

IRAN

The Forecast, 2018

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DOMESTIC POLITICS AND POLICY

Past patterns suggest that external pressure usually leads to greater cohesion in domestic politics. To some extent, recent developments in regional and international relations have compelled the Iranian administration and the Islamic Revolutionary Guard Corps (IRGC) to show unity and to cooperate on regional issues.

Furthermore, since Rohani's re-election the moderate forces around him and the centrist conservatives around Majles speaker **Ali Larijani** have decided to align their agendas in order to limit the space for extremists on both ends of the political spectrum.

While these alignments are positive phenomena, other issues are creating new political ructions. The most critical is the competition for the succession of the Supreme Leader.

Arch-conservatives who feel threatened by the centrist coalition wish to push for Ayatollah **Ali Khamenei** to be replaced by a cleric with similar conservative tendencies. But their preferred candidate, judiciary head **Sadegh Larijani** (Ali's younger brother), has been undermined by corruption allegations as well as a frontal political attack by former president Mahmoud Ahmadinejad.

Important signs to watch will be how Ahmadinejad manages to position himself and his camp as an 'opposition to the Larijani family' and any appointment by Khamenei or the Assembly of Experts (the organ that will elect the successor) that favour one faction over another.

The moderate forces are likely to converge further in 2018 in order to prevent hard-line domination of the top leadership beyond Khamenei. In response, hard-line forces will use external tensions, especially US pressure on Iran and Saudi-Iranian relations, to impose their footprint on policies – particularly through military and intelligence operations.

SECURITY

Iran generally has a positive track record on internal security. Though Tehran's very active role in defeating the so-called **Islamic State** (IS) has made the country a target for extremist attacks, soft intelligence and the presence of Iranian proxies in neighbouring countries have mitigated that risk.

Nonetheless, border regions to Iraq, Pakistan, and Afghanistan should be avoided for the foreseeable future due to cross-border terrorist activity.

Important signs to watch will be the actions of the IRGC intelligence unit, which is now operating more independently and representing the most hard-line elements in Iranian politics.

Activities such as arrests of dual citizens and harassment of foreign businesses will remain on the agenda as these forces try to impose themselves on the overall political map.

Greater cohesion among the centrist forces is nonetheless likely to gradually weaken the hard-line agenda over the upcoming year, though their opportunistic actions in response to external pressure will remain intact in 2018.

INTERNATIONAL AND REGIONAL AFFAIRS

Since the implementation of the nuclear accord, also known as the JCPOA, Iran has been normalising relations with the rest of the world, especially the European Union.

That has made three international players unhappy. The United States, Israel, and Saudi Arabia are all concerned about the gradual empowerment of Tehran in the post-JCPOA phase and will continue to use all instruments at their disposal to antagonise Iran.

The core question is whether these parallel animosities will lead to direct military confrontation or whether we will continue to see various proxy wars. The problem in anticipating developments in 2018 is that two of the four players – the administration of **Donald Trump** and Saudi Arabia under **Mohammad bin Salman** (MBS) – are relatively unpredictable.

While inherently anti-Iranian, the Trump administration will meet significant challenges in actively confronting Iran in 2018. It is faced with the North Korean crisis, on one side, and pressure from the major international powers not to withdraw from the JCPOA, on the other.

As far as MBS is concerned, his erratic actions against Yemen, Qatar, Lebanon, and other regional players have only weakened Saudi Arabia in its regional competition with Tehran. One can expect further confrontational approaches by Riyadh until inner-Saudi developments change the composition of power.

Tehran, in the meantime, will continue its two-track approach, i.e., a government that will look for opportunities to engage the Saudi government, and a military that will use opportunities to project regional power by expanding its proxy capabilities. These will include the missile programme that continues to irritate international players.

Important signs to watch will be the introduction of new anti-Iran sanctions

by the US Congress and the signing of executive orders by President Trump. Both types of action will be interpreted as a lack of US compliance with the JCPOA.

Furthermore, proxy confrontations between Iran and Israel in Lebanon, and between Iran and Saudi Arabia in the rest of the region, need to be monitored.

It is our assessment that all three external players – the Trump administration, Saudi Arabia, and Israel – will continue to put pressure on an Iran they believe has been emboldened by the lifting of sanctions and by regional developments. This pressure will take the form of continued proxy confrontations and will foster Iran's relations with the European Union, Russia, China, and Turkey.

Iranian moderate forces will continue to look for ways to defuse tensions, sometimes through indirect messages such as the recent decree by Ayatollah Ali Khamenei that Iran does not need to develop missiles with a range beyond 2,000 km.

The key risk factor in the year ahead is US policy under Donald Trump. A new wave of US sanctions would surely present serious challenges to Iran and undermine the outlook for major foreign investment, though it is not expected that these policies would bring about an end to the JCPOA.

These challenges will become more manageable as Tehran faces an increasingly favourable global climate, especially a more constructive relationship with the European Union.

ECONOMY

The Iranian economy is now firmly in a growth cycle, though challenges such as unemployment and inflation remain. Above-average growth in the services sector, especially tourism, health tourism, and IT start-ups, could act as positive game changers in the employment outlook.

In the country's post-JCPOA process of reintegration in the global economy, the continued hesitation of international first-tier banks to engage Iran has been the main impediment. The Iranian economy will need massive domestic and foreign investments, and for that reason, the following are key factors to monitor:

- improvements in the business climate;
- any new US sanctions on Iran-related business, as these will affect the willingness of international investors to engage the market;
- actual foreign investment activity, especially the materialisation of investment plans by major companies such as **Total SA**.

Furthermore, development in Iran-EU trade and investment relations will be significant. Iran's policy will be to encourage investment from as many Western companies as possible in order to deepen bilateral relations and to strengthen the EU's role in the Iranian economic and technological developments.

Relations between Iranian and international banks are likely to improve in 2018, mainly through the growing willingness of international second-tier banks to engage the country.

In addition, the EU will continue its favourable policies towards Iran, as it sees Tehran as one of the more stable powers in the complex region.

Iranian GDP can be expected grow by about 6% in 2018, though unemployment will remain a key issue due to demographic pressures. The upcoming year may also be the one in which Iran unifies the two exchange rates to promote greater market stability.

ENERGY

The oil and gas sector remains the backbone of the economy. Iran has successfully recovered from the period of

harsh sanctions, fully rehabilitating its oil production and export levels. That trend is set to continue in 2018 as production and export capacity expand.

Capacity is growing most quickly in the gas and gas liquids subsector. The availability of gas liquids and condensates allows Iran to export more liquids, in some cases through blending crude and condensate. The key impediment remains the challenges in financial transactions, though bottlenecks are being removed gradually.

It will be important to monitor the signing of new contracts with international companies in all sub-sectors, especially upstream oil and gas and petrochemicals. Iran expects to sign more than US\$20 billion in energy contracts in 2018.

In addition to upstream activities, Tehran will continue its push to invest in value-add sectors, especially refining and petrochemicals. The key focus will be on downstream petrochemicals – a field in which Iran has also successfully reached international markets.

The surprise factor in the energy sector has been renewable energy.

The massive investments in the sector will eventually make Iran an important producer of solar and wind energy and enhance its capacity to export electricity to regional markets. So far, Iran has signed agreements with 124 companies to install 2,380 MW in renewable capacity.

Furthermore, gradual investments in the LNG sector and improved gas production capacity will also make Iran a potential exporter of LNG, although this process won't be complete in 2018.

In the absence of significant external sanctions, the energy sector will continue to grow, empowering the country economically, financially, and technologically.

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IRAN STRATEGIC FOCUS HAS AN EXCELLENT TRACK RECORD OF PREDICTIONS ON IRAN

25 JANUARY 2013

ISF predicted a change in Iranian politics due to external pressures and economic difficulties that compelled Khamenei to open up the domestic political space. Most other analysts were predicting the continuation of the Ahmadinejad line with the election of Saeed Jalili:

“The Iranian political constellation will shift in 2013 – [read the full article](#)

14 JUNE 2013 – Hassan Rouhani is elected president of Iran.
— Source: Arms Control

21 JANUARY 2016

ISF accurately warned foreign investors of challenges associated with the implementation of the JCPOA and Iran's prospects as a new major frontier market:

“Improvement will be very gradual and will continue to be influenced by domestic, regional, and international developments” – [read the full article](#)

2016 – Rouhani set a target of \$50bn dollars in FDI, by year end he achieved \$11.8bn — Source: Financial Tribune

17 APRIL 2017

One month before the presidential elections, ISF predicted Rouhani's re-election despite economic challenges and Raissi's candidacy as the 'establishment candidate':

A turnout of some 30 million would undoubtedly produce a majority vote for Rohani – [read the full article](#)

19 MAY 2013 – Rohani is re-elected with 57% of the vote — Source: Reuters

29 JANUARY 2012

Whilst other analysts were predicting a military confrontation between Iran and the US, ISF correctly predicted the beginnings of positive nuclear negotiations:

“The key issue in nuclear negotiations will be to ensure a bill of clean health from the IAEA – [read the full article](#)

14 APRIL 2012 – Iran meets with the P5+1 in Istanbul for talks both sides call 'positive'. — Source: Arms Control

23 JANUARY 2015

ISF correctly predicted the emergence of the nuclear deal in 2015, and the victory of reformists and moderates in the Parliamentary elections:

“It is our prediction that the two sides [of the nuclear negotiations] will manage to sign a framework agreement – [read the full article](#)

14 JULY 2015 – Iran and the P5+1 announce a comprehensive nuclear deal — Source: Arms Control

10 JUNE 2016

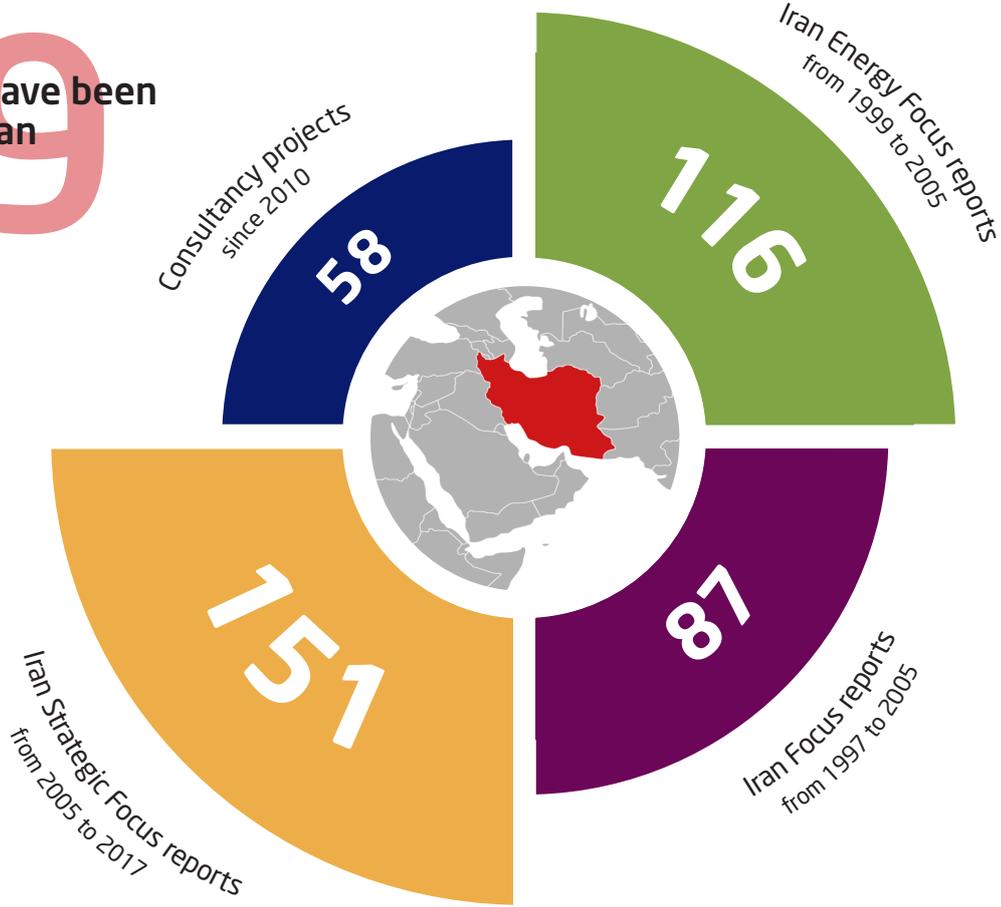
Analysts were debating whether NIOC would be able to adopt the new contractual framework (IPC) for agreements with IOCs, yet we predicted:

“As long as the moderates remain dominant, the overall trend will be towards greater engagement with IOCs within the confines of a potentially slightly amended IPC that should still provide a workable platform for future investments – [read the full article](#)

AUGUST 2016 – approval of the by-law governing the IPC
FEBRUARY 2016 – the Ministry of Petroleum, via NIOC, ran a competitive tender process for foreign companies to participate in up to 52 oil and gas field developments and 18 exploration blocks — Source: Law Business Research Limited

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