach towards Iran as he looks to deliver a new deal and limit potential oil price pressures – in turn providing political space for Iran to enter negotiations without appearing weak. The Iranian leadership could also prove more concerned about economic deterioration and popular discontent than what we currently anticipate, spurring a diplomatic opening. Multilateral peace talks over the Yemen conflict – in which Iran and the US back opposite sides – could, for example, serve as a confidence-building measure leading to wider discussions.

Conversely, it is also not impossible that the Trump administration takes an even tougher stance against Iran, encouraging a hardline shift within the latter's leadership that leads to more regional expansionism and escalating tensions. Such a shift could even take place without further US provocation – for example as the hardliners position themselves for supreme leader succession or seek to produce a rally-around-the-flag effect. Should escalating tensions spark direct military confrontation between the two sides, potentially dragging their respective allies into conflict, then this would have severe negative consequences for overall regional stability, as well as global trade and oil markets (*for more on the implications of upside and downside risk scenarios, see 'US Sanctions Re-Imposed: Scenarios & Implications For The Iranian Economy,' July 14*).



## Long-Term Political Outlook

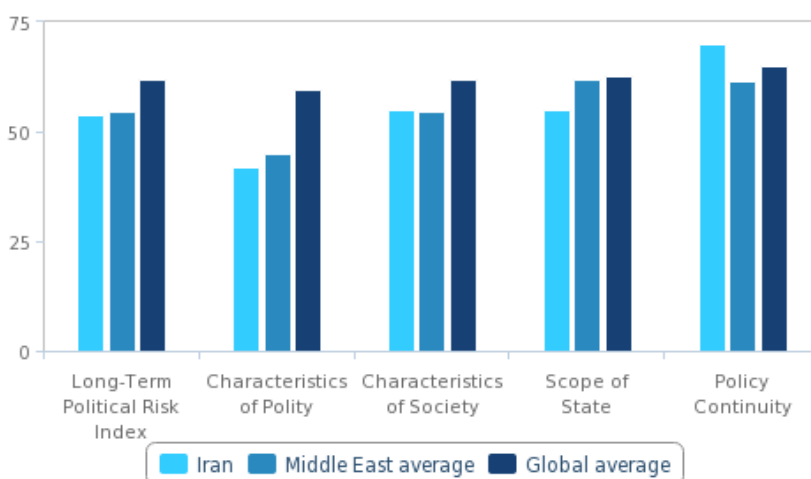
### Hardliners Look Set To Maintain Control, But Power Struggle Likely

**Key View:** Iran's hardliners will most likely retain their hold on power over the coming decade, although moderates will continue to push for greater political and social liberalisation. Even following the election victory of relatively moderate President Hassan Rouhani in 2017, the main institutions of power – namely the Supreme Leader, Assembly of Experts and Revolutionary Guards – remain under conservative control. Economic necessity led to a nuclear deal between Iran and the West, Russia and China in 2015, but risks to the deal collapsing remain elevated following the US's withdrawal.

We expect Iran's hardliners to maintain their overall control of the country over the coming decade, although this does not preclude a partial liberalisation of the political scene. The main power centres in Iran – the Supreme Leader, Assembly of Experts and Islamic Revolutionary Guards Corps (IRGC) – will probably remain dominated by conservatives and resist attempts at liberalisation, but there will still be considerable pressure for greater political and social freedoms. A key event in this struggle would be the passing of Supreme Leader Ayatollah Ali Khamenei, who has held that post since 1989, which would be seen as a defining moment in Iran's post-revolutionary history. The successor is likely to be a hardliner, but he will need time to consolidate his authority, and this could provide an opportunity for moderates to challenge the conservatives. Regarding foreign policy, we maintain our view that the process of nuclear inspections will not be smooth. We also see elevated risks of the nuclear deal eventually breaking down – although we note that the Iranian leadership would be unlikely to aggressively pursue a nuclear weapon even if it broke out of the deal, as this would likely affect its trade ties to Asia and Russia. Still, we cannot completely rule out US or Israeli military action against Iran's nuclear facilities over the decade ahead.

#### Political Risk Level Broadly In Line With Region, But Below Global Average

Iran, Middle East & Global – Long-Term Political Risk Index & Sub-Components



Note: Higher score = lower risk. Source: Fitch Solutions Political Risk Index

Although a period of lower oil exports will undoubtedly place strains on the government, the regime's resilience should not be underestimated. Iran's political system is virtually unique in the world, combining an Islamist theocracy with revolutionary republicanism and a very heavily managed democracy. Ever since the establishment of the Islamic Republic following the Iranian Revolution of 1979, outside observers have been predicting the collapse of the clerical regime, but it has proved highly resilient, surviving a

brutal eight-year war with Iraq (1980-1988), subsequent international isolation and rising domestic opposition, most evident in the aftermath of the disputed 2009 presidential election.

## Challenges And Threats To Stability

**Democratic Shortcomings:** Although the Islamic regime swept to power in a mass uprising in 1979, the clerics who subsequently established control have failed to build liberal democratic institutions. Elections are held for parliament and the presidency, but candidates are thoroughly vetted and the process is heavily managed. Moreover, parliament and the president are subordinate to the clerics and the Supreme Leader. The legitimacy of the previous administration was tested severely in the aftermath of the disputed re-election of President Mahmoud Ahmadinejad in June 2009, when thousands of opposition supporters took to the streets to protest the result. Although the security services quickly quelled the demonstrations, they represented the biggest outburst of popular discontent since the 1979 revolution. Since then, Iranians have seen from the Arab Spring that popular uprisings are capable of toppling long-established leaders, but that they do not automatically result in democracy, and in some cases can make matters worse.

**Replacing The Supreme Leader:** The revolution established the position of Supreme Leader, which stands above day-to-day politics, whilst retaining command of the armed forces and judiciary, with more power than the office of president. Since 1979, Iran has had two such figures: Ayatollah Ruhollah Khomeini (1979-1989) and Ayatollah Ali Khamenei (1989-present). Khamenei is now 79. Although procedures are well established for the selection of his successor, the transition period could be destabilising. Given that the Supreme Leader is the true centre of power in Iran, whoever assumes the role will have a major bearing on Iran's future.

**Competing Power Centres:** Iran has many powerful institutions, including the Supreme Leader, president, Majlis (parliament), Expediency Council, Assembly of Experts, armed forces, Islamic Revolutionary Guards Corps (IRGC), Basij militia and intelligence service. Whilst it could be argued that different bodies provide useful checks and balances on one another, competition between them can destabilise the political scene from time to time.

**Growing Power Of The IRGC:** The IRGC is an elite military force whose purpose is to defend the Islamic revolution (whereas the regular armed forces are responsible for national defence). The IRGC's power has grown in recent years, and it has substantial business interests which are estimated to comprise around 30% of the overall economy. Under Ahmadinejad's presidency (2005-2013), many IRGC officers were appointed to the cabinet, provincial governorships and other key political posts. Given its influence, the IRGC could eventually come to challenge the authority of the clerical establishment and possibly the Supreme Leader himself.

**Demographic Shifts:** Iran's population is relatively youthful, at least on a global comparison. Historically, youth bulges have created instability, not least because of the challenges of creating sufficient employment opportunities for all new entrants to the workforce. Iran is no different; the official unemployment rate is 12.1%, but unofficial estimates put it closer to 20%, with youth unemployment likely even higher. That said, Iran's total fertility rate has been falling sharply, from above 6.0 in the early 1980s to below 2.1 (the replacement level) by the early 2000s. This is likely to gradually reduce population pressure in Iran.

**Diverse Population:** According to the CIA World Factbook, Persians make up around 60% of Iran's population, with Azeris accounting for around 15%. Other minorities also are present, such as Kurds (10%), Arabs and Baluchis. Given that Iran's minorities are geographically concentrated, the country could become vulnerable to separatist pressure, especially if ethnic minorities are provided with external support as part of covert activities aimed at destabilising Iran. That said, Iran's Azeris are hardly a repressed minority; they are fully integrated with the Iranian religious, military and commercial elites.

**External Pressure:** Iran is subject to considerable external pressure. Until Rouhani's election, it had minimal political interaction with Western countries because of its perceived radical foreign policy, and because the Iranian government has been accused of being a sponsor of terrorism. In addition, Iran is viewed warily by most Arab states, who fear that the country is seeking to export radicalism and become the dominant power in the Middle East. In recent years, Iran's nuclear programme led to speculation that the US and/or Israel will attack the country to destroy its atomic facilities. Furthermore, geopolitical competition between Iran and Saudi Arabia has intensified, most notably in Lebanon, Syria, Iraq and Yemen. Although Rouhani's election has led to more cordial relations with the West, we highlight the risk that the nuclear deal could break down, increasing the possibility of confrontation between Iran and its adversaries over the coming years. Although Iran maintains amicable relations with Russia, China, India and Brazil, none of these countries has the ability or willingness to come to Tehran's defence in the event of conflict.

## Long-Term Political Risk Index

Our Long-Term Political Risk Index score for Iran is 54.0 out of 100. This low score implies that we have considerable doubts about the sustainability of the current political system. Of the index's four sub-components, the lowest is the 'characteristics of polity' score, at 41.8/100. This reflects Iran's authoritarian political system. The 'characteristics of society' score is somewhat low at 55.0/100, owing to a diverse population and high levels of poverty. The 'scope of state' score also stands at 55.0/100, reflecting severe external pressure on the government as a result of international sanctions. The 'policy continuity' score is high at 70.0/100, because Iranian governments generally pursue similar policies especially domestically.

## Scenarios For Political Change

While we maintain our core view that hardline control will continue over the next decade, we see four possible alternative scenarios for Iran's evolution over the coming decade:

**Elite-Led Transformation:** While not our core view, there is potential for the current religious and secular elite to gradually transform the political system. The trigger for this could be the death of the Supreme Leader, who could be succeeded by a more flexible figure. A more moderate Supreme Leader could gradually ease political, economic and social restrictions with the aim of pre-empting the kind of mass unrest seen during the Arab Spring.

'Regime transformation' could include some of the following changes: some devolution of power away from supreme rule by clerics in favour of secular politicians; the conduct of elections with reduced vetting of candidates for the presidency and parliament or a manipulation of the results; a relaxation of media censorship; and an easing of excessive state interference in social and cultural norms. These changes will likely lead to some forms of economic liberalisation, although conservative forces will still hold considerable sway. They would also most likely lead to Iran toning down its hostility (at least in public) towards the US, Israel and various Western countries. Partial reform would increase the likelihood of a nuclear deal holding firm, as a more moderate Supreme Leader would see the benefits of an easing of sanctions and the economic bounce that follows.

We expect the political scene to become more unstable over the coming years, as competing forces vie for power. As the regime's ideological appeal weakens, Iranian leaders will seek new causes to boost their support. The obvious replacement to radical Islam is Persian nationalism, but given that ethnic Persians constitute only 61% of the population, this could prove divisive. Furthermore, even if the clerics' political power somewhat weakens, they are bound to seek continued influence in society through religious means. It is quite possible that Iran's political scene could become divided along similar lines to present-day Turkey, where secular institutions struggle against Islamist ones.

In terms of external relations, we expect Iran to pursue a multi-vector foreign policy, boosting ties with China, Russia, India and other emerging nations. Despite some improvements, a partially reformed Iran is unlikely to experience a permanent rapprochement with the West, even with the nuclear accord.

**Popular Uprising:** Alternatively, Iran could experience a new popular uprising over the coming years as public frustration with poor economic conditions, insufficient democratic representation, the absence of social freedoms and political infighting prompt hundreds of thousands of people to converge in the streets of Tehran and other cities to demand the resignation of key leaders and radical political change. The trigger for this could be a sharp deterioration of living standards, a sharp worsening of the economic situation following a possible breakdown of the nuclear agreement and re-imposition of sanctions, or any other 'shock' event. The regime cracked down heavily on post-election unrest in 2009, but there could come a time when intra-regime divisions become so pronounced that the leadership will be paralysed in the face of protests. The Iranian opposition currently lacks charismatic leaders capable of galvanising the public, but we highlight that the Arab Spring took place despite the absence of such figures. In any crisis triggered by an uprising, the stance of the military will be crucial to the outcome. For example, the Tunisian and Egyptian uprisings of 2011 succeeded because the armed forces largely refused to crack down on demonstrators. Iran's regime has the IRGC and Basij militia in addition to the regular military, but even these forces could eventually abandon the regime.

Even if the regime is nominally toppled by an uprising, we would expect any transition to democracy to be a long process, probably lasting at least five years. As events in Egypt since the Arab Spring have demonstrated, removing the president is not the same as removing the regime.

**Military Takeover:** Iran could conceivably experience a military coup or a creeping militarisation of political institutions over the coming decade. A sudden coup is unlikely unless Iran's political or economic environment deteriorated very sharply. This could occur as a result of an economic crisis followed by mass uprisings, which the regime would be unwilling to put down. If that were to happen, the regular armed forces or IRGC could conclude that they are the only ones capable of restoring order. Alternatively, Iran could experience a gradual but pronounced increase in military influence over the polity and economy as clerical rule falters. Although the IRGC is an ideological force, the weakening of the state's ideology could allow it to serve as bridge between religious and secular rule.

**Descent Into War:** Over the coming decade, Iran could find itself caught up in either foreign or civil wars. There is a possibility that Israel and/or the US could attack Iran if the country is discovered to be producing highly enriched uranium in secret facilities, in breach of the nuclear deal or other international regulations. Although such action would not necessarily be directed towards regime change, the potentially resulting regional war would be the Islamic Republic's biggest challenge since the Iran-Iraq war. While a foreign attack may initially cause the Iranian people to rally around the regime, the damage done to the country's infrastructure, the spectre of endless confrontation with the West, and the possibility of defeat could eventually discredit the regime irreversibly, prompting an uprising or a coup. This would be a similar situation to the way in which military defeats in Argentina after the Falklands War (1982) and in Serbia after the Balkan wars (1991-1999) eventually helped topple their respective regimes.



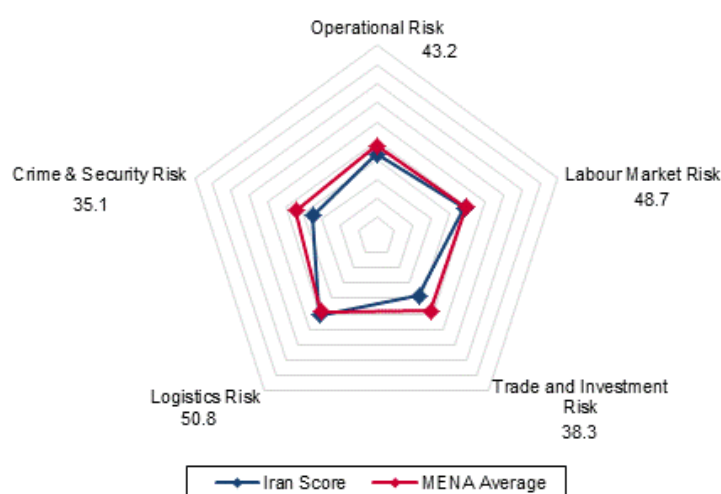
# Operational Risk

Our Operational Risk report series provides a comprehensive overview of potential risks facing investors operating in a country, as well as a cross-country regional evaluation of threats and advantages. The Operational Risk service evaluates Logistics Risk, Trade and Investment Risk, Labour Market Risk and Crime and Security Risk. Below are sections from these reports.

Iran's operating environment is facing considerable setbacks resulting from the decision by US President Donald Trump to reintroduce secondary sanctions, all but ending the nuclear agreement reached in July 2015. While the other signatories to the agreement – the EU, Russia and China – have agreed to continue upholding it, most improvements to Iran's economy and business environment over the last three years are likely to be erased. Doing business in the country will become near impossible once again for Western firms, while structural risks including obstacles to trade, regulatory restrictions, onerous taxes, stringent labour laws, and widespread corruption are likely to worsen. Iran currently scores below the regional average in our Operational Risk Index, with an overall score of 43.2 out of 100 placing it in 11th position out of 18 states in the MENA region, and we expect this position to slip over the coming quarters as the effects of the restored sanctions filter through.

## Businesses Face Significant Structural Risks And Sanctions Uncertainty

Iran & Regional Average – Operational Risk Scores



Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Operational Risk Index

**Crime And Security (35.1/100):** Iran's isolated international position is the main driver behind the major security risks to business operations. The most pertinent concerns for investors are the potential for exposure to financial crime and cybercrime, both of

TABLE: OPERATIONAL RISK

	Operational Risk	Labour Market Risk	Trade And Investment Risk	Logistics Risk	Crime And Security Risk
Iran score	43.2	48.7	38.3	50.8	35.1
MENA average	47.6	49.3	48.1	48.8	44.1
MENA position (out of 18)	11	8	12	10	12
Global average	49.7	49.8	50.0	49.3	49.9
Global position (out of 201)	122	110	140	89	145

Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Operational Risk Index

which occur on a large scale in the country. In addition, the risk of interstate conflict remains high, as the country has poor relations with most global powers and its rivalries with Israel and Saudi Arabia have frequently appeared to bring it to the brink of conflict. Businesses also face risks from non-state actors such as Islamic State (IS), which launched its first successful attack on the country in June 2017, and Sunni insurgent groups in the border region with Pakistan. Having said that, reasonably competent (if oppressive) security forces mean that the terrorist threat is lower than in other MENA states, while property crime is not a major problem for foreign workers and businesses.

**Trade And Investment (38.3/100):** The international sanctions imposed on Iran crippled the country's economy by preventing trade with major economies, restricting access to international financial markets, and prohibiting foreign involvement in most industries. This resulted in falling trade flows and tipped the country into recession in 2012, while the economic recovery was hindered by the sharp drop in oil prices over 2014. An initial improvement in economic growth following the agreement on Iran's nuclear programme in July 2015 is now under threat from the US's withdrawal, meaning that Iran's appeal to investors will remain limited, despite considerable opportunities for foreign direct investment. A wide range of structural risks, including the pervasive presence of the state in the economy, caps on foreign ownership in key sectors, a high tax burden, inefficient bureaucracy and rampant corruption, also remain unresolved and are likely to worsen following the reintroduction of sanctions.

**Labour Market (48.7/100):** The labour market in Iran boasts strong fundamentals due to the large size of the working-age population, relatively robust healthcare, and an education system which produces large numbers of highly skilled workers. However, Iran suffers from a brain drain of its most well-educated citizens, who leave in order to seek more lucrative employment and better prospects abroad. This contributes to a lack of highly educated personnel in the Iranian labour force, representing significant risk for employers in terms of the cost of importing skilled labour. In addition, while there is a large pool of dormant labour to be tapped into due to the high unemployment rate, formal work experience and vocational skills are lacking, particularly among young workers, increasing the costs of training for new employees. The costs of employment are further raised due to excessive government regulation of the labour market, which significantly restricts the flexibility of hiring and firing practices, and results in generous mandatory benefits for workers.

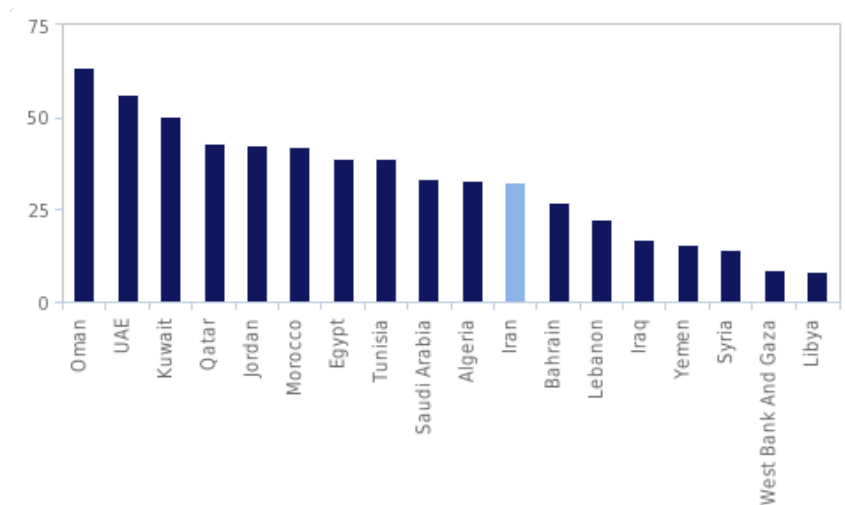
**Logistics (50.8/100):** The detrimental impact of sanctions on the utilities and transport networks has left existing infrastructure in a poor condition, resulting in continuing risks of disruption to utilities supplies and supply chains. In addition, bureaucratic and customs barriers to trade remain prominent and issues with internet connectivity and water scarcity will be key concerns for businesses. Despite some recent improvements to the utilities supply following the nuclear agreement, the reintroduction of US sanctions will prevent much needed investment in logistics infrastructure and weigh on the country's performance – although Chinese investment could remain a bright spot.

## Conflict Risk

Iran presents businesses with a heightened level of security risk, which must be factored into operational costs for any companies considering entering the country. Iran is mired in a web of interconnected internal and external security threats which stem from the region-wide instability currently convulsing the Middle East. As the largest Shi'a state, the country plays an active role in supporting fellow Shi'a countries and groups, such as Iraq, Hizbullah (in Lebanon) and Houthi rebels (in Yemen). This foreign policy puts it at odds with Sunni Saudi Arabia and has led to a severe heightening of sectarian tensions throughout the Middle East. Increasing

military assistance to Iraq following the rise of IS has spurred retaliatory attacks on Iran by the Sunni extremist group. In addition, Israel and Iran are fundamentally opposed, and Tehran remains at risk from an aerial bombing campaign aimed at its nuclear and military infrastructure. The high level of security threats means that Iran scores a low 32.3 out of 100 for Conflict Risk. This places the country in 11th position out of 18 states in the MENA region.

**Multiple Conflict Risks Weigh On Score**  
MENA – Conflict Risk



Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Crime and Security Risk Index

## Latest Conflict Risk Analysis

- Iranian military forces in Syria were repeatedly targeted by Israeli airstrikes in early 2018, following an alleged chemical attack on rebels in the town of Douma by the Iranian-supported Syrian government in April. Although Iran's involvement in the Syrian conflict has not affected the country directly thus far, these recent clashes have highlighted the potential for Tehran to become drawn into a much wider conflict, particularly given the large number of powers involved, which include Russia and the US. Combined with the risks to a breakdown of the nuclear agreement, this could lead eventually to direct strikes on Iranian soil or a broader regional conflict.
- Widespread public protests, which first erupted in late December 2017 but have recurred throughout the year to date, have indicated the potential for spontaneous unrest in Iran caused by myriad grievances including high unemployment, still-elevated inflation and rampant corruption. The protests have been the largest to take place since the Green Movement protests which followed the presidential election in 2009. Although business interests have not been specifically targeted, the unrest nevertheless indicates the potential for widespread political upheaval in Iran, which could result in damage to business property, disruption to supply chains and violence, which poses a risk to foreign nationals.
- Iran remains a top target for attacks by Islamic State (IS), due to its proximity to the group's area of operations, its key role in the Iraqi counter-attack and its large Shi'a population, although the risk has reduced somewhat following the group's territorial losses. The country has suffered two major terrorist attacks in recent years which have been claimed by IS – with 12 people killed in coordinated attacks on the Iranian parliament and the mausoleum of Ayatollah Ruhollah Khomeini in Tehran in June 2017 and 29 killed during an attack on a military parade in Ahvaz in September 2018. Responsibility for the latter was also claimed by an Arab nationalist separatist group, the Patriotic Arab Democratic Movement in Ahwaz. These incidents highlight



the ongoing threat that IS and other terrorist groups present to Iran. The country's extensive security apparatus helps to limit the capabilities of terrorist operatives, but their presence in Iran indicates that there remains a high risk of an attack that could affect foreign personnel and business property.

## Terrorism And Political Violence

Businesses in Iran are at risk from a number of terrorist groups that operate in and around the country. Domestic terrorist organisations are concentrated in Iran's largely Sunni south-eastern region of Sistan-Baluchistan, which shares porous borders with Afghanistan and Pakistan. This allows Sunni militant groups to operate with relative impunity throughout this poorly policed region and terrorist attacks are relatively frequent. Other areas of the country, including Tehran, have also been targeted by these groups and, although businesses and Western interests are less common victims than government buildings and security services, they have sustained damage in the past. Iran's explicit support for the Iraqi government, Shi'ite militias and Kurdish peshmerga forces fighting against IS has also made it a prime target for retaliatory attacks. Large-scale protests in the country also have the potential to turn violent, potentially damaging Western interests, and over the long term, Iran's heavily managed political system is unsustainable. Consequently, Iran is ranked eighth out of 18 MENA countries for Terrorism and Political Violence Risk, with a score of 19.0 out of 100.

### Terrorist Threat

TABLE: MAIN ACTIVE TERRORIST GROUPS

Terrorist Group	Targets	Regional/Sector Exposure	Threat Level
Jundallah	Government buildings, law enforcement, military, private property	Mainly based in Sistan-Baluchistan. Port operators, construction firms and companies with supply chains passing through Chabahar port most at risk	<ul style="list-style-type: none"> <li><b>Moderate:</b> Attacks are concentrated in south-east but have been large-scale in the past. The group has professed support for IS, though its operations remain largely separate.</li> </ul>
Jaish al-Adl	Law enforcement, military	Mainly based in Sistan-Baluchistan	<ul style="list-style-type: none"> <li><b>Moderate:</b> Splinter group of Jundallah largely targeting government forces.</li> </ul>
Kurdistan Free Life Party	Law enforcement, military	Border with Iraq, particularly Kurdistan region	<ul style="list-style-type: none"> <li><b>Low:</b> Violence is contained to small area and targeted at military.</li> </ul>
Islamic State	Shi'a religious sites, government buildings, military	Major towns and cities, border areas, Western companies	<ul style="list-style-type: none"> <li><b>Moderate:</b> Iran's participation in the campaign against IS, as well as its large Shi'a population, makes it a prime target for a retaliatory attack. The group launched its first successful attack in Iran in June 2017, despite its recent territorial losses. More attacks may follow as fighters return and the group lashes out following its military defeats.</li> </ul>

Source: Fitch Solutions

**Political Violence Risk:** Underlying tensions in Iranian society mean that there is an ongoing risk of political violence which could affect business operations. The main source of potential instability is the tension between the population and the ruling elites, with the country's heavily managed democracy and strict religious laws causing friction. Iran has seen mass protests in recent years, particularly following the controversial elections in 2009, while violence has also flared in response to international events, often targeted at foreign embassies. Limited economic gains for the general public since the signing of the nuclear deal, combined with the agreement's potential collapse, have contributed to ongoing and widespread protests since late 2017, while the potential for political violence over the long term remains.

**Counterterrorism Capability:** Iran boasts an extensive, heavily armed and well-trained network of intelligence services which are capable of defending the country from both internal and external security threats. The closed nature of the Iranian regime means that it is difficult to assess the exact size and strength of the security services; however, in October 2014 the state-owned Fars News Agency reported that there were 16 separate intelligence agencies operating in Iran under the aegis of the Council for Intelligence

Coordination (CIC). This body oversees the activities of each agency, which include the Ministry of Intelligence, the Revolutionary Guards Intelligence Unit, the Islamic Republic Armed Forces Intelligence Unit, the General Security and Intelligence Police and the Cyber Police. Each of these organisations utilises their own network of security forces, responding to various different threats according to their area of operations. The Ministry of Intelligence remains the main coordinator of intelligence activities, working with several of the other security organisations.

In line with its policing and law enforcement prowess, Iran has a reputation for maintaining order, often through brutal measures. Iran's disregard for international human rights norms and severe penal code allows the country's security institutions an extra degree of power and autonomy with regard to combating terrorism, which is not enjoyed by their counterparts in Western states. The security services frequently employ harsh measures to eliminate opponents of the regime, whether these are peaceful advocates for democracy, regional separatists or religious extremists. This is evidenced by the mass arrests which occurred in the aftermath of attempted IS attacks on Iran in 2014.

Additionally, Iran has external allies in its fight against terrorism in the region. Iran and Russia have recently announced they will be holding regular consultations to achieve bilateral cooperation on counterterrorism issues. Also, President Rouhani has called for a quadrilateral front of Iran, Afghanistan, Tajikistan and Pakistan to counter the threat of the Taliban and other insurgent groups in the region. He has warned that any negligence on the part of Iran's neighbours with regard to fighting extremism is likely to affect bilateral relations. Indeed, tensions between Tehran and Islamabad have risen as Sunni militant groups have continued to launch attacks in the Sistan-Baluchistan region from bases in neighbouring Pakistan.

**TABLE: POLITICAL VIOLENCE RISK**

Main Causes	Key Flashpoints	Risk Level And Impact On Business Environment
Heavily managed democracy	Death of Supreme Leader Ayatollah Ali Khamenei and transition of power; breakdown of the nuclear deal with Western powers; perceived election rigging leading to mass protests.	<ul style="list-style-type: none"> <li><b>Moderate:</b> There is a clear disconnect between the religious ruling elites and the more secular general population in Iran, with the latter increasingly dissatisfied with heavily managed and restrictive democratic processes.</li> <li>Tensions will remain below the surface during the presidency of reformist Hassan Rouhani, but could resurface if the death of the Supreme Leader results in a shift to more hardline policies or if elections are perceived to have been rigged.</li> <li>Mass protests have the potential to turn violent, and while pro-reform protesters are unlikely to target foreign businesses or embassies, counter-protests could do so.</li> </ul>
Tense international relations	Breakdown of nuclear deal; air strikes on military installations; intensification of aggressive rhetoric with Saudi Arabia.	<ul style="list-style-type: none"> <li><b>Moderate:</b> Violent protests have occurred in recent years in response to international events, for example the Saudi embassy in Tehran was attacked in January 2016 following the execution of a Shi'a cleric in Saudi Arabia. The British embassy was also attacked following the imposition of sanctions in 2011.</li> <li>While relations with Western powers have improved since the signing of the nuclear deal in 2015, reducing the risk to Western interests from violent protests, tensions with Saudi Arabia remain elevated and relatively minor actions or events could catalyse large-scale unrest. In addition, the re-introduction of US sanctions and/or collapse of the nuclear deal could also lead to large-scale unrest.</li> </ul>
Separatism	Declaration of independent Kurdistan in Iraq.	<ul style="list-style-type: none"> <li><b>Low:</b> Iran has a significant Kurdish minority largely based in the border region with Iraqi Kurdistan, which is held an unofficial independence referendum in September 2017.</li> <li>While the outcome of the referendum was in favour of full independence for Kurdistan, it was met with a strong response from the central government and neighbouring states, culminating in the Iraqi government moving its forces into territory held by the KRG since the fightback against IS began.</li> <li>This occurred without bloodshed or significant opposition, and while we do not expect the issue of Kurdish independence to disappear, it has fallen from the top of the political agenda in the short term.</li> </ul>

Source: Fitch Solutions

However, despite the vast presence of state security services in Iran, there remain significant deficiencies in their operational capabilities. The key weakness is a lack of cohesion between each intelligence agency as, despite the presence of the overarching CIC, every department sets their own agenda and intelligence-gathering is not adequately coordinated or shared. Exacerbating this issue is the competition between the various security services, which is a symptom of the wider complexities and rivalries in Iran's opaque regime. Some departments are loyal to the IRGC, others to the Ministry of Intelligence and still others report directly to the president and Supreme Leader themselves. This severely hinders the capability to effectively prevent and investigate terrorist activity and encourages the use of heavy-handed measures such as mass arrests which often implicate innocent civilians.

In addition, despite the large size of the military and police force, there are areas of the country in which the rule of law is very poorly enforced. In particular, the border areas with Iraqi Kurdistan in the west and Afghanistan and Pakistan in the east are inadequately policed and therefore very porous, hence the ease with which terrorist groups are able to operate in these regions. The lack of border security is also a wider issue, allowing other criminal groups to flourish and profit from activities such as drugs and weapons smuggling. Consequently, Iranian security services are not able to prevent all terrorist activity which is planned in the country, and businesses should not expect comprehensive protection.

## Interstate Conflict Risk

The Iranian government's combative rhetoric and assertive foreign policy mean that the country faces a multitude of interstate security risks. Iran is involved, to a varying extent, in a number of the conflicts which are currently playing out in other MENA states, including in Syria, Iraq and Yemen. This has set it increasingly at odds with regional rival, Saudi Arabia, and fuelled sectarian tensions between Shi'ite and Sunni Muslims throughout the Middle East. In addition, Iran refuses to recognise the legitimacy of the Israeli state and Tehran's support of Hamas, Hizbullah, and other groups opposed to Israel, as well as its previous attempts to develop a nuclear programme, have severely heightened tensions between the two countries. On top of this, Iran has had largely strained relations with the rest of the world, particularly the West, since the Islamic revolution in 1979. Although President Rouhani is seeking rapprochement through compromise on Iran's nuclear agenda and this has resulted in some thawing of relations with the West, Israel is likely to remain hostile while President Trump's decision to withdraw from the nuclear deal has raised tensions. The consequently high risks of Iranian involvement in an interstate conflict are not fully mitigated by its extensive armed forces, and therefore the country is ranked 10th out of 18 MENA states for Interstate Conflict Risk, with a score of 45.5 out of 100.

## Likelihood Of Conflict

**TABLE: IRAN'S INVOLVEMENT IN REGIONAL TROUBLE SPOTS**

Location	Nature Of Involvement
Syria	<ul style="list-style-type: none"> <li>Provided personnel, training and equipment to the government in order to prop up the friendly regime of President Assad against rebel groups. Iranian forces in Syria have been targeted directly by Israeli airstrikes, indicating the risks of a wider conflict emerging.</li> </ul>
Lebanon	<ul style="list-style-type: none"> <li>Tehran funds and equips Shi'a militia group Hizbullah, which runs a parallel armed force alongside the Lebanese army and has been involved in conflicts against Israel and IS.</li> </ul>
West Bank and Gaza	<ul style="list-style-type: none"> <li>Supports Hamas and other Palestinian militant groups fighting against the Israeli state.</li> </ul>
Yemen	<ul style="list-style-type: none"> <li>Allegedly funding Houthi rebels which have risen up against the Saudi-backed government.</li> </ul>
Iraq	<ul style="list-style-type: none"> <li>Provided extensive support to the Iraqi army, Shi'a militias and Kurdish forces combating IS.</li> </ul>

Source: Fitch Solutions

**Military Capability: Size:** Iran boasts the largest military in the Middle East, comprised of a number of complementary forces including the official Iranian Army, the Iranian Revolutionary Guard Corps (IRGC), and Basij paramilitary militias. Altogether, the active armed forces number some 523,000 personnel, as well as 350,000 reservists and up to 1mn combat capable paramilitaries as of

2016. The country also boasts the largest manpower fit for military service (both males and females) in the MENA region at 39.6mn people. Consequently, Iran is well-equipped to defend itself against a conventional invasion of land-based forces, reducing the risk of a full-scale incursion by IS or an attack by a rival Middle Eastern state such as Saudi Arabia.

**Weaponry:** The Iranian armed forces are largely under-equipped and under-resourced, with the mechanised brigades severely lacking in military equipment. The large majority of military hardware in Iran is antiquated, mostly dependent on weapons acquired by the Shah (before 1979), or relatively low-quality imports. The majority of Iran's imported weaponry comes from Russia or China but even so, these nations do not export their most technologically advanced equipment to Iran. Russia has agreed to provide a more advanced missile defence system to Iran, which would boost the country's defence capabilities in the event of an aerial attack, however, the US has insisted that the UN arms embargo remains in place for five years following the lifting of other sanctions, restricting Iranian access to much of the global arms market. The government has attempted to develop a domestic arms industry, but procurement of advanced weaponry continues to lag behind regional peers. This stands in stark contrast to rival Saudi Arabia, which spends a huge 7.9% of GDP on the military, and is able to obtain the latest equipment from US and European manufacturers.

Consequently, Iran has a competent enough military to defend its own territory and deter external aggression; however, it does not have the power to project its influence or sustain large-scale combat overseas. This has not precluded the country's involvement in several regional conflicts but will prove an issue as Iraq becomes increasingly reliant on Iranian military assistance to combat IS. There is likely to be a reduction in Iranian involvement in other regional conflicts, particularly Syria, while the armed forces focus on tackling the threat of IS in Iraq, as this would risk overstressing the capabilities of the military.

**Dispute Management (Bilateral):** There are few countries with which Iran has cordial relations, though Tehran has fostered strong ties with a number of Shi'a regimes in the Middle East, including Iraq, Lebanon, Syria, as well as global powers China and Russia. Iran-Iraq relations have flourished since the overthrow of Saddam Hussein's Sunni regime and former Iraqi President Maliki made numerous visits to Iran. The two countries are also economically and religiously intertwined and we expect Iraq to become increasingly dependent on Iran as it attempts to deal with the advance of IS. Iran's proximity to the Caucasus makes it strategically important to Russia and they both share ambitions of limiting US influence in the Middle East. China and Iran are also strongly linked through

TABLE: MAJOR CONFLICT FLASHPOINTS

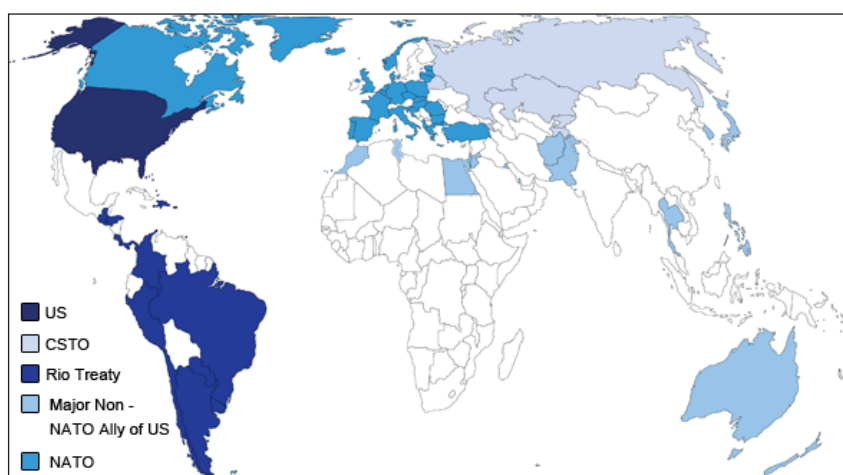
Protagonist	Likely Cause Of Conflict	Form Such A Conflict Would Take	Likelihood Of Conflict
Israel	Israeli airstrikes on Iranian nuclear facilities.	Aerial bombing campaign led by Israel, some retaliation from Iran in the form of missile strikes or blocking the Strait of Hormuz.	<ul style="list-style-type: none"> <li><b>Moderate:</b> The agreement over Iran's nuclear programme has largely closed the window of opportunity for Israeli airstrikes. However, while the nuclear deal is likely to remain in place in some form, rising tensions surrounding Iran's involvement in the Syrian conflict could result in an escalation of hostilities with Israel and the West.</li> </ul>
US/Israel	Breakdown in nuclear agreement leads Iran to step up its development of nuclear weapons.	Aerial bombing campaign to destroy nuclear facilities.	<ul style="list-style-type: none"> <li><b>Moderate:</b> US President Trump's decision to withdraw from the nuclear deal has raised tensions with Iran considerably, with secondary sanctions likely to be reintroduced in November 2018. There is the potential for an Iranian backlash to sanctions to spark a military confrontation.</li> </ul>
Saudi Arabia	More overt Iranian support for Shi'a uprisings or rebel groups in Bahrain, Yemen, Lebanon, or Saudi Arabia.	Escalation of proxy wars, with direct hostilities between Iranian and Saudi forces. Aerial bombing campaigns.	<ul style="list-style-type: none"> <li><b>High:</b> Growing assertiveness of both Tehran and Riyadh raising the risk of an escalation in proxy conflicts or a miscalculation sparking a direct confrontation.</li> </ul>
Pakistan	Intensification of Sunni insurgent attacks launched on Iran from Pakistan.	An Iranian aerial or ground force campaign in Pakistan to degrade the capabilities of militant groups, which would result in retaliation by Islamabad.	<ul style="list-style-type: none"> <li><b>Low:</b> Bilateral cooperation to contain rebel activities is preferred by both sides for now.</li> </ul>

Source: Fitch Solutions

trade. Diplomatic ties with Saudi Arabia and Israel are fraught, however, and there is limited scope for disputes to be settled by direct negotiation with these states.

**Dispute Management (Multilateral):** Iran's international isolation has resulted in limited means for the peaceful settlement of disputes through multilateral forums. However, the country's engagement with the UN-brokered negotiations over its nuclear programme has signalled the potential for it to return to the international fold. An agreement between the five permanent members of the UN Security Council (China, France, Russia, the UK and the US) plus Germany (the P5+1 nations) and Iran over the latter's nuclear programme was finalised in July 2015, with all parties involved in the negotiations aware of the need to reach a deal while domestic political and foreign policy conditions were conducive. This agreement is certainly positive for Iran's strategic international position and though it will by no means guarantee a lasting settlement and rapprochement with the West, if Iran complies with measures to reduce its nuclear capabilities the risk of an aerial bombing campaign by either Israel or the US will be significantly reduced.

## Global Defence Agreements



Note: The US is a member of the Rio Treaty and NATO; Kuwait and Bahrain are also Major Non-NATO Allies of the US.  
Source: d-maps.com, Fitch Solutions

**Defence Agreements:** Iran's isolated international position means it has few allies and no mutual defence agreements in place which would deter a potential aggressor or provide assistance in the event of an external attack. The country has generally poor relations with most Arab states and has frequently found itself ranged against powerful Sunni countries such as Saudi Arabia and its Gulf allies. Although Russia and China have a generally more favourable view towards Iran, neither would be willing to risk a wider conflict by stepping in to defend the country in the event of an attack such as an aerial bombing campaign against nuclear sites by Israel.

## TABLE: BUSINESS RESPONSE TO CONFLICT RISK

Risk Level	Business Response
High	<ul style="list-style-type: none"> <li>Hire armed private security guards for transport and operations in Sistan-Baluchistan province.</li> <li>Prepare for higher insurance premiums for all operations.</li> <li>Closely monitor sanctions updates and have contingency plans in place.</li> <li>Be aware of international developments and update employees with news and potential risks when necessary.</li> <li>Establish evacuation plans for foreign workers in the event of mass protests or a flare-up in violence.</li> <li>Provide guidance and training for employees in what to do in the event of large-scale protests or terrorist attacks.</li> <li>Avoid locating operations in potentially dangerous regions such as Sistan-Baluchistan and western border areas.</li> </ul>

Source: Fitch Solutions

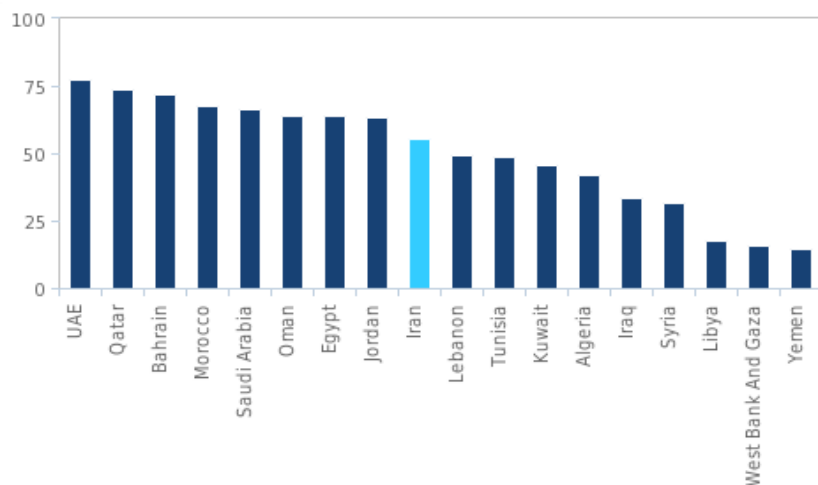
**Business Response:** Despite a relatively high risk from terrorism, political violence and international conflict, businesses will not have to take excessive security measures to protect their personnel and assets in Iran. The main additional costs will be in terms of insurance provision as the situation is not severe enough to require armed guards or security details, except in remote border regions. Businesses must, however, remain acutely aware of and well-briefed on international developments, domestic political events and changes to the sanctions regime as this may precipitate sudden changes to the security landscape.

## Transport Network

Iran's transport network provides good coverage throughout the country, with strong road and rail connections to urban areas, ports and airports as well as to neighbouring states. However, international sanctions have inhibited investment in the country's ageing transport infrastructure, resulting in some safety risks, and significant improvements are unlikely over the medium term as foreign investors remain largely excluded from the market. While the country is well placed to become a major transit hub for east-west trade routes, it is unlikely to realise this potential while the sanctions remain in place. Iran scores 57.6 out of 100 for Transport Network, placing it ninth regionally.

### Transport Network Remains Uncompetitive Under US Sanctions

MENA – Transport Network



Note: 100 = Lowest risk; 0 = highest risk. Source: Fitch Solutions Logistics Risk Index.

### Latest Transport Network Analysis

- The development of a new deep-water port at Chabahar by **India Ports Global** has faced significant headwinds due to ongoing concerns about the sanctions regime and the reluctance of Western banks to deal with Iran. Although Iran and India have signed a number of agreements committing to the port's development, the project has struggled to attract offers for tenders to provide equipment such as cranes. Western companies, including Switzerland's **Liebherr** and Finland's **Konecranes**, announced in June 2017 that they had declined to participate in bids due to lingering concerns over sanctions, as well as the reluctance of their banks to deal with the Iranian market due to previous fines imposed for sanctions violations. This is indicative of the difficulties faced in the development of transport infrastructure in Iran, and will ensure that companies from neighbouring states and Asian countries continue to take the largest share of projects.



- Historic deals between US and European aircraft manufacturers **Boeing** and **Airbus** are now likely to be cancelled following the reintroduction of US secondary sanctions on Iran. In April 2017 Boeing had signed a USD3bn deal to sell planes to Iranian carrier **Aseman Airlines**, following the ground-breaking deal made by the company in June 2016 with the Iranian government to provide 100 new planes to upgrade the ageing fleet of the national flag carrier, **Iran Air**. The likely cancellation of these agreements will prevent much needed investment in new aircraft which is needed to improve the performance, safety and international connections of Iranian airlines.

## Extent And Quality Of Transport Network

The coverage of the Iranian transport network provides strong supply chain connections for businesses both within the country and with neighbouring states. Extensive road and railway networks connect all the major urban areas and provide cross-border links. The large number of ports and airports offer potential for expansion and indeed shipping liner connectivity has improved since 2016, but the reintroduction of secondary sanctions in November 2018 will reverse some of these gains and increase Iran's international isolation. Consequently, reliance on transshipments will add to the cost and delays of international trade, damping Iran's score for Extent of Transport Network, which at 57.3 out of 100 places it eighth in the MENA region.

Iran's entire transport infrastructure is in need of upgrading and expanding, having suffered from limited investment over recent years. The road and railway networks are of a reasonable standard regionally, but rail lines in particular require significant updating and electrification. In contrast, ports and airports have suffered more noticeably under the sanctions regime, which targeted both these transport sectors specifically. The ageing plane fleet has resulted in safety concerns for air transport, while port infrastructure may struggle to cope with an increase in trade volumes. The poor state of transport infrastructure means that Iran underperforms for Quality of Transport Network, scoring 57.8 out of 100 and ranking ninth out of 18 states in the MENA region.

### TABLE: ROAD RISKS

#### Internal Coverage

- |                               |  |
|-------------------------------|--|
| Total road network: 198,866km | <ul style="list-style-type: none"> <li>• Iran boasts an extensive road network which is largely paved and provides internal connections to all major economic hubs in the country.</li> <li>• Roads are the major transport mode for freighted goods and therefore provide vital supply chain links for businesses.</li> </ul> |
|-------------------------------|--|

#### International Connections

- |  |  |
|--|--|
| Roads connect to all neighbouring states | <ul style="list-style-type: none"> <li>• The road network offers good connections to all of Iran's seven direct neighbours, with two major highways to Pakistan, Afghanistan and Turkmenistan in the east, three to Azerbaijan, one to Armenia, and one to Turkey in the north, and five to Iraq in the west, including one major route to Baghdad.</li> <li>• These connections reflect Iran's position between key markets in the Middle East and Central and Southern Asia, with the country forming an important transit point between these regions.</li> </ul> |
|--|--|

#### Infrastructure Quality

- |                        |  |
|------------------------|--|
| 19.4% of roads unpaved | <ul style="list-style-type: none"> <li>• The majority of Iran's roads are paved, meaning the quality of surfaces is sufficient for heavy freight haulage.</li> <li>• However, the country lacks modern, multi-lane highways connecting its major cities to its ports, resulting in slower internal transit times.</li> </ul> |
|------------------------|--|

#### Usage

- |  |  |
|--|--|
| Accounts for 79% of internal freight tonnage | <ul style="list-style-type: none"> <li>• Roads are the major mode of freight transport in Iran, with greater importance for imports of capital goods and consumer items as hydrocarbons exports are shipped through pipelines to ports.</li> </ul> |
|--|--|

#### Disruption

- |                                     |   |
|-------------------------------------|---|
| 32.1 road deaths per 100,000 people | <ul style="list-style-type: none"> <li>• Traffic congestion in urban areas has become a severe problem, causing delays to supply chains which are heavily reliant on the road network.</li> <li>• A more serious issue is the high frequency of road accidents. Iran has the second highest rate of road deaths in the MENA region, and the eighth highest globally. Most accidents are due to poor driving standards, inadequate road maintenance and unsafe vehicles.</li> <li>• This increases the likelihood of accidents causing damage to freight carried by road and creating delays for supply chains.</li> </ul> |
|-------------------------------------|---|

Source: World Bank, WHO, Fitch Solutions

**Roads:** Road transport is the dominant freight mode in Iran, having largely developed to meet the supply chain needs of the country's freight imports. The nation's key export, oil, is transported to ports via pipelines. The road network therefore currently meets the needs of Iran's supply chains for manufacturing and agricultural exports, and imports of capital goods, metals and foodstuffs. It also offers good connections to all of the country's seven direct neighbours, through which there is access to the Middle Eastern, Central Asian, and South Asian markets. The main risk to road-based supply chains is the high rate of accidents, which is exacerbating congestion and delays.

### Extensive Road Network Offers Regional Connections

Main Road Links



Source: d-maps.com, Fitch Solutions

**Railways:** The railway network accounts for a significant proportion of total freight tonnage in Iran and provides an attractive diversification option for supply chains due to its good coverage and strong international connections.

### Ports And Airports Most Damaged By Sanctions

Iran & Regional Average – Infrastructure Quality



Note: 7 = Highest score; 1 = lowest score. Source: World Economic Forum's Global Competitiveness Index, 2017-18

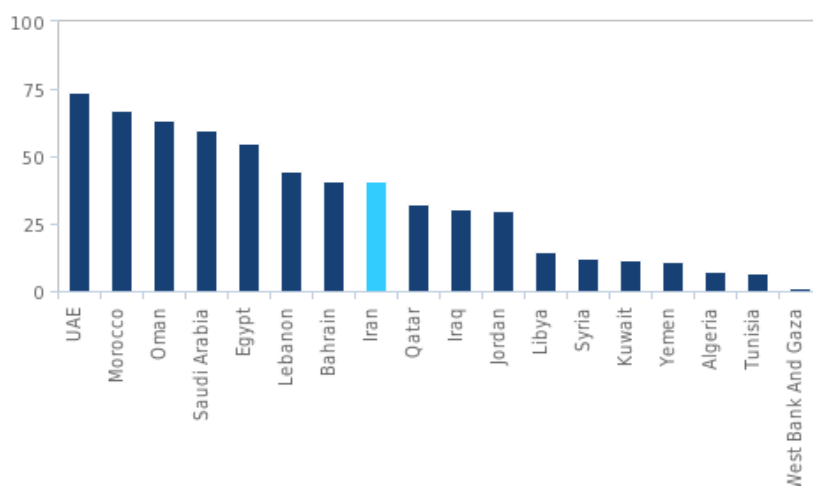
Rail freight currently caters mostly for containerised goods such as manufacturing and agricultural products, as well as fuel and cotton. Inward investment is expected to improve the condition of rail lines and rolling stock, while international trade will be boosted by Iran's position on increasingly important land-based trade routes between Europe and Asia.



**Ports And Inland Waterways:** International sanctions have hit Iran's port sector particularly hard. Sanctions have been targeted specifically at the country's port operators and the state-owned shipping line, the **Islamic Republic of Iran Shipping Line (IRISL)**, hindering its operational abilities.

## Limited Potential For Further Improvements To Shipping Connections

MENA – Liner Connectivity



Note: 158.76 = Highest score; 0 = lowest score. Source: UNCTAD

In addition, international shipping companies ceased calling at Iran's ports, leading to a decline in container throughput and more limited maritime trade connections. The lifting of sanctions in early 2016 began to strengthen links to global shipping routes and

## TABLE: RAIL RISKS

### Internal Coverage

Total railway network: 8,484km (mostly standard gauge)

- Iran's railways stretch to 8,484km in total, with 94km of broad gauge and the rest standard gauge, representing the longest railway network in the MENA region. The network connects Tehran to most other major cities including Tabriz in the north, Shiraz in the south, and Mashad and Zahedan in the east, as well as to the country's main seaports at Bandar Abbas and Bandar Imam Khomeini.
- A number of projects are underway to expand and update Iran's railway infrastructure, boosting supply chain connections over the medium-to-long term.

### International Connections

Railways connect to five neighbouring states: Pakistan, Turkmenistan, Azerbaijan, Turkey and Iraq

- There are rail connections to five of Iran's seven direct neighbours, but there is a break of gauge with all of these countries apart from Turkey and Iraq. These connections help to integrate Iran with the wider Middle Eastern and Asian railway networks, but we highlight that the break of gauge will add time delays and costs, as bogies will have to be changed on trains travelling north or east out of Iran. Over the long term, Iran is aiming to become a major transit hub for Europe-Asia trade, and railways will form an integral part of this role.
- Iran's potential to take a key role in global supply chains was highlighted by the arrival of the first freight train from China in February 2016. The two countries have strong trade links and Iran's location means that it is primed for Chinese investment in infrastructure as part of the 'Belt and Road' project to boost overland trade between Europe and Asia. This investment is likely to focus on road and railway routes which connect Iran with its neighbours, improving both internal supply chains and international links over the medium-to-long term (see 'Poised For Growing Role In Global Supply Chains', February 23 2016).

### Infrastructure Quality

- Iran's railway infrastructure is ageing and in dire need of investment. The poor quality of the network slows down transit speeds and increases the risk of accidents and derailments disrupting supply chains. The state of infrastructure is expected to improve over the medium-to-long term, mainly driven by Chinese investment as Western investors have been locked out of the market. A number of deals are in the pipeline to fund track extensions, high-speed lines, electrification and new rolling stock.

### Usage

Accounts for 22% of internal freight tonnage

- Though of secondary importance for supply chains compared to roads, railways still account for a large share of freight transport. There is potential for this to expand considerably over the medium term as investment in railway infrastructure improves transit times, reliability and international connections.

boosted international investment in port infrastructure, but further gains will be limited by the reintroduction of US secondary sanctions and significant obstacles to development remain.

## TABLE: RAIL RISKS (CONTINUED)

### Disruption

- Rail connections to Europe have been disrupted by fighting between the Turkish government and Kurdish militants, closing this supply chain route in the short term.

### Planned Projects

- Iran's railways are undergoing an ambitious expansion programme expected to cost USD25bn and increase the railway's share of freight transport to 30% over the next five years.
- Two new sections of railway were completed in September 2017, including a new crossing point at the border with Azerbaijan, with a third section linking the border to the Iranian city of Rasht due to be completed in three years.

Source: World Bank, Fitch Solutions

## TABLE: PORTS AND INLAND WATERWAY RISKS

### Internal Coverage

Main container ports located at: Bandar Imam Kohmeini, Bandar Abbas, Amirabad and Anzali. Total length of navigable inland waterways: 5,279km

- There are main seaports spread throughout the country, on both the Persian Gulf coast and the Caspian Sea, providing good access to maritime trade routes.
- Bandar Abbas (the premier container terminal), Bandar Imam Khomeini, and Chabahar are all located on the Persian Gulf, and Anzali and Amirabad are on the Caspian Sea. These terminals mostly cater for containerised imports. The Caspian Sea ports play an important role in the import of cereals from Russia and Kazakhstan to Iran and other Persian Gulf countries.
- Iran's main export, oil, is transported to dedicated oil terminals on the Persian Gulf at Khark Island, Sirri Island, Lavan, Bandar Abbas and Assaluyeh.

### International Connections

Liner connectivity: 40.75 (highest score 158.76)

- Liner connectivity in Iran has suffered due to the impact of sanctions. Historically, Iran has been reliant on transshipments from the UAE port of Jebel Ali, meaning that it has never outperformed, but the country's score in UNCTAD's Liner Connectivity Index fell as low as 5.8 in 2014. This is for the most part due to the discontinuing of services to Iran's ports by global shipping companies.
- The gradual lifting of sanctions since 2015 has had a positive effect on liner connectivity, with the score rising significantly to 40.75 in 2017 due to the reinstatement of shipping services, offering better connections and lower freight costs. Further improvements will be slow, however, as multinational shipping companies and insurers remain cautious in dealing with the Iranian market.

### Infrastructure Quality

- Underinvestment in port facilities and the lack of major multinational port operators overseeing activities at any of Iran's ports means that the quality of infrastructure and facilities is sub-standard, and the management of ports may not be able to adequately cope with increased throughput. This suggests that investment will be necessary to prevent congestion and provide more direct connections for shipping liners when trade volumes begin to pick up.

### Usage

Port of Shahid Rajaee (Bandar Abbas) throughput: 2.72mn TEUs (2018 estimate)

- Iran's ports are currently able to meet the demands of imports and exports, as they are still operating below capacity due to the impact of sanctions. There is therefore potential for an increase in trade and port throughput as sanctions are lifted. Though Iran has 5,279km of navigable inland waterways, ranking it highest in the region, the river Karun is the only waterway suitable for freight transport, running from the Persian Gulf to Khorramshahr. The use of inland waterways for supply chains is very limited at present, and we highlight that they do not offer a viable alternative to roads and rail for inland freight transport

### Disruption

- The main risk of disruption to the port sector is that investment will not keep pace with an increase in throughput, leading to congestion and supply chain delays. Plans for large-scale port expansions and upgrades should largely mitigate this.

### Planned Projects

- Ports are a key area of transport infrastructure development as Iran seeks to boost its role as a transit hub for regional trade. The port of Chabahar has been a key focus for investment, with Iran and India signing several agreements in recent years for Indian companies, including India Ports Global, to invest in expanding and upgrading the terminal.
- Improvements in port infrastructure continue to be hindered by lingering concerns about the sanctions regime. Western companies, often needed for their engineering expertise, are reluctant to bid for tenders due to fears that the nuclear deal will break down, and banks are extremely cautious about financing projects in Iran as many have been fined in the past for violating sanctions.

Source: World Bank, UNCTAD, Fitch Solutions

**Airports:** Iran's air transport sector has been seriously affected by the sanctions regime, which has prevented national airlines from upgrading their ageing fleets. This has contributed to poor safety standards, which has in turn hindered international connectivity and the development of the air freight sector. Numerous deals to replace planes and improve airport infrastructure following the initial lifting of sanctions are now unlikely to materialise, which will restrict improvements to freight and passenger air travel over the coming years.

## TABLE: AIR TRANSPORT RISKS

### Internal Coverage

Total of 140 airports with paved runways, 42 have runways of at least 3,047m needed for the largest planes in service to land

- Iran has a large number of international airports located throughout the country, with the busiest terminals located in Tehran. Mehrabad International Airport is the main domestic air transport hub, while Imam Kohmeini International Airport (IKIA) caters for international services. Air travel is well used for domestic passenger and freight transport.

### International Connections

0.24 air passengers carried per capita

- The national airline is Iran Air, which operates frequent direct flights to a number of destinations in Europe, the Middle East and Asia, including London, Paris, Frankfurt, Istanbul, Dubai, Mumbai, Beijing and Kuala Lumpur. International airlines including Air Asia, Emirates and Etihad also operate out of IKIA. In 2016 British Airways, KLM and Lufthansa all resumed passenger flights from Iran to the UK, the Netherlands and Germany respectively, but the former two suspended flight connections once again in September 2018.

### Infrastructure Quality

- International sanctions have prevented upgrades to the planes owned by national carriers and hindered improvement in airport infrastructure. The EU has highlighted safety concerns with the country's national airline, and only 12 Iran Air planes out of a total of 44 are permitted to fly within the EU. In the last 25 years, Iran Air has experienced 17 plane crashes and lost 1,500 lives. The International Civil Aviation Organisation has warned that Iranian aviation safety organisations have not been vetted and domestic flights may not comply with international standards.
- Deals struck with Airbus, Boeing and other international investors in 2016 have provided some upgrades to the ageing aircraft fleet, but further improvements will be limited as the reintroduction of US secondary sanctions will likely result in the termination of these contracts.

### Usage

Air freight volumes: 175.8mn tonnes-km in 2017

- Safety issues and inadequate infrastructure have hindered the development of the air freight industry in Iran. Air freight volumes were moderate on a regional comparison in 2017, at 175.8mn tonnes-km, which ranks the country eighth in MENA. This also reflects the general restrictions on trade which have been imposed by the international sanctions.
- Air freight capabilities are therefore limited at present, although Iran Air does have a dedicated cargo arm, and Lufthansa and Qatar Airways operate direct cargo flights between Tehran and Frankfurt and Doha respectively, offering some options for air freight supply chains.

### Disruption

- Strikes do occur in the air transport sector, though they are not common. Safety concerns are the main risk to freight and passengers, but these will be alleviated by the replacement of aircraft and growing investment in infrastructure

### Planned Projects

- Ground-breaking deals between plane manufacturers Boeing and Airbus and Iranian airlines signed in the aftermath of the nuclear deal in 2016 have yielded some improvements to aircraft fleets, but further gains will be prevented by the reintroduction of US secondary sanctions in November 2018, which will likely result in the termination of these agreements.

Source: CIA World Factbook, World Bank, Fitch Solutions

# Global Macro Outlook

## Volatility Feeding Into Slower Growth

The global economic outlook continues to weaken, and we at Fitch Solutions have revised down our global growth forecast for 2019, from 3.1% to 3.0% in December 2018. This downward revision accentuates our view that global growth will peak at 3.4% in 2018 and then slow over the coming years. Emerging and developed markets are in the crosshairs of this slowdown as we have seen downward revisions to our growth forecasts in both groups of countries. Argentina, Malaysia, Hong Kong and Thailand are the economies that saw the largest downward revisions for the 2018-2019 period. However, we also highlight downward revisions to Italy, France and Spain, which will result in an even faster deceleration for the eurozone as a whole, to 1.7% and 1.6% in 2019 and 2020 respectively, from 1.8% and 1.7% previously.

While 2019 is increasingly looking like it could be an inflection point for the global economy, we are not anticipating a recession as our aggregate forecasts still point to global growth of 3.0%. In addition, we have seen three important developments in recent weeks that should help to support the global economy. First, global policymakers have shown an increased propensity to help allay fears, initially with the US Federal Reserve striking a slightly more dovish tone in early-November comments, followed more recently with Presidents Donald Trump and Xi Jinping agreeing on a temporary truce on further escalation in their trade war, pending further negotiations, and signalling greater – albeit still limited – co-operation on the trade front. Second, oil prices

TABLE: GLOBAL ASSUMPTIONS

	2017	2018f	2019f	2020f	2021f	2022f
<b>Real GDP Growth (%)</b>						
US	2.2	3.2	2.5	2.0	1.9	1.9
Eurozone	2.4	2.0	1.7	1.6	1.5	1.5
Japan	1.7	1.0	0.5	0.6	0.5	0.4
China	6.9	6.7	6.5	5.8	5.4	5.4
World	3.3	3.4	3.0	2.9	2.9	2.9
<b>Consumer Inflation (ave)</b>						
US	2.1	2.3	2.3	2.2	2.1	2.1
Eurozone	1.5	1.8	1.6	1.8	1.8	1.8
Japan	0.5	1.2	1.6	1.9	2.1	2.4
China	1.6	2.3	2.3	2.2	2.2	2.3
World	2.8	3.1	3.2	2.9	2.8	2.7
<b>Interest Rates (eop)</b>						
Fed funds rate	1.25	2.25	3.00	3.00	3.00	3.00
ECB refinancing rate	0.00	0.00	0.25	0.75	1.25	1.50
Japan overnight call rate	-0.10	-0.10	-0.10	0.00	0.25	0.50
<b>Exchange Rates (ave)</b>						
USD/EUR	1.13	1.20	1.20	1.24	1.26	1.26
JPY/USD	112.15	109.50	110.00	109.00	108.00	107.50
CNY/USD	6.76	6.62	7.10	7.00	6.90	6.75
<b>Oil Prices (ave)</b>						
OPEC basket (USD/bbl)	52.43	70.00	72.00	79.00	81.00	82.00
Brent crude (USD/bbl)	54.75	73.00	75.00	82.00	84.00	85.00

f = forecast. Source: Fitch Solutions

currently around the USD60 per barrel (/bbl) level are neither too high nor too low for the global economy. This provides an anchor to inflation expectations in developed markets and respite to several emerging markets (EMs) that were hit by a double whammy of higher oil prices and weaker currencies versus a resurgent US dollar through much of 2018 to the end of September. Third, we continue to see the potential for a small cyclical upswing in the Chinese economy as the various stimulus measures implemented since April start to feed through – as evidenced in the OECD's leading indicator, which has started to turn higher. Any pickup in Chinese growth momentum would be a positive for other EMs, which have come under pressure in 2018 from a stronger US dollar and slightly weaker growth.

That said, we see increasing risks from the impact on growth of tightening liquidity, negative sentiment, increased financial market volatility and several key political and macro risks looming (Brexit, trade tensions and populism). We often flag up the

**TABLE: DEVELOPED STATES, REAL GDP GROWTH, % y-o-y**

	2017	2018f	2019f	2020f
<b>Developed States Aggregate Growth</b>	<b>2.3</b>	<b>2.5</b>	<b>2.0</b>	<b>1.8</b>
G7	2.1	2.4	1.9	1.6
Eurozone	2.3	2.0	1.7	1.6
EU-27	2.4	2.0	1.8	1.7
<b>Selected Developed States</b>				
Australia	2.3	3.0	2.5	2.3
Austria	3.0	2.5	2.1	1.7
Belgium	1.7	1.4	1.3	1.3
Canada	3.1	2.3	1.9	1.8
Czech Republic	4.4	3.2	2.8	2.6
Denmark	2.3	1.5	1.9	1.7
Finland	2.6	2.5	2.0	1.8
France	2.2	1.8	1.7	1.6
Germany	2.2	1.8	1.7	1.7
Hong Kong	3.8	3.3	2.5	2.3
Ireland	7.2	8.2	4.5	4.1
Italy	1.5	0.9	0.8	0.7
Japan	1.7	1.0	0.5	0.6
Netherlands	2.9	2.4	1.7	1.5
Norway	1.8	2.2	2.0	1.8
Portugal	2.8	2.1	1.5	1.3
Singapore	3.6	3.3	2.8	3.1
South Korea	3.1	2.5	2.3	3.2
Spain	3.0	2.5	2.2	2.0
Sweden	2.4	2.7	2.3	1.9
Switzerland	1.1	3.1	2.0	1.7
Taiwan	2.9	2.7	2.3	2.2
UK	1.8	1.4	1.5	1.6
US	2.2	3.2	2.5	2.0

f = forecast. Source: Fitch Solutions

US high yield market (USHY) as a key barometer of risk in credit and broader markets. With USHY credit spreads now pushing higher – driven mainly by the rout in oil – this could mark the topping out of the asset class and a broader move higher in risk premia, which could have a more pronounced negative impact across other areas of the economy and growth. As such, we will continue to closely monitor how financial market volatility and trade policy uncertainty feed through to our country-specific and global growth forecasts.

## Developed Markets

After peaking at 2.5% in 2018, we expect growth in developed markets to gradually ease to 2.0% and 1.8% in 2019 and 2020 respectively, mainly due to lower growth in the US and eurozone. Several leading indicators point to an already slowing US economy, and the first quarterly drop in Germany's GDP since Q115 suggests that the single currency bloc is losing some momentum. We

TABLE: EMERGING MARKETS, REAL GDP GROWTH, % y-o-y

	2017	2018f	2019f	2020f
<b>Emerging Markets Aggregate Growth</b>	<b>4.8</b>	<b>4.8</b>	<b>4.6</b>	<b>4.6</b>
<b>Latin America</b>	<b>1.8</b>	<b>1.8</b>	<b>2.4</b>	<b>2.7</b>
Argentina	2.9	-2.1	-0.4	3.1
Brazil	1.0	1.6	2.4	2.4
Mexico	2.0	2.3	2.1	2.2
<b>Middle East And North Africa</b>	<b>2.0</b>	<b>2.6</b>	<b>2.3</b>	<b>3.1</b>
Saudi Arabia	-0.9	2.0	3.5	2.2
UAE	0.8	2.8	3.4	3.2
Egypt	4.2	5.3	5.0	5.1
<b>Sub-Saharan Africa</b>	<b>2.9</b>	<b>2.9</b>	<b>3.8</b>	<b>4.3</b>
South Africa	1.3	0.7	1.7	2.1
Nigeria	0.8	2.8	3.4	4.7
<b>Emerging Asia</b>	<b>6.6</b>	<b>6.5</b>	<b>6.3</b>	<b>5.8</b>
China	6.9	6.7	6.5	5.8
India*	6.5	7.1	7.1	6.6
Indonesia	5.1	5.2	5.3	5.4
Malaysia	5.9	4.6	4.2	4.2
Philippines	6.7	6.2	6.1	6.2
Thailand	3.9	4.1	3.5	3.7
<b>Emerging Europe</b>	<b>3.9</b>	<b>3.0</b>	<b>1.7</b>	<b>2.5</b>
Russia	1.6	1.6	1.5	1.3
Turkey	7.4	3.6	-2.0	3.5
Hungary	4.5	4.4	3.4	2.7
Romania	7.0	4.2	3.9	3.5
Poland	4.7	4.5	3.8	2.8

f = forecast; \*Fiscal years ending March 31 (2018 = 2018/19). Source: Fitch Solutions

at Fitch Solutions have revised down our forecasts for the eurozone real GDP growth to 1.7% in 2019 and 1.6% in 2020, from 1.8% and 1.7% previously. The revisions largely reflect lower than expected growth in Spain due to weakening external dynamics and an expected slowdown in tourism revenues, and in Italy where a mildly expansionary fiscal policy will not be enough to compensate for faltering export growth amid worsening macroeconomic conditions in Italy's key trading partners. In Asia, we have revised down our 2018, 2019 and 2020 growth projections for Hong Kong by 0.3 percentage points (pp), 0.5pp and 0.7pp respectively to 3.3%, 2.5% and 2.3% respectively due to lingering trade headwinds, tightening monetary conditions and weaker consumer spending.

On the trade war front, although the temporary tariff truce agreed on by China and the US during the G20 on December 1 was a key step towards the de-escalation of a globally damaging trade war between Washington and Beijing, we maintain our view that a long-lasting resolution to escalating US-China trade tensions is unlikely in the near term as many sensitive issues remain unsolved. In contrast, some uncertainty over NAFTA has risen following Trump's announcement that he would 'shortly' formally terminate NAFTA. While we maintain our view that preferential trade access in North America will ultimately remain in place, a US notice of withdrawal would raise the risk of a major policy rupture and likely precipitate a deluge of judicial and congressional activity.

## Emerging Markets

Heightened financial market volatility and risk aversion will remain in play across global markets over the coming months and in 2019, which in our view will skew risks to the downside for EMs. Combined with the fact that the US-China trade dispute remains at the heart of negative sentiment weighing on growth, this suggests that EMs will remain vulnerable to bouts of risk aversion and outflows to safe haven assets in 2019. The global market sell-off following the arrest of the **Huawei** CFO on December 1 is the latest example of heightened market sensitivity to negative news surrounding trade, as doubts over the temporary trade détente have intensified and fears over global growth have resurfaced.

Despite mounting risks, we believe that key indicators of financial market stress are not yet at levels that would constitute a material revision lower in our growth forecasts, and as we highlight above, the prospect of a more dovish US Federal Reserve, coupled with lower oil prices and greater stimulus from China, should provide some support to EMs over the short term, helping to mitigate some of these risks. The balance of factors has accordingly led us to maintain our broad expectation for robust EM growth in the years ahead. We have therefore kept our 2018 growth forecast unchanged at 4.8%, while trimming our 2019 forecast by 0.1pp to 4.6%. The modest slowing in EM growth compares to a more pronounced drop-off in developed markets, which will see EM outperformance accelerate slightly over the next two years.

The largest downward revision to our GDP forecasts was to Argentina's growth forecast, where more aggressive fiscal austerity, coupled with contractionary monetary policy (the central bank has committed to a policy rate of 60.0% until inflation expectations decline), is set to weigh on consumption and curtail investment. We now forecast a more acute contraction in 2018 real GDP of 2.1%, compared to prior expectations of a 1.3% contraction. We also see Argentina's recession extending into 2019, with a 0.4% contraction in the economy compared with 2.0% expansion previously forecast. While we maintain our forecast for 2018 growth at 2.3% for regional competitor Mexico, we have revised down our 2019 forecast by 0.4pp to 2.1%, expecting negative effects of policy uncertainty under the new administration of President Andrés Manuel López Obrador to outweigh positives from greater clarity on US trade relations following the signing of the United States-Mexico-Canada Agreement (USMCA).

Other notable downward revisions to our growth forecasts for 2018 and 2019 in some South East Asian economies over December 2018 are in part due to their exposure to China's supply chains, and these include Malaysia (revised lower by 0.5pp to 4.6% for 2018,

and lower by 0.3pp to 4.2% in 2019), Hong Kong (-0.3pp to 3.3% and -0.5pp to 2.5%) and Thailand (-0.3 pp to 4.1% and -0.4pp to 3.5%). We also made some very minor downward adjustments to the Philippines in December 2018. Importantly, these changes follow on from downward revisions to our growth forecasts in countries such as Taiwan and South Korea in recent months, highlighting our expectations for slightly softer growth across the region.





# Index Tables

	Short-Term Political	Trend	Regional Rank	Global Rank
United Arab Emirates	86.7	+	1	8
Oman	81.3	+	2	21
Qatar	81.0	-	3	23
Kuwait	77.5	+	4	33
Bahrain	72.9	+	5	51
Saudi Arabia	71.7	-	6	57
Morocco	70.6	=	7	63
Jordan	63.1	=	8	95
<b>Iran</b>	<b>59.6</b>	<b>=</b>	<b>9</b>	<b>114</b>
Tunisia	56.9	-	10	127
Egypt	53.3	=	11	137
Algeria	52.3	=	12	142
Lebanon	46.7	=	13	160
Iraq	35.4	=	14	178
West Bank and Gaza	33.1	=	15	180
Syria	27.9	=	16	183
Libya	26.7	=	17	184
Yemen	19.6	=	18	187

Regional ave 56.5/Global ave 63.1/Emerging markets ave 59.3

	Long-Term Political	Trend	Regional Rank	Global Rank
United Arab Emirates	76.1	+	1	35
Jordan	71.2	=	2	57
Qatar	70.6	+	3	60
Morocco	69.2	=	4	68
Tunisia	68.6	=	5	72
Kuwait	66.4	=	6	74
Oman	64.8	-	7	81
Bahrain	57.5	=	8	112
Saudi Arabia	56.7	-	9	116
Algeria	54.4	=	10	126
Egypt	54.0	=	11	127
<b>Iran</b>	<b>54.0</b>	<b>=</b>	<b>11</b>	<b>127</b>
Lebanon	53.9	=	13	129
West Bank and Gaza	40.0	=	14	172
Iraq	36.7	=	15	175
Yemen	26.4	=	16	183
Syria	24.2	+	17	184
Libya	20.2	=	18	187

Regional ave 53.6/Global ave 61.8/Emerging markets ave 57.0

	Short-Term Economic	Trend	Regional Rank	Global Rank
Kuwait	67.7	+	1	38
Saudi Arabia	65.6	-	2	51
United Arab Emirates	61.5	-	3	63
Iraq	58.8	+	4	67
Qatar	55.4	-	5	77
Egypt	54.6	-	6	83
Algeria	53.3	-	7	87
Lebanon	50.8	-	8	95
Morocco	50.0	+	9	96
Oman	49.0	+	10	104
<b>Iran</b>	<b>44.8</b>	<b>+</b>	<b>11</b>	<b>126</b>
Bahrain	42.7	-	12	138
Libya	41.3	+	13	146
Jordan	39.0	+	14	155
West Bank and Gaza	36.3	+	15	163
Syria	32.7	+	16	175
Tunisia	32.5	=	17	176
Yemen	25.6	+	18	185

Regional ave 47.9/Global ave 53.4/Emerging markets ave 49.1

	Long-Term Economic	Trend	Regional Rank	Global Rank
Saudi Arabia	66.0	-	1	47
Kuwait	63.2	+	2	56
United Arab Emirates	62.3	-	3	61
Lebanon	57.7	+	4	72
Algeria	54.3	-	5	82
Qatar	54.0	-	6	85
Morocco	53.0	+	7	91
Egypt	51.0	-	8	106
Bahrain	49.6	-	9	114
Oman	49.5	+	10	115
Jordan	48.8	-	11	119
<b>Iran</b>	<b>46.9</b>	<b>-</b>	<b>12</b>	<b>125</b>
Iraq	45.1	-	13	134
Tunisia	44.3	+	14	138
West Bank and Gaza	39.6	+	15	157
Libya	39.0	+	16	163
Syria	31.5	+	17	181
Yemen	22.0	+	18	187

Regional ave 48.8/Global ave 54.8/Emerging markets ave 50.3

TABLE: IRAN – MACROECONOMIC DATA AND FORECASTS

	2018e	2019f	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f
Nominal GDP, USDbn	509.7	520.0	533.0	613.3	686.6	758.6	826.5	891.5	959.6	1,038.7	1,122.8
Nominal GDP, EURbn	424.7	435.2	438.7	496.6	553.7	606.8	661.2	713.2	767.7	830.9	898.3
Real GDP growth, % y-o-y	-0.5	-4.1	0.9	5.3	5.8	4.3	3.6	3.5	3.5	3.6	3.8
GDP per capita, USD	6,214	6,278	6,376	7,274	8,079	8,860	9,588	10,278	11,001	11,846	12,744
GDP per capita, EUR	5,177	5,254	5,248	5,890	6,515	7,088	7,671	8,222	8,801	9,476	10,195
Population, mn	82.01	82.82	83.59	84.31	84.98	85.61	86.19	86.73	87.23	87.68	88.10
Consumer price inflation, % y-o-y, ave	21.0	30.0	17.0	14.0	10.0	10.0	8.0	7.0	6.0	6.0	6.0
Lending rate, %, ave	15.0	15.0	13.0	10.0	8.0	8.0	8.0	7.0	7.0	7.0	7.0
Private final consumption, % of GDP	44.1	45.7	45.5	45.8	46.5	47.7	48.8	49.8	50.7	51.5	52.2
Private final consumption, real growth % y-o-y	-0.8	-1.4	0.8	4.0	4.6	4.2	4.0	4.0	4.0	4.0	4.0
Government final consumption, % of GDP	12.2	12.7	12.8	12.9	13.2	13.5	13.7	13.9	14.1	14.3	14.6
Government final consumption, real growth % y-o-y	3.8	-0.5	2.0	4.0	5.0	4.0	3.4	3.5	3.5	4.0	4.5
Fixed capital formation, % of GDP	14.3	11.7	10.4	9.5	9.2	9.0	8.9	8.9	8.9	8.9	8.9
Fixed capital formation, real growth % y-o-y	0.9	-2.0	1.0	3.0	6.0	5.5	5.3	5.0	5.0	5.0	5.0
Exchange rate IRR/USD, ave	39,882.50	48,500.00	56,000.00	57,000.00	57,500.00	58,000.00	58,250.00	58,750.00	59,000.00	59,000.00	59,250.00
Exchange rate IRR/EUR, ave	47,868.97	57,957.50	68,040.00	70,395.00	71,300.00	72,500.00	72,812.50	73,437.50	73,750.00	73,750.00	74,062.50
Budget balance, USDbn	-10.2	-17.3	-20.0	-20.6	-20.6	-22.3	-23.5	-24.7	-26.1	-27.6	-29.2
Budget balance, % of GDP	-2.0	-3.3	-3.7	-3.4	-3.0	-2.9	-2.8	-2.8	-2.7	-2.7	-2.6
Goods and services exports, USDbn	92.1	79.1	80.9	87.3	91.9	97.2	102.8	108.3	114.1	119.1	123.4
Goods and services imports, USDbn	81.4	76.8	76.2	79.0	82.0	84.6	87.1	89.6	92.1	94.6	97.0
Balance of trade in goods and services, USDbn	10.7	2.3	4.7	8.2	9.9	12.6	15.7	18.6	21.9	24.5	26.4
Balance of trade in goods and services, % of GDP	2.1	0.4	0.9	1.3	1.4	1.7	1.9	2.1	2.3	2.4	2.4
Current account balance, USDbn	11.2	2.9	5.3	8.9	10.6	13.4	16.5	19.6	22.9	25.6	27.6
Current account balance, % of GDP	2.2	0.6	1.0	1.5	1.5	1.8	2.0	2.2	2.4	2.5	2.5
Foreign reserves ex gold, USDbn	114.6	106.6	90.6	87.9	91.4	95.0	98.8	102.8	106.9	111.2	115.6
Import cover, months	15.7	14.2	13.8	13.9	13.9	14.0	14.2	14.3	14.5	14.7	0.0

e/f = Fitch Solutions estimate/forecast. Source: UN, CBI, Fitch Solutions



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