As the P5+1 and Iran enter the final days to conclude a nuclear agreement, the details of the emerging deal are becoming clearer. In the final deal, Iran is likely to receive substantial payments from oil assets currently held in escrow accounts. Sanctions on Iran's crude oil export transactions appear likely to be suspended, as will sanctions on key sectors of the Iranian economy including upstream energy investment and energy-related technology transfers, auto, petrochemicals, and shipping, as well as the precious metals trade. The timing of this sanctions relief is still being negotiated between Iran and the P5+1—the Iranian Supreme Leader has demanded an immediate lifting of all sanctions while the P5+1 position reportedly remains that sanctions relief will follow verifiable (but not necessarily irreversible) nuclear commitments.

Sanctions on Iran's central bank are also likely to be waived; many of Tehran's previously sanctioned banks will be de-designated; and, with the coordinated lifting of European banking sanctions, these banks will find their way back onto the SWIFT financial messaging system. The Obama administration is also likely to lift sanctions on many Iranian entities designated for their role in Iran's nuclear program. These “de-designations” reportedly may also include entities which were sanctioned for a variety of illicit activities, notably ballistic missiles, money laundering, and sanctions evasion, in addition to those that are strictly nuclear-related. Whether or not these de-designations will include specific Islamic Revolutionary Guard Corps (IRGC) entities, like NIOC (the National Iranian Oil Company), the giant IRGC conglomerate Khatam al-Anbiya, and IRGC banks remains an open question. Finally,
European economic sanctions, almost exclusively based on Iran's nuclear-related activities, will be terminated leaving Iran free to sell its oil, access insurance services, re-engage with European banks, and expand its trade in many key sectors.

The following report examines the impact of this sanctions relief on Iran's economy. It builds on previous Roubini Global Economics (RGE) and Foundation for Defense of Democracies (FDD) economic analysis reports which have measured and forecasted the economic impact of sanctions relief. Our previous analyses assessed that Iran would experience a moderate bounce-back in growth in FY 2014/15, which has been confirmed by Iranian officials at just over 3%. This new report concludes that, if Iran receives the sanctions relief as outlined above, the country is likely to experience moderate growth in FY 2015/16 followed by an acceleration of economic growth in FY 2016/17 as domestic investment begins to pick up. This report forecasts that Iran's economic growth will average about 3.5-4% after the initial two years of the agreement, suggesting it will slowly begin closing the output gap.

The economic impact of sanctions relief is likely to be substantial, starting slowly after an agreement and building over time. This relief will enable economic growth, and increased resilience against future sanctions-induced economic pressure. Iran will benefit from regained access to its foreign assets, reduced transaction costs that facilitate first greater imports, then some increase in oil export volumes, and finally investment at home and from foreign players. The enforcement of the emerging nuclear deal is predicated on the ability of the United States and the European Union to re-impose, or “snap” sanctions back into place if Iran violates its commitments. The efficacy of the snapback, however, will diminish as Iran builds a more powerful and resilient economy and international consensus over Iran's nuclear program weakens over time.

International sanctions were developed over decades. It took years before a critical mass of international companies terminated their business ties with Tehran. Once loosened, with many international companies positioning to get back into Iran, it will likely be difficult to persuade these companies to leave again should Iran violate the nuclear deal. Politically, snapbacks are also likely to be challenging to implement, regardless of agreed-to procedural mechanisms, because the United States, European states, and members of the U.N. Security Council are likely to disagree on the evidence, the seriousness of infractions, the appropriate level of response, and likely Iranian retaliation.

At the same time, the deal's limits on certain Iranian nuclear activities will lapse—or “sunset”—after ten years and many of the key nuclear restrictions will sunset after fifteen years. At that point, Iran will likely emerge with an industrial-sized and widely dispersed nuclear program—with an advanced centrifuge-powered enrichment


7. The output gap is the difference between the growth of Iran’s economy without sanctions and what it has experienced under sanctions.

capacity that will leave Tehran as a threshold-nuclear state with the “breakout” capability to enrich rapidly a bomb’s worth or more of weapons-grade uranium. At that point, when Iran could engage in a rapid breakout or a clandestine “sneak-out” to a nuclear weapon, U.S. and international leverage and ability to use economic pressure to peacefully deter Iran likely will be much weaker than at any time during the life of the agreement. Indeed, in the years leading up to that point, increasing Iranian economic resilience could make it more difficult to use economic pressure to respond to Iranian incremental cheating or stonewalling of weapons inspectors as Tehran “inches-out” to free itself from the existing restrictions on its program.

FDD has previously outlined a more effective way to provide smart sanctions relief. The relief plan should provide incentives for Iranian compliance with a nuclear deal while also predicating any suspension and eventual lifting of sanctions imposed for both nuclear and non-nuclear reasons like ballistic missiles, terrorism, money laundering, and sanctions evasion on verifiable steps by Iran to cease the conduct for which the sanctions were imposed in the first place. This new RGE-FDD report raises serious concerns about how the emerging nuclear agreement may affect the Iranian economy—and in turn, the ability of the United States and its allies to maintain sufficient leverage to effectively enforce an agreement that provides Tehran with an expanding nuclear program through a period in which economic pressure will be diminishing.

Macroeconomic Takeaways by Rachel Ziemba

The Near-Term Impact of Sanctions Relief

- The report assesses the impact of the reported sanctions relief on Iran’s economy in the next 18-24 months and how it might change Iran’s resilience to future sanctions pressure over the longer term. The impact of a deal depends not only on its composition, the sequencing of sanctions suspension, and the subsequent business decisions of Iran’s trading partners, but also on Iranian government policy choices around foreign investment and its use of increasingly accessible reserves and revenues.

- The economic benefits of a deal will build over time. The economic impact of sanctions relief will start slowly after an agreement and build over time. Iran will benefit from regained access to its foreign assets, reduced transaction costs that facilitate first greater imports, then some increase in oil export volumes, and finally investment at home and from foreign players. Under this scenario, after growing around 3.2% in 2014/15, Iran’s economic growth is likely to moderate at around 2.6% in FY 2015/16 (which ends in March 2016) and accelerate in 2016/17, as domestic investment picks up, consumption remains the key growth driver, and net exports become less of a drag as oil export volumes begin to pick up. Iran’s GDP growth could reach a 4%-plus pace as early as FY 2016/17 as its economy continues catching up from years of stagnation and recession and should remain at that pace in FY 2017/18. Should Iran’s government choose to save more of its foreign assets rather than spend them or should foreign actors be sluggish in picking up Iranian oil inventories or starting to invest, the pace of growth would be somewhat slower.

- More meaningful reforms to improve the business environment would be necessary to increase output growth beyond a 4% pace. Inflation will likely remain contained below 20% (admittedly high compared to global peers but sharply reduced from 2012-2013 period of sanctions escalation). The rial will be

relatively stable as oil export volumes partly offset the import surge, and an improvement in sentiment increases the willingness of local actors to hold Iranian assets.

- With the reported deal based on a plan to provide Iran with access to its frozen assets and suspend rather than lift several of the most impactful sanctions, the initial effects of the deal will be skewed toward supporting imports and improving Iran’s purchasing power by reducing transaction costs. Investment will lag, and will likely only become more pronounced in FY 2017/18 when foreign investors move beyond an initial phase. In addition to uncertainty about sanctions, Iran’s business climate remains a likely deterrent for investors, given the dominance of IRGC-linked groups in key sectors, a lack of investor protections, and the difficulty in accessing credit.

**Figure 1: Summary of Key Economic Indicators**

<table>
<thead>
<tr>
<th></th>
<th>2011/12</th>
<th>2012/13</th>
<th>2013/14</th>
<th>2014/15(f)</th>
<th>2015/16(f)</th>
<th>2016/17(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth (%)</td>
<td>3.7%</td>
<td>-6.6%</td>
<td>-1.9%</td>
<td>3.2%</td>
<td>2.6%</td>
<td>4.1%</td>
</tr>
<tr>
<td><strong>Real Total Consumption</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Growth (%)</td>
<td>2.9%</td>
<td>-2.6%</td>
<td>-0.6%</td>
<td>3.5%</td>
<td>4%</td>
<td>3.8%</td>
</tr>
<tr>
<td><strong>Reserves</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>92</td>
<td>104</td>
<td>118</td>
<td>130</td>
<td>120-150</td>
<td>125</td>
</tr>
<tr>
<td>Unrestricted</td>
<td>25</td>
<td>20</td>
<td>50*</td>
<td>N/A</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>CPI Inflation</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Average</td>
<td>21.5%</td>
<td>30.5%</td>
<td>34.7%</td>
<td>15.6%</td>
<td>16.7%</td>
<td>15%</td>
</tr>
<tr>
<td>End of Period</td>
<td>20.5%</td>
<td>41.2%</td>
<td>19.7%</td>
<td>17.2%</td>
<td>15%</td>
<td>17%</td>
</tr>
<tr>
<td><strong>Exchange Rate (IRR/USD, eop)</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Official</td>
<td>12,260</td>
<td>12,260</td>
<td>25,444</td>
<td>25,979 - 26,504</td>
<td>26,693 - 28,918</td>
<td>27,440 - 30,328</td>
</tr>
<tr>
<td>Unofficial/Black Market</td>
<td>19,050</td>
<td>34,325</td>
<td>30,250</td>
<td>33,100 - 34,100</td>
<td>32,479 - 34,488</td>
<td>32,840 - 36,402</td>
</tr>
<tr>
<td><strong>Per Capita</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Real GDP (2011=100)</td>
<td>100.0</td>
<td>93.4</td>
<td>91.6</td>
<td>94.4</td>
<td>97.0</td>
<td>101.4</td>
</tr>
<tr>
<td>Total Consumption</td>
<td>100.0</td>
<td>97.4</td>
<td>96.8</td>
<td>100.5</td>
<td>105.0</td>
<td>108.6</td>
</tr>
</tbody>
</table>

* The degree of unrestricted reserves is highly contingent on the terms of any final deal.

**Source:** Roubini Global Economics, Haver Analytics, International Monetary Fund, and Jutab Marin International Consulting Co.

- **Iranian government’s policy choices matter:** Sanctions relief provided under the Joint Plan of Action (JPOA) demonstrated that the way in which the Iranian government allocates resources within the economy will be pivotal to determining the scale, scope, and composition of growth patterns and deciding who benefits within the economy. This report assumes that the government will spend some of its foreign assets to support the real economy, carry out some modest structural reforms to improve the business climate, and gradually compromise on its terms with foreign investors in the pivotal energy sector. Failing to take any of these steps would temper the benefit of a deal to Iran’s economy and population. Additionally, the Iranian government might choose to spend more on supporting Iran’s
overseas military and terrorist activities, which would change the composition of growth domestically and could leave less for domestic projects.

- **After a bounce-back in 2014/15:** Economic activity bounced back in 2014 due in large part to sanctions relief provided under the JPOA, the decision by the Obama administration to de-escalate the sanctions pressure through the blocking of new sanctions legislation, improvements in sentiment towards the Iranian economy by domestic actors, and improved economic and fiscal policy choices by the Rouhani government compared to its predecessor which helped reduce inflation. With oil export volumes stabilizing around 1.1-1.3 mbd, and Iran regaining access to $11.9 billion in monies previously trapped in oil escrow accounts, domestic demand bounced back, inflation dropped, and there was a mini-boom in investment as construction projects restarted. Although domestic fixed investment levels in the economy remain well below 2011 levels, activity nonetheless picked up and growth averaged just over 3%, as highlighted in our February report.¹⁰

- **A slow start to 2015/16:** Since mid-2014, however, economic momentum has slowed, and we expect growth will decelerate to 2.6% (about 1 percentage point higher than in a scenario where the JPOA is extended indefinitely). Dashed hopes of immediate economic improvements to the average Iranian citizen, lower oil prices and greater austerity caused growth to stagnate at the end of the last fiscal year and early in the current fiscal year. While the trend partly reflects only a stabilization after the previous bounce-back, it does suggest that financial conditions remain tight and the private sector cautious about investing. Although a final deal will likely improve domestic sentiment as early as Q3 2015, uncertainty of implementation, lower oil prices, and tight domestic policy all suggest growth will be slow to pick up in the second part of the year, leaving gains to the future.

- **Oil is a drag:** Oil export volumes will pick up slowly, and low global oil prices, ample domestic oil inventories, and uncertainty about investment terms all suggest that new energy-sector output and investment will lag. Lower oil prices seem to have reduced the willingness of trading partners to increase oil volumes in the face of sanctions, and some buyers may remain cautious as they test the implementation of sanction suspensions. The decisions of key OPEC competitors like Saudi Arabia may also weigh on the speed at which buyers are willing to purchase cargos.

- **Benefits to build in 2016/17 and beyond:** With investors uncertain about remaining sanctions liability, counterparty risk, supply chain issues, as well as the terms they will receive from Iranian players, we assume investment will pick up slowly. Foreign investors will likely remain in the exploration phase, waiting for new contracts. By 2016/17, oil prices should increase towards a $75 average, supporting revenues, and government spending should support construction. In future years, investment could be a more meaningful driver of growth which should broaden out beyond consumption. However, investment will remain well below 2011 levels for the better part of the next decade.

- **‘No deal’ scenarios:** The negotiators could agree to extend the talks; alternatively, the negotiations could fail, triggering the imposition of new sanctions. An extension of talks would result in economic stagnation for Iran rather than a return to recession. If no deal is reached in the coming weeks and the negotiations continue through year end, Iran’s GDP growth would be weaker in 2015/16.

(closer to the 1.5% we forecasted in our February report\textsuperscript{11}) as the Iranian government hunkers down, holding back on spending its assets in the escrow accounts and purchasing fewer goods, even from the countries where it can use those locked-up funds. In the event of a breakdown in the talks, we assume Iran would rely more on barter agreements with Russia and China, which would be able to set prices and determine the terms of the trade relationship. The prospect of little new oil output might marginally increase global oil prices and Iran's oil revenues, but would do little to support growth. In the event of an outright failure in the talks, we envision a much more adverse outlook for Iran's economy, with growth flatlining and recession a possible risk if new sanctions are imposed. An outright failure in the negotiations could set in motion new sanctions, though the enforcement of these measures would depend on how the breakdown of the talks was interpreted in the international community and an assessment of the impact of U.S. secondary sanctions.

\textbf{Looking Ahead: Future Resilience and 'Snapback Sanctions'}

- In the next five-to-10 years, we assume Iranian growth would rise slightly above 3.5-4% if the government front-loads structural reforms, attracts meaningful investment, and avoids the development of asset bubbles. As with the short-term impact, Iran's economic growth path and its resilience to new sanctions depend on the policies its government takes today and in years to come to support investment and diversify its economy and funding structure. Should Iran's economy remain dominated by government- and military-linked entities and fail to clean up bad loans, it may settle into a lower pace of growth.

- The effectiveness of the snapback will likely diminish as Iran builds a more powerful and resilient economy. And we assume it would be difficult to gain the same consensus on Iran's nuclear program and on the appropriate response to Iranian violations five-to-10 years from now given the evolution of domestic trade patterns and other geopolitical developments (changes in Russia, China, Turkey, for example).

- A number of policy decisions will have a meaningful effect on the Iranian economy's resilience to snapback sanctions:
  
  1. \textbf{Asset allocation}: Where Iran's government chooses to put its assets will likely affect how difficult they are to target in a snapback scenario.
  
  2. \textbf{Choice of spending versus savings}: Should the Iranian government choose to deploy more of its revenue to local projects, it could result in stronger near-term growth, but it would reduce capital available for future projects or reduce the cushion against future shocks.
  
  3. \textbf{Investment terms for Iran's energy sector}: Should the terms be attractive enough to persuade international energy companies to return to Iran, investments could form a significant deterrent to the re-imposition of sanctions by their national governments.
  
  4. \textbf{Fiscal reforms}: Should Iran's government further rationalize spending or diversify financing sources domestically, its resilience to sanctions would increase.
  
  5. \textbf{Dominance of SOEs/IRGC and other entrenched players}: Will sanctions relief increase private competition against entrenched interests? Will this build up a domestic constituency with sufficient pressure to persuade the Iranian government to comply with a nuclear deal?

Or will the IRGC and other entrenched interests successfully resist greater competition and undermine Iranian nuclear compliance?

**The Policy Conundrum: Nuclear vs Economic Timelines**

Under the emerging Iran nuclear agreement, there is an inherent asymmetry between an expanding Iranian nuclear program and diminishing economic leverage. Tehran over time will be permitted to develop an industrial-sized nuclear program with zero or near-zero breakout and will build a strong economy increasingly immunized against future economic pressure—and the United States and its allies will increasingly lose economic leverage to peacefully prevent Iran from developing nuclear weapons.

The emerging deal does not link the sunset of restrictions on Iran's nuclear activities to a broader conclusion by the International Atomic Energy Agency (IAEA) that Iran is not engaged in any undeclared nuclear activities and its program is entirely peaceful in nature. The IAEA issues these so-called broader conclusions for states whose nuclear programs pose no proliferation concern because there is “no indication of diversion of declared nuclear materials from peaceful nuclear activities” and “no indication of undeclared nuclear material or activities.” On June 10, the IAEA issued the key findings from its latest safeguards implementation report and noted that the Agency had reached a broader conclusion for 65 countries.

In this latest report, the IAEA instead concluded about Iran:

> “Contrary to the relevant binding resolutions of the Board of Governors and the United Nations Security Council, Iran did not: implement the provisions of its additional protocol; implement the modified Code 3.1 of the Subsidiary Arrangements General Part to its Safeguards Agreement; suspend all enrichment related activities or suspend all heavy water related activities. Neither did Iran resolve the Agency’s concerns about possible military dimensions to Iran's nuclear programme. This resolution is necessary in order to establish international confidence in the exclusively peaceful nature of that programme.”

Rather than link the expansion of Iran's program to a broader conclusion, the deal will allow Iran to ramp up its nuclear program after an arbitrary ten-year period with many of the key nuclear restrictions sunsetting after fifteen years.

*Information in the following two tables is drawn from analysis of the U.S. fact sheet on the Joint Comprehensive Plan of Action (JCPOA) from April 2, 2015.***
Figure 2: Iran’s Nuclear Program Will Grow as Restrictions Expire:

| Years 0-10, Iran can:            | • Perform R&D on advanced centrifuges.  
|                                | • Continue to produce centrifuges and components.  
|                                | • Enriched uranium at Natanz up to 3.67%.  
|                                | • Maintain a stockpile of no more than 300 kg of 3.67% enriched uranium.  

| After 10 years, Iran can:       | • Increase the number of operating centrifuges enriching at Natanz beyond 5,060 IR-1s.  
|                                | • Operationalize advanced centrifuges at Natanz.  
|                                | • Reduce its breakout time to less than one year and then to near zero in years 13-15.  

| After 15 years, Iran can:       | • Build and operate an unlimited number of enrichment facilities.  
|                                | • Install and operate an unlimited number of existing centrifuges and advanced centrifuges.  
|                                | • Enrich uranium at Fordow.  
|                                | • Enrich uranium above 3.67%.  
|                                | • Increase its stockpile of LEU above 300 kg.  
|                                | • Build additional heavy water reactors and accumulate heavy water.  

| Permanent restrictions:        | • All spent fuel from modified Arak heavy water reactor shipped out of Iran.  
|                                | • No reprocessing or reprocessing R&D.  
|                                | • Iran implements the Additional Protocol and Modified Code 3.1.  

Figure 3: IAEA’s Access Will Diminish:

| After 20 years, the IAEA can no longer: | • Conduct continuous surveillance of centrifuge component manufacturers.  

| After 25 years, the IAEA can no longer: | • Have access to uranium mines and continuous surveillance at uranium mills.  

| Permanent access: | • IAEA will have certain access rights.  

As a result of this agreement, after fifteen years, Iran will likely have an industrial-sized and widely dispersed nuclear program, with unlimited advanced centrifuge capacity, virtually undetectable breakout, and multiple heavy-water reactors—all of which will be increasingly seen as legitimate by the international community.

Simultaneously, over time, the agreement will leave only residual economic leverage to peacefully deter Iranian nuclear weapons development because sanctions relief will enable Iran to expand its economy and build economic resiliency to future sanctions pressure.

Snapback sanctions (the re-imposition of sanctions in response to Iranian violations of its obligations) may be somewhat successful in the early years of the agreement when international companies are still reluctant to return to Iran, Tehran's economic recovery is still modest, and countries are still relatively united in their response to Iranian violations. However, snapbacks are likely to become much less effective in the later years. The international sanctions regime took decades to put in place and have an impact on Iran's economy and decision-making. In the later years of the agreement, international companies may have invested tens of billions of dollars back into Iran and will likely be less willing to forgo their business interests because of Iranian nuclear violations.

19. For a detailed analysis of the economic impact of the de-escalation of sanctions (since mid-2013), the optimism surrounding the election of President Rouhani (June 2013), the announcement of the JPOA agreement (November 2013), the announcement of the JPOA implementation agreement (January 2014), and the subsequent direct sanctions relief, see Mark Dubowitz & Paul Domjan, "New Sentiment Indicator Shows Positive Impact of Sanctions Relief on Iran's Economy," Foundation for Defense of Democracies & Roubini Global Economics, May 15, 2014. (http://www.defenddemocracy.org/content/uploads/documents/Final_Sentiment_Report.pdf)


23. Jeffrey Goldberg, "’Look ... It's My Name on This’: Obama Defends the Iran Nuclear Deal," The Atlantic, May 21, 2015. (http://www.theatlantic.com/international/archive/2015/05/obama-interview-iran-isis-israel/393782/)
It is also at this point, particularly after year ten of the agreement when key constraints on Iran’s nuclear program disappear, that economic leverage will be needed most to deter Iranian violations and to prevent Tehran from using its expanding nuclear infrastructure to move to a nuclear weapon.

Sunsets and snapbacks are fundamental design flaws of the emerging nuclear agreement. They give Iran an asymmetrical advantage as it expands its nuclear program under diminishing, and difficult-to-reestablish, economic pressure.

**Economic Impact of the Composition and Sequencing of a Final Deal**

Nuclear negotiators are currently working to finalize a deal which would include a sequencing of sanctions relief and nuclear concessions. Although the details of this agreement have yet to be revealed, the U.S. fact sheet on the parameters of the Joint Comprehensive Plan of Action (JCPOA) released on April 2, as well as press reports since then, give a framework for a possible final deal. We summarize the reported sanctions relief below and in Figure 6.

Key elements include:

1. Lump-sum payment reportedly of $30-50 billion in funds from Iran’s escrow accounts, with possible phased access to additional funds over the course of several months and access to new earnings from energy exports in the future.

2. Suspension of financial sanctions on Iran’s energy trade, which will remove the need for oil buyers to seek out “significant reduction” exceptions from the United States to engage in oil transactions with Iran.

3. Suspension of sanctions on key sectors like upstream energy investment, petrochemicals, shipping, and auto-related trade.

4. Sanctions on Iran’s central bank will be waived, many of its previously sanctioned banks will be de-designated, and, with the coordinated lifting of European banking sanctions, these banks will find their way back onto the SWIFT financial messaging system.

5. Lifting of gold and precious metals sanctions.

6. Termination (or suspension with snapbacks) of most, if not all, European economic sanctions including the EU oil embargo, banking and insurance sanctions, and sector-based sanctions.

7. Termination (or suspension with snapbacks) of U.N. sanctions which may diminish the international legitimacy of U.S. snapback sanctions and the willingness of countries and their companies to comply with these U.S. measures.

8. The measures are tilted toward allowing Iran access to assets that it has already accrued and reducing transaction costs on trade, which should give the Iranian government (and possibly other actors) more pricing power by allowing them to purchase goods from a wider range of suppliers. By having more suppliers to choose from, Iran would likely become less reliant on goods from China, which have dominated domestic investment. Over time the benefits could be much greater as Iran regains access to the global financial system and gains access not only to trade finance but also to a wider array of financing options. The degree of this benefit would depend on the progress towards lifting of sanctions related to anti-money laundering measures.


## Figure 6: Summary Impact of Near-Term Sanctions Relief

<table>
<thead>
<tr>
<th>Elements of Sanctions Relief</th>
<th>Type of Measure</th>
<th>Expected Impact</th>
<th>Comment/Signposts to Watch</th>
</tr>
</thead>
<tbody>
<tr>
<td>Access to 30-50 billion in FX savings</td>
<td>Access to assets</td>
<td>Facilitate imports from preferred trade partners, diversify imports.</td>
<td>Choice of import supplier could allow Iran to increase the quality of imports rather than buying primarily from key Asian economies. This could be impeded by logistical hurdles, uncertainty among foreign banks, and/or bureaucratic issues in Iran and partner banks abroad. Iran may also decide to save these funds or provide support to its regional allies including Hezbollah, the Assad regime in Syria, Iranian-backed Shia militias in Iraq, and Iranian-backed Houthi militias in Yemen.</td>
</tr>
<tr>
<td>Oil exports waiver relaxation</td>
<td>Suspended sanctions</td>
<td>Oil exports to grow from 1.3 mbd to 2 mbd over 12 months.</td>
<td>Export volumes would rise as waiver program is phased out. Ample supply of oil and Iranian unwillingness to discount crude could temper the increase in volumes. Iran would initially draw on oil inventories (volumes held in floating storage are estimated at 38-40 mb in NITC tankers, plus possibly a few non-NITC vessels) before it restarts mothballed production capacity and eventually increases investment pending new contracts with IOCs.</td>
</tr>
<tr>
<td>Insurance/Financial services</td>
<td>Suspended sanctions</td>
<td>Reduced transaction costs for non-oil trade, which reduce payments made to middle men.</td>
<td>Global banks may remain uncertain about implementation.</td>
</tr>
<tr>
<td>Petrochemical exports</td>
<td>Suspended sanctions</td>
<td>Modest increase in exports.</td>
<td>Glut of global petrochemicals (including from Saudi Arabia) may limit demand for Iranian exports. There are some signs that Iran is currently importing petrochemical products and plastics from China.</td>
</tr>
<tr>
<td>Auto trade</td>
<td>Suspended sanctions</td>
<td>Increase in output, parts imports, and domestic output that began in JPOA will continue.</td>
<td>Impact began already in 2014 and should continue to be concentrated on domestic production rather than exports. Iran has imported significant volumes of car parts and vehicles.</td>
</tr>
<tr>
<td>Precious metals trade</td>
<td>Suspended sanctions</td>
<td>Moderate increase in gold imports as one way to repatriate profits. An improvement in household purchasing power may also fuel some demand.</td>
<td>Gold trade seems to be picking up modestly and will likely be a part of Iran’s asset diversification. Still, underlying gold demand in Iran is likely to remain well below 2012 levels due to tight monetary policy (which reduces the appeal of non-interest-bearing assets).</td>
</tr>
<tr>
<td>Multiplier effect on non-oil trade</td>
<td>Indirect</td>
<td>Increase unsanctioned trade due to lower transaction costs (access to trade financing).</td>
<td>Non-oil exports are likely to continue to stagnate and fall slightly as Iran is no longer as concerned about maximizing revenue from other sectors given access to revenues. It would find it difficult to continue boosting non-oil revenues.</td>
</tr>
<tr>
<td>Improved sentiment/Investment</td>
<td>Indirect</td>
<td>Global sentiment toward Iran to improve, but investment to be modest when sanctions are suspended—or until companies do not believe that suspended sanctions will be re-imposed or penalties for sanction violations levied.</td>
<td>Sentiment has been on a bumpy upswing but has softened since late 2014 as policy has tightened and Iran’s private sector has been waiting for benefits.</td>
</tr>
</tbody>
</table>

*Source: Roubini Global Economics*
In summary, we would expect to see some improvement in growth momentum in the latter part of the current fiscal year (FY 2015/16), with Iran’s economy likely reaching a 4% growth rate in 2016/17 assuming that the government spends some of the assets it receives and is able to increase oil exports. We assume a slow return to growth in the current fiscal year for the following reasons:

1. Sanctions relief measures take time to build and will grow over time. The beginning of the current fiscal year seems to have been weaker than the previous fiscal year as Iranian fiscal austerity dampened growth, oil export revenues were softer, and trade volumes only slowly increased.

2. As a result of conservatism and a desire to save rather than spend funds, the Iranian government may continue to focus on building up its resilience to future shocks, including potential snapback sanctions, as it waits for foreign investors to come knocking. Fiscal and monetary policies in place are restraining the growth of domestic demand.

3. Weaker oil prices led to a modest decline in oil exports in the first half of 2015, and we forecast that the pick-up in export volumes will be moderate, in part because global demand for oil is growing only slowly while other key OPEC members have substantially increased supply. Saudi Arabia is focused on maintaining its market share rather than ceding space to Iran.

4. Import growth will be a drag on economic growth, particularly net exports, as most of the sanctions relief measures will facilitate Iran’s access to the revenues that it has already accumulated rather than encouraging investment in the short term. Moreover, Iran’s difficult business climate and the lack of clarity on terms for new investment may keep foreign investors cautious about moving from the exploration and MOU phases to actual investment.

5. Iran’s banks are ill-equipped to provide capital for new investment, and the private sector has few resources to do so, having been crowded out by IRGC-led entities and construction.

Key Iranian decisions—whether to spend the assets that are now unlocked or save them, where to keep these assets, whether to provide the population with access to foreign exchange, how much to spend on supporting its overseas military and terrorist activities, and, critically, what terms it offers to foreign investors in the energy sector and other crucial areas—will frame the impact of a final deal. Should Iranian authorities fail to recognize the extent of global competition in the energy sector, for example, and therefore fail to facilitate deals with attractive payouts and cost recovery, Iran might struggle to attract the necessary capital to revitalize its oil and gas sector.

In short, we assume that the most meaningful early impact of a final deal would be felt through improved consumer and investor sentiment and increased imports as Iran’s access to greater revenues facilitates imports and strengthens domestic demand. With most of these demands being met by imports, trade will be a drag on growth but Iran’s gross domestic income could increase. Moreover, the lifting of financial sanctions could increase the willingness of key export partners, initially in Asia, to increase oil export volumes. We assume that oil exports will pick up first, with investment in the sector lagging until Iran has run down some of its inventories in floating storage and until the Iranian government clarifies the terms of investing in the oil and gas sector. Indeed, investment will also lag until sanctions enforcement bodies like OFAC (the Office of Foreign Assets Control at the U.S. Treasury Department) offer more explicit guidance on what is allowed. Although European oil sanctions are likely to be lifted or suspended, we assume European oil companies will be slower to re-enter the market. Oil export volumes will likely be dominated by Asian economies and Turkey; though we could see some European companies more quickly enter the resale market.
The impact on the rial will be muted: Although increased oil export volumes will keep oil prices lower for longer in 2016, the increase in export volumes should still increase Iran's international revenues. Both of these trends (access to finance and stronger oil revenues) support an increase in domestic demand and imports. These, in turn, will limit the positive impact of the new reserves and sentiment on the Iranian rial, which we anticipate will rise only moderately. A meaningful increase in global oil prices and demand or stronger investment and portfolio inflows could trigger a stronger rial than we forecast. On a structural longer-term basis, the rial should still depreciate as Iran's inflation remains much higher than that of the United States.

Inflation likely to stay under control at around 20%: Stronger growth will bring moderate inflationary pressure to Iran; however, a gradually appreciating currency will help contain price pressures. Some increase in the ability of Iranian individuals to send money abroad will reduce the risk of asset bubbles re-forming in equity and property markets.

Investment picks up slowly: We assume domestic and international investment will only start to accelerate toward the end of 2017, with most of the benefits coming later in the decade. Investment cycles are long, given the need to carry out due diligence; corporate assessments of potential sanctions liabilities could extend this process further. The Iranian government could choose to prime the pump by investing in some public infrastructure projects or placing deposits with local banks in exchange for a commitment to lend these funds out to the private sector (as they seem to have done in the 2014/15 mini-investment boom). As we previously discussed, FY 2014/15 growth reflected a strong bounce-back in construction and investment, and prompted extensive imports from China. It is highly likely that the initial part of the new cycle would follow this pattern.


**Figure 8: Net Exports Become a Growth Driver Again in 2016 (contributions to GDP growth, percentage points)**

[Graph showing net exports, total consumption, gross investment, and GDP growth from 2012/13 to 2016/17]

*Source: Central Bank of Iran and Roubini Global Economics*

**Figure 9: Fixed Investment Remains Well Below Pre-Sanctions Levels, Even in 2016 (2010/11 = 100)**

[Graph showing GDP, private consumption, public consumption, and fixed investment from 2004/05 to 2016/17]

*Source: Central Bank of Iran and Roubini Global Economics*
Iran’s Economic Resilience Against Snapback Sanctions Will Grow Over Time

A key part of the reported deal as well as the Obama administration’s case to Congress is based on the assessment that sanctions can be snapped back into place if Iran fails to abide by its nuclear obligations and that such a “snapback” will be effective in imposing sufficient economic pressure to enforce an agreement. This report also assesses how the economic trends we discussed above will affect Iran’s economic resilience to renewed sanctions pressure five-to-10 years from now and beyond. As discussed earlier, it is at year ten when key restrictions on Iran’s nuclear program will expire, between years five and 15 when Iran can diminish its breakout time, and after year 15 when many more of the restrictions on Iran’s nuclear program will sunset. At that point, Iran can emerge with an industrial-size nuclear program with an advanced centrifuge-powered enrichment program that will bring Tehran to a virtually undetectable breakout capability.

While it is difficult today to model Iran’s economy over the longer term, we focus on some of the major signposts and policy measures that would impact its resilience and degree of vulnerability to new sanctions. Although our modeling focuses on the outlook for Iran’s economy over the next two years, we include some general considerations of the trends that will shape its economic growth over the coming five-to-10 years, which we assume could average 3.5-4% or higher, if the government front-loads structural reforms, attracts meaningful investment, and avoids the development of asset bubbles. As with the short-term impact, Iran’s economic growth path and its resilience to new sanctions depend on the policies its government takes today to support investment and diversify its economy and funding structure.

In general, we assume that it would be more difficult to reconstitute the sanctions regime as major U.S. and EU economic sanctions are suspended, even if several key sanctions, especially U.S. measures, remain on the books.

Source: Haver Analytics and Roubini Global Economics

Looking Ahead: Future Resilience and ‘Snapback Sanctions’

Figure 10: Levels of Crude Oil Output and Revenue Will Grow

![Graph showing levels of crude oil output and revenue growth over time.](image)

Crude and Oil Product Exports

Brent Crude

Crude and Oil Product Exports

Brent Crude


0 500 1000 1500 2000 2500 3000

0 20.0 40.0 60.0 80.0 100.0 120.0 140.0

IRAN’S ECONOMIC RESILIENCE AGAINST SNAPBACK SANCTIONS WILL GROW OVER TIME

15
The effectiveness of the “snapback” will likely diminish as Iran builds a more powerful and resilient economy. And, we assume it would be difficult to gain the same consensus on Iran’s nuclear program and on the appropriate response to Iranian violations five-to-10 years from now given the evolution of domestic trade patterns and other geopolitical developments (changes in Russia, China, Turkey, among others).

The following policy decisions will have a meaningful effect on the Iranian economy’s resilience to new sanctions:

1. **Asset allocation:** Should Iran’s government choose to save the newly freed-up funds—perhaps in foreign currency onshore (within Iran) or in jurisdictions less likely to comply with snapback sanctions in order to reduce the risk that its assets could be frozen in any future sanctions process—the economy would be more resilient to future sanctions.

2. **Choice of spending versus savings:** Iran’s $150 billion in FX reserves, a number suggested by the U.S. government, are still relatively small compared to GDP (and to Iranian infrastructure and bank recapitalization needs) but more than seven times the estimated size of Iran’s fully accessible FX reserves prior to the JPOA and equal to about two to three years of oil revenues at the current price and pace of production. Should the Iranian government choose to deploy more of its revenue to local projects, it could result in stronger near-term growth, but it would reduce capital available for future projects or reduce the cushion against future shocks.

3. **Investment terms for Iran’s energy sector:** Should the terms be attractive enough to convince international oil companies and other national oil companies to begin investing significant sums of money in Iran’s energy sector, these returns on capital and domestic labor could form a significant deterrent to governments that might otherwise re-impose sanctions in response to Iranian non-compliance with its obligations under the nuclear deal. International companies that reinvest in Iran are likely to put pressure on national governments not to re-impose measures that would increase sanctions on both their Iranian counterparts and foreign players and limit their own ability to do business with Iran. Furthermore, as European companies reinvest in Iran, the United States may be less likely to re-impose sanctions that penalize its European allies in a snapback scenario.

4. **Fiscal reforms:** A combination of sanctions and lower oil prices in 2012-14 encouraged Iran’s government to first increase its revenues from non-energy sources and to scale back government spending to levels that it could afford. The government has also reduced transfer payments and subsidy payments. Should Iran’s government further rationalize spending or diversify financing sources domestically away from energy, its resilience to sanctions would change.

5. **Dominance of SOEs/IRGC and other entrenched players:** State-owned enterprises and banks, as well as thousands of IRGC-controlled entities, including key pillars of the Iranian economy such as NIOC (the National Iranian Oil Company) and the IRGC conglomerate Khatam al-Anbiya, have increased their role in Iran’s economy. These entities received privileged access to finance, billions of dollars in no-bid government contracts, and engaged in sanctions busting. To the extent that these entities now face greater competition from private enterprises (unlikely in the near term; possibly in the medium term), this could increase the number of Iranians who are supportive of the deal and may put some

---

26. Jeffrey Goldberg, ““Look ... It’s My Name on This’: Obama Defends the Iran Nuclear Deal,” *The Atlantic*, May 21, 2015. (http://www.theatlantic.com/international/archive/2015/05/obama-interview-iran-isis-israel/393782/)

pressure on the Iranian government to avoid violations that trigger an imposition of sanctions. One must, however, be cautious in overstating this given the entrenched interests that may resist greater competition and undermine Iranian nuclear compliance.

**Figure 11: Local Banks Are Unlikely to Support Demand (Growth in loans, % y/y)**

*Source: Haver Analytics and Roubini Global Economics*
The Foundation for Defense of Democracies is a non-profit, non-partisan policy institute dedicated exclusively to promoting pluralism, defending democratic values, and fighting the ideologies that drive terrorism. Founded shortly after the attacks of 9/11, FDD combines policy research, democracy and counterterrorism education, strategic communications, and investigative journalism in support of its mission.

FDD focuses its efforts where opinions are formed and decisions are made, providing cutting-edge research, investigative journalism and public education - transforming ideas into action and policy.

FDD holds events throughout the year, including the Leading Thinkers series, briefings on Capitol Hill, expert roundtables for public officials, diplomats and military officers, book releases, and panel discussions and debates within the policy community.

Roubini Global Economics (RGE) is the independent, global macroeconomic strategy research firm built by world-renowned economist Nouriel Roubini.

Roubini research combines expert insight with systematic analysis to translate economic, market and policy signals into actionable intelligence for a wide range of financial, corporate and policy professionals. This holistic approach uncovers opportunities and risks before they come to the attention of markets, helping clients arrive at better decisions in a timelier manner.

Roubini is headquartered in New York, with offices in London and Singapore.

FDD’s Center on Sanctions and Illicit Finance (CSIF) provides policy and subject matter expertise in areas of illicit finance, financial power, and economic pressure to the global policy community.

CSIF seeks to illuminate the critical intersection between the full range of illicit finance and national security, including money laundering, terrorist financing, sanctions evasion, proliferation financing, cyber crime and economic espionage, and corruption and kleptocracy. This includes understanding how America can best use and preserve its financial and economic power to promote its interests and the integrity of the financial system. The Center also examines how America’s adversaries may be leveraging economic tools and power.

For more information, please visit www.defenddemocracy.org/csif.