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Whitepaper

IRAN: Promise of riches, or a false awakening?

January 17 could mark a pivotal moment in Iran's economic history; the day Tehran shrugged off the shackles of Western-imposed sanctions and stepped back onto the global energy stage as a serious competitor. Or it may not.

A group of world powers comprising of the five permanent UN Security Council members Britain, France, Russia, China and the US plus Germany (P5+1) lifted sanctions on Iran in January following a comprehensive deal that was negotiated at a typically bureaucratic pace.

Iran's new economic freedom could reverse the fortunes of its struggling economy and open the biggest bonanza for international energy companies since the ouster of Iraqi President Saddam Hussein in 2003, especially as the Islamic republic is arguably a safer political and economic bet than Iraq.

International energy firms' appetite has already been well illustrated by foreign delegations flocking to Tehran; a city crossed off many companies' travel list during the sanctions era. While all are treading gingerly, there can be little doubt that interest amongst international firms in developing Iran's hydrocarbon resources is enormous.

TRICKY TERRITORY

Iran is re-emerging into a volatile market – oil prices have collapsed by around 75% since June 2014 and dipped below $30 a barrel (bl) in January, marking a 12-year low. Energy companies' accountants have curbed millions of dollars worth of oil and gas expenditure and tens of thousands of job cuts have dramatically shortened payrolls over the last six months. Total, Shell, BP and Lukoil are a small selection of some of the world's major energy companies eyeing new investment opportunities in Iran; the country is home to the world's second largest natural gas reserves and the fourth largest oil reserves. Change is on the way for Iran's domestic sector, which is dominated by state-run NIOC and its multiple subsidiaries, among the most important of which are National Iranian Drilling Company (NIDC), Iranian Offshore Oil Company (IOOC) and Pars Oil & Gas Company (POGC).

A tentative agreement was made between OPEC linchpin Saudi Arabia, Russia, Qatar and Venezuela in Doha on February 16 to 'freeze' production at January levels in a bid to address the global oil glut and boost the price to $50-$60/bl. The deal – noteworthy for the rare cooperation between OPEC and non-OPEC producers – gained unexpected traction, with Ecuador and other South American producers holding similar meetings shortly after. Iran's Oil Minister Bijan Namdar Zanganeh said that Iran will consider joining the negotiations once it recovers from sanctions and hits 4 million barrels a day (b/d) of oil production – roughly a 35% increase on today's 2.93m b/d.

LOFTY AMBITIONS?

Zanganeh maintains that the country can bring 1mn b/d of new oil supply per day to the market now that sanctions have been lifted – a confidence that triggered a 6.7% drop in WTI Brent prices on January 20. But it seems unlikely that Iran's energy infrastructure and current pot of cash is able to support the minister's plans – just yet.

Political eyes are focused on how the Sino-Iran ties – two major powers along the New Silk Road – will evolve. Following the first visit to Iran by a Chinese leader in fourteen years, the two countries agreed in January to expand trade to $600bn over the next decade – the historic Sino-Iran relationship is back on. A small collection of Chinese oil companies in particular were unwilling to pull out from Iran during the sanctions to retain a prime position for when the country's energy economy was revived.

Japan's Prime Minister plans to step on Iranian soil for the first time this year in nearly four decades, while Tehran and Indonesia are negotiating a short-term 120,000 b/d supply deal of Iranian crude, alongside a memorandum of understanding (MOU) to expand cooperation in the oil, gas and petrochemical sectors. Iran is also pursuing gas supply MOUs with Turkey, Oman and Europe, amongst others. While MOUs are often tools of political posturing, any public ties to Tehran are noteworthy following the country's exile from the global economic scene.

Within Central Asia, a sanctions-free Iran means that the 2,700km Iran-Pakistan-India gas pipeline – first touted in 2002 – could finally gain traction. Indian and Pakistani energy officials say the obvious economic and societal benefits of the gas pipeline through their lands could override their fractious relationship. However, given Pakistan's proximity to Iran, it is likely that Pakistan

A 115 year history and counting...

Iran's oil and gas industry is the oldest in the Middle East, stretching back to exploration in 1901 by a wealthy English adventurer and petroleum entrepreneur William Knox D'Arcy. D'Arcy won an oil concession from the Iranian government and subsequently struck oil at the Masjid-e Soleiman field in the country's southwest in 1908.

A year after first production at Masjid-e Soleiman started, Anglo-Persian Oil Company (APOC)—which has since become BP—was formed and tasked with extracting and marketing the oil produced in the southwestern region. The field would remain Iran's main crude source for some time, producing some 100,000 b/d by 1930. It is still pumping today - such resilience bodes well for Tehran's bold plans going forward.

"Competitive edges will need fine tuning, as Iran's tenacious appetite to push to the front of the global jostle for Asian and European clients remains unabated."

will be the immediate beneficiary of Iran's gas long before India. Such energy infrastructure plans are complex and demand significant investments – all of which will take time.

Political and economic clarity surrounding Iran's gas MOUs and pipeline projects is likely in 2016 and the country will not be a contender for Qatar's crown as the world's largest LNG exporter for a long while yet. Looking westwards, 1mn b/d of crude landed in Europe on the Monte Toledo oil tanker on March 6 – the first delivery of Iranian crude since mid-2012.

Closer to home, the escalating discord between the Middle East's vying hegemons, Saudi Arabia and Iran, will add another element of geopolitics into what is already a convoluted picture. The ongoing wars and security unrest in Syria, Libya, Iraq and Yemen have had a manageable impact on global oil supply. However, the significance of the long-running power struggle between Riyadh and Tehran gained momentum in January, following Saudi Arabia's execution of prominent Shia cleric Sheikh Nimr al-Nimr and the lifting of the P5+1 sanctions on Iran. Have accusations of proxy wars and economic angst set a potentially treacherous tone for 2016?

REVIVING STRAINED ECONOMICS

Iran's economy was hit hard by the United Nations (UN) and international bilateral sanctions imposed in 2006 and 2010. But it was the particularly stringent measures enacted by the US and the European Union (EU) in late 2011 and 2012 that had the most devastating impact on the local economy.

Fiscal challenges persist on the back of collapsing oil prices, multifarious geopolitics and non-performing bank assets. Economic performance has stalled in recent months with key sectors – notably manufacturing and construction – contracting and GDP growth expected to decelerate from 3% in 2014/2015 to around 0.5% in 2015/16, the International Monetary Fund (IMF) said.

Tehran may see GDP growth jump to 4-5.5% in 2016/17, as domestic energy production increases and the country's foreign assets flow back into the country. Still, to join other top emerging market economies – China and India, for example – Iran must continue to diversify its hydrocarbon economy and address unemployment amongst youth and women. Repeating the economic health check carried out in 2015 and strengthening communication linkages between government and suppliers and curbing public debt to banks would be good steps going forward.

The outlook is not as woeful as the figures suggest, as Iran has a wealth of cost-cutting acumen developed during the sanctions. Iran reduced its inflation rate from 45% in mid-2013 to less than 10% in 2015 – a move that helps reinvigorate investors' appetite and is in stark contrast to the overspending in other parts of the Middle East. Iran will have to spend billions on upgrading and expanding its oil and gas sector if it is to meet domestic requirements on the one hand and to meet its goal of becoming a growing oil and LNG exporter on the other. Latest estimates put Iran's cash needs at $185 billion (bn) through to 2020; $85bn for upstream oil and gas, $80bn for petrochemicals and $10bn each for downstream oil and gas. Navigating around nervy investors – especially those with US-links – could prove tricky.

Despite the challenges, global energy investors should not be fooled; Iran's reemergence will translate into a wake-up call for the Gulf, especially. Competitive edges will need fine tuning, as Iran's tenacious appetite to push to the front of the global jostle for Asian and European clients remains unabated. ■

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