Fitch Solutions

Q4 2020

Iran

Country Risk Report

Includes 10-year forecasts to 2029

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Executive Summary

Core Views

- We at Fitch Solutions forecast Iranian real GDP growth at -4.1% in 2020, marking the third consecutive year of contraction in the country's sanctions-hit economy. The Covid-19 pandemic and related social distancing measures have severely disrupted activity and trade, and the government has limited fiscal firepower with which to soften the blow for local businesses and households.

- Q220 will probably mark the lowest point in growth as Iran's partial lockdown was eased in May, although risks of a 'second wave' of infections and fresh restrictions on activity are evident. We expect the economy will return to moderately positive growth in 2021 as the impact of the Covid-19 crisis eases.

- In the medium term, Iran's economic prospects will depend on its relationship with the US and the future of the US sanctions regime. We see some scope for an improvement in bilateral ties from next year onwards, especially in the event that a Democratic candidate wins the US presidential elections in November 2020. A subsequent return to the nuclear deal would provide Iran with much-needed sanctions relief, facilitating trade and investment.

- That said, we also see substantial risks of a further escalation in US-Iran tensions, which could see Tehran pursue a more aggressive nuclear policy and/or regional military expansion that further isolates it from its trade partners (including China). This scenario would likely prolong the country's ongoing recession, and potentially also trigger a sharp economic adjustment further down the line, for example in the form of hyperinflation.

Key Risks

- Tighter US sanctions enforcement or greater international compliance with sanctions would exacerbate already-dire economic conditions inside Iran. 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. In addition, the Covid-19 pandemic and ongoing slump in oil prices will disrupt activity and restrict the government's fiscal policy space. The rial, as a result of these dynamics, will remain weak and inflation will stay elevated, weighing on domestic investment and consumption.

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 large-scale protests that have taken place across the country in the past year. 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 up 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 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' withdrawal from the nuclear deal, then this could damage trade relations with China, Russia, India and others.

Political – SWOT Analysis

Strengths

- The Trade relations are maintained with countries such as China, Russia and Turkey, providing a lifeline to the economy.
- The government remains able to subsidise basic goods imports and fund welfare programmes, reducing near-term 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.
- 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

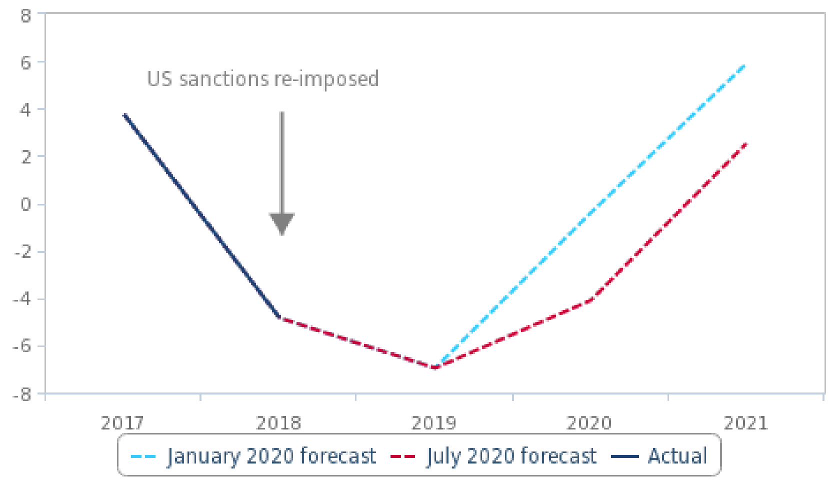
Iran To Experience Third Consecutive Year Of Recession In 2020 As Covid-19 Hits

Key View

- We at Fitch Solutions forecast Iranian real GDP growth at -4.1% in 2020, marking the third consecutive year of contraction in the country's sanctions-hit economy.
- The Covid-19 pandemic and related social distancing measures have severely disrupted activity and trade, and the government has limited fiscal firepower with which to soften the blow for local businesses and households.
- Q220 will probably mark the lowest point in growth as Iran's partial lockdown was eased in May, although risks of a 'second wave' of infections and fresh restrictions on activity are evident.
- We expect the economy will return to moderately positive growth in 2021 as the impact of the Covid-19 crisis eases. In the medium term, Iran's economic prospects will likely depend on its relationship with the US and the future of the US sanctions regime.

Post-Sanctions Shock Recovery Delayed By Covid-19

Real GDP Growth, % y-o-y (January Vs July 2020 Fitch Solutions Forecasts)



Source: UN, CBI, Fitch Solutions

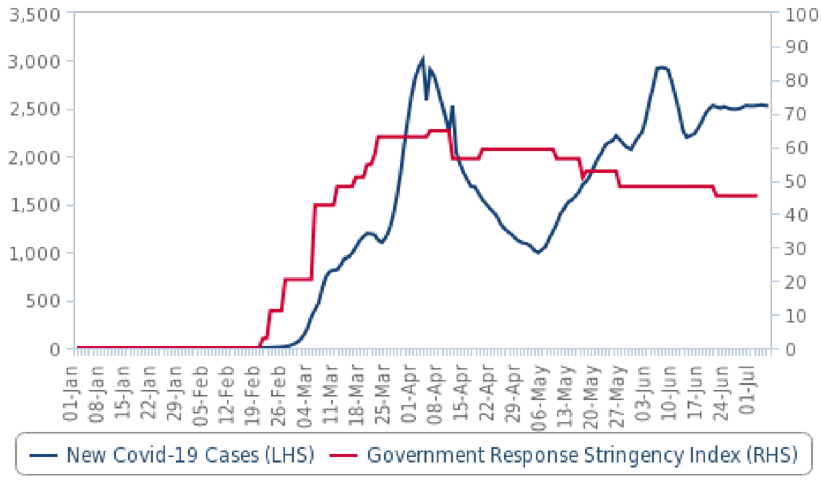
We forecast Iranian real GDP growth at -4.1% in 2020, compared with an estimated -7.0% in 2019. This would represent the third consecutive year of steep contraction in Iran's economy, which was negatively affected by the re-imposition of US sanctions in November 2018. Initially, we had expected the economy to somewhat stabilise over 2020 as the impact of the initial sanctions shock faded, but the Covid-19 pandemic has caused severe disruptions to local activity and trade, delaying this recovery.

Iran is the country hardest hit by the Covid-19 outbreak in MENA, counting over 240,000 confirmed cases and more than 11,000 deaths (as of July 5). In a bid to contain the virus, the government imposed a range of social distancing measures over March and April, including partial air travel restrictions, the closure of schools, malls, markets and religious sites, bans on social gatherings and inter-city travel, and the closure of public offices for two weeks. These measures in turn caused severe disruptions to local economic activity, reflected in a sharp drop in Purchasing Managers' Index (PMI) readings.

Meanwhile, government stimulus in response to the crisis has been limited, reflecting the country's deteriorating fiscal and external dynamics. Iranian fiscal revenues have reduced sharply in recent years as a result of falling oil exports and oil prices, as well as declining tax earnings (amid the ongoing economic recession). Consequently, the government's ability to scale up spending in support of local households and businesses affected by Covid-19 and related restrictions is heavily constrained. Indeed, additional funding for cash transfers to vulnerable households and unemployment benefits amounts to just 0.6% of GDP in total. The value of subsidised loans made available to households and businesses impacted by the crisis stands at around 4.4% of GDP, but these are generally not interest-free. Some businesses have received extensions on tax payments, but only for a period of three months.

Partial Lockdown Introduced In March-April In Response To Large Localised Virus Outbreak

Daily New Covid-19 Cases & Government Response

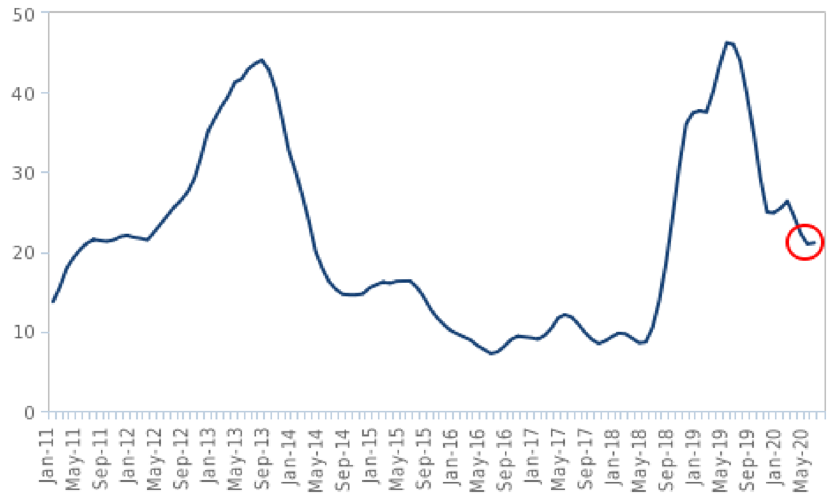


Note: Stringency Index is a composite measure based on 9 response indicators including school closures, workplace closures, and travel bans, rescaled to a value from 0 to 100 (100 = strictest response). Source: Our World In Data, Oxford University, Fitch Solutions

The rial has depreciated sharply against the dollar on the parallel market as well, despite central bank liquidity injections (reportedly amounting to USD1.5bn). This has likely been driven by a steep decline in exports as a result of the virus outbreak (which has weakened external demand and disrupted supply chains), and, according to the central bank, the refusal of some exporters to repatriate their proceeds. The weakening exchange rate is resulting in shortages and rising costs of imported goods, thus fuelling inflation, which – while still elevated – had been on a decelerating trend for the past year. Indeed, recent data from the Statistical Center of Iran show year-on-year inflation at 22.5% in June, up from a multi-month low of 19.8% in April. Rapid price growth is in turn eating into local households' purchasing power and businesses' profit margins, weighing on domestic demand.

Amid these pressures, the government has decided to ease social distancing measures – suggesting Q220 may mark the lowest point in growth. Most restrictions on movement and activity were lifted in May, and as a result, business conditions appear now to have improved, with the PMI headline reading jumping up to 50.2 between April 20 and May 20 from 28.1 in the preceeding month. This bodes relatively well for business activity over the remainder of 2020, although we caution that local Covid-19 cases have spiked up in recent weeks, highlighting risks of a 'second wave' of infections resulting in the re-imposition of a partial lockdown. This could also occur in Iran's key export markets, once again dragging down export demand. As such, risks to our current GDP growth forecast for FY2020/21 appear heavily weighted to the downside. In 2021, we expect the economy to stabilise somewhat as the impact of the Covid-19 crisis eases. By then, the initial shock of the re-imposition of US sanctions will also have faded, facilitating a return to positive real GDP growth of around 1.8%. Beyond this, Iran's economic prospects will primarily be determined by Tehran's relationship with Washington, and the future of the US sanctions regime.

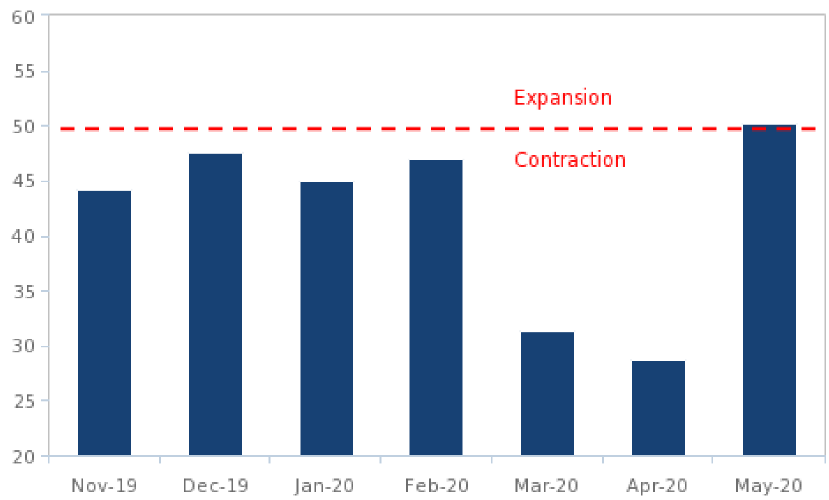
FX Shortages Halting Multi-Month Slowdown In Inflation
Annual Inflation, 3mma



Source: CBI, Fitch Solutions

We see some scope for an improvement in bilateral ties from next year onwards, especially in the event that a Democratic candidate wins the US presidential elections in November 2020. A subsequent return to the nuclear deal would provide Iran with much-needed sanctions relief, facilitating trade and investment.

PMI Readings Suggest Business Conditions Improving After Difficult Q2
Purchasing Managers' Index (Headline)



Source: Iran Chamber of Commerce, Industries, Mines and Agriculture, Fitch Solutions

We also see substantial risks of a further escalation in US-Iran tensions, which could see Tehran pursue a more aggressive nuclear policy and/or regional military expansion that further isolates it from its trade partners (including China). This scenario would likely prolong the country's ongoing recession and potentially also trigger a sharp economic adjustment further down the line, in the form of hyperinflation.

GDP By Expenditure Outlook

Key View: *Iran's economy will be weakened by the re-imposition of US nuclear-related sanctions in H218, and the ongoing slump in oil prices. Even in the event that international sanctions compliance falters significantly, or oil prices recover, 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 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. 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, than we could conceivably see a

TABLE: GDP GROWTH FORECASTS

	2018e	2019e	2020f	2021f	2022f	2023f
Nominal GDP, IRRbn	19,332,545.0	22,075,386.4	26,378,999.3	30,846,429.2	36,312,520.3	41,749,567.9
Real GDP growth, % y-o-y	-4.8	-7.0	-4.1	2.5	7.1	6.0
GDP per capita, IRR	248,886,673.9	266,244,680.2	314,062,068.2	404,782,116.7	437,476,568.4	484,187,604.0
	2024f	**2025f**	**2026f**	**2027f**	**2028f**	**2029f**
Nominal GDP, IRRbn	46,549,636.6	51,311,729.1	56,118,391.1	61,411,211.1	67,095,805.0	73,411,612.0
Real GDP growth, % y-o-y	4.7	4.3	4.3	4.4	4.2	4.2
GDP per capita, IRR	531,896,092.7	580,458,540.0	626,163,803.3	679,080,382.7	738,739,907.2	801,721,724.8

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

TABLE: PRIVATE CONSUMPTION FORECASTS

	2018e	2019e	2020f	2021f	2022f	2023f
Private final consumption, IRRbn	8,692,064.6	10,760,776.0	13,063,582.0	15,088,437.3	17,110,287.8	19,539,948.7
Private final consumption, % of GDP	45.0	48.7	49.5	48.9	47.1	46.8
Private final consumption, real growth % y-o-y	-6.4	-4.2	-3.6	1.5	3.4	4.2
	2024f	**2025f**	**2026f**	**2027f**	**2028f**	**2029f**
Private final consumption, IRRbn	21,884,742.6	24,292,064.3	26,721,270.7	29,393,397.7	32,038,803.5	34,922,295.9
Private final consumption, % of GDP	47.0	47.3	47.6	47.9	47.8	47.6
Private final consumption, real growth % y-o-y	4.0	4.0	4.0	4.0	3.0	3.0

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

sharper increase in spending levels, in order to address some of the Iranian people's economic grievances, or fund military crack-downs. In turn, inflation would be likely to spike.

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 2019-2020 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: GOVERNMENT CONSUMPTION FORECASTS

	2018e	2019e	2020f	2021f	2022f	2023f
Government final consumption, IRRbn	2,495,149.0	3,106,460.5	3,814,733.5	4,425,090.9	5,084,429.5	5,796,249.6
Government final consumption, % of GDP	12.9	14.1	14.5	14.3	14.0	13.9
Government final consumption, real growth % y-o-y	-8.6	-3.5	-2.2	2.0	4.9	4.0
	2024f	**2025f**	**2026f**	**2027f**	**2028f**	**2029f**
Government final consumption, IRRbn	6,462,818.3	7,141,414.2	7,819,848.6	8,601,833.4	9,505,025.9	10,550,578.8
Government final consumption, % of GDP	13.9	13.9	13.9	14.0	14.2	14.4
Government final consumption, real growth % y-o-y	3.5	3.5	3.5	4.0	4.5	5.0

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

TABLE: FIXED INVESTMENT FORECASTS

	2018e	2019e	2020f	2021f	2022f	2023f
Fixed capital formation, IRRbn	3,552,293.9	2,675,514.0	2,373,725.3	2,491,864.7	2,656,520.0	2,856,276.2
Fixed capital formation, % of GDP	18.4	12.1	9.0	8.1	7.3	6.8
Fixed capital formation, real growth % y-o-y	-3.8	-4.0	-14.5	1.3	3.0	4.0
	2024f	**2025f**	**2026f**	**2027f**	**2028f**	**2029f**
Fixed capital formation, IRRbn	3,097,260.1	3,355,201.7	3,631,194.3	3,926,398.2	4,242,044.5	4,579,439.4
Fixed capital formation, % of GDP	6.7	6.5	6.5	6.4	6.3	6.2
Fixed capital formation, real growth % y-o-y	5.0	5.0	5.0	5.0	5.0	5.0

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

TABLE: NET EXPORTS FORECASTS

	2018e	2019e	2020f	2021f	2022f	2023f
Net exports of goods and services, IRRbn	271,459.4	578,424.4	686,483.5	1,176,871.3	2,647,493.1	3,421,235.1
Net exports of goods and services, % of GDP	1.4	2.6	2.6	3.8	7.3	8.2
Net exports of goods and services, real growth % y-o-y	-47.4	-61.1	-40.8	28.8	401.8	48.6
	2024f	**2025f**	**2026f**	**2027f**	**2028f**	**2029f**
Net exports of goods and services, IRRbn	3,651,295.8	3,695,106.7	3,707,061.7	3,684,274.1	3,766,039.6	3,885,578.4
Net exports of goods and services, % of GDP	7.8	7.2	6.6	6.0	5.6	5.3
Net exports of goods and services, real growth % y-o-y	11.4	3.0	3.0	3.0	6.5	6.5

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

10-Year Forecast

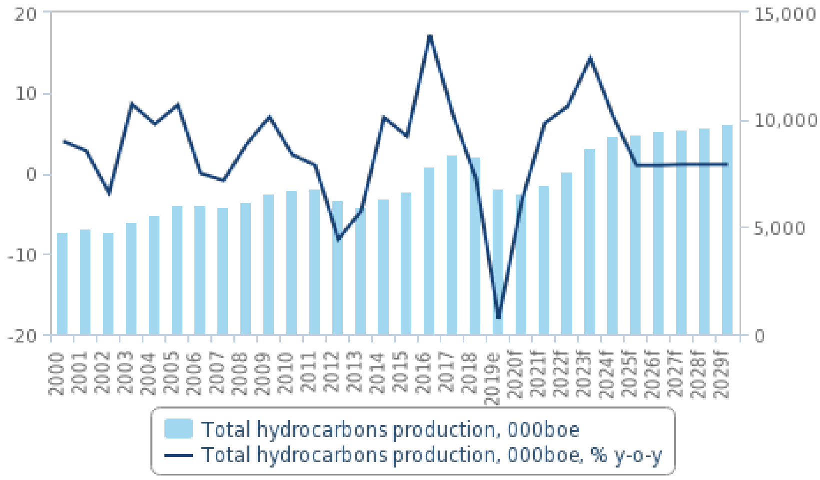
The Iranian Economy To 2029

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: National sources, 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 around 3.5% over the 2020-2029 period, far below pre-sanction highs.

TABLE: LONG-TERM MACROECONOMIC FORECASTS

	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f	2029f
Nominal GDP, USDbn	628.1	649.4	660.2	726.1	799.1	873.4	951.2	1,040.9	1,132.4	1,228.6
Real GDP growth, % y-o-y	-4.1	2.5	7.1	6.0	4.7	4.3	4.3	4.4	4.2	4.2
Population, mn	83.99	85.03	86.02	86.98	87.89	88.77	89.62	90.43	91.21	91.95
GDP per capita, USD	7,477	7,637	7,675	8,348	9,092	9,838	10,612	11,509	12,415	13,362
Consumer price inflation, % y-o-y, ave	25.0	14.0	10.0	10.0	8.0	7.0	6.0	6.0	6.0	6.0
Current account balance, % of GDP	-0.8	-0.8	-0.7	-0.5	-0.4	-0.2	-0.1	0.0	0.2	0.3
Exchange rate IRR/USD, ave	42,000.00	47,500.00	55,000.00	57,500.00	58,250.00	58,750.00	59,000.00	59,000.00	59,250.00	59,750.00
Parallel IRR/USD, eop	47,000.00	52,500.00	60,000.00	62,500.00	63,250.00	63,750.00	64,000.00	64,000.00	64,250.00	64,750.00

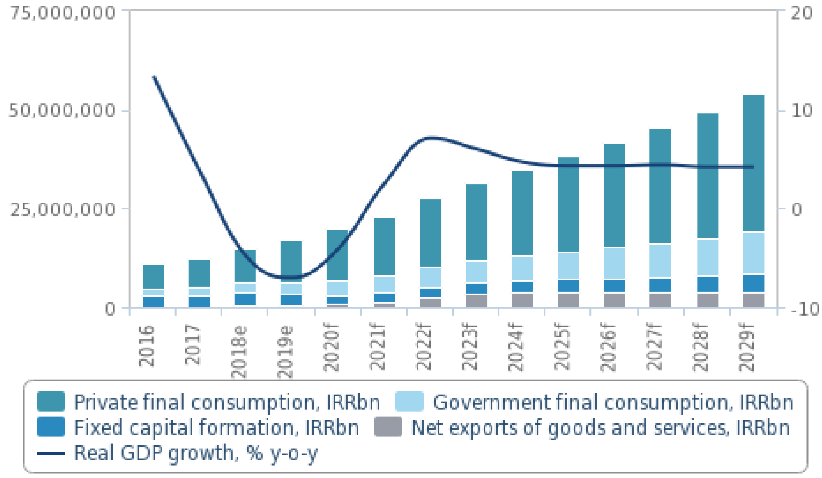
f = Fitch Solutions forecast. Source: UN, CBI, Fitch Solutions

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.

Consumer To Drive Positive Growth Outlook

Macroeconomic Forecasts



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

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.

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 2018-2019, 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 (80) 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

Q&A: US Push To Extend Iran Arms Embargo – Implications And Risks

Key View: *The US is pushing for an extension of the UN conventional arms embargo on Iran, due to expire in October 2020 under the terms of the 2015 Joint Comprehensive Plan Of Action ('nuclear deal'). The Trump administration has specifically stated it is looking to extend the embargo 'indefinitely' via a new UN Security Council resolution, in order to prevent Iran from exporting arms to non-state actors (such as Lebanon's Hezbollah and the Houthis in Yemen), and importing equipment that could help Tehran pose a greater direct threat to the US and its allies in the region. Should the extension not be granted, then the Trump administration has threatened to exercise the nuclear deal's 'snapback' mechanism, which in theory would restore all the UN sanctions on Iran that were lifted as part of the deal. In this Q&A article, we discuss the prospects for an embargo extension, and the potential implications of such a move. We also take a look at possible responses from Iran, and outline our core view for future developments in US-Iran relations.*

Is The UN Arms Embargo On Iran Likely To Be Extended?

At Fitch Solutions, we view it as unlikely that the UN will pass a new formal resolution to extend the embargo indefinitely or for a prolonged period of time. Many Security Council members share the US' concerns that easing restrictions on Iran's arms trade could help it transfer military equipment to proxies and improve its direct strike capabilities – thus negatively impacting regional stability.

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 21 2021
	Presidential – May 19 2017
Next election	Parliamentary – February 2024
	Presidential – 2021
Key figures	Mayor of Tehran: Pirouz Hanachi, Speaker of parliament: Mohammad Bagher Ghalibaf, Chairman of the Assembly of Experts: Ahmad Jannati
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 Rezaii; 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 rapproachment 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 make-up	Hardliners-Conservatives – 221 seats (76%), Reformists – 20 seats (7%).
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	54.1

Source: Fitch Solutions

This includes the European signatories to the nuclear deal, namely France, Germany and the UK (the 'EU3'); indeed, the EU has a separate arms embargo in place on Iran until at least 2023. That said, the EU3 seem to view the threat of a nuclear-capable Iran as comparatively greater than an uptick in Iran's conventional weapons trade (which in any case would be restricted by separate embargoes, separate regulations for advanced equipment such as missile technology, and Iranian budget constraints). Iran has indicated it may quit the Joint Comprehensive Plan Of Action (JCPOA) and scale up nuclear development should the UN embargo be extended – which in turn suggests the EU3 may prefer to let it expire. In any case, it seems highly unlikely that China and Russia – both strategic partners of Iran and rivals of the US – would allow an indefinite embargo extension to pass in the Security Council. Beijing and Moscow have publicly rejected the US' proposed resolution, which, as permanent Council members, they would be able to veto in an eventual vote.

Might The EU3 Negotiate A 'Compromise Arrangement' With The US, China And Russia?

The EU3 have made clear their preference for some sort of compromise arrangement that restricts Iran's conventional arms trade enough to placate the US, without being too comprehensive in time or scope to discourage cooperation from China and Russia. Specifically, the European powers have reportedly put forward proposals for an agreement that: allows Iran to purchase some types of arms, while other advanced weapons systems remain off limits or subject to UN approval; involves inspection schemes for Iranian arms exports; and has a limited timeframe. Should the US, China and Russia decide it is in their best interests to de-escalate tensions over Iran – even if only temporarily, to prioritise other more pressing political issues – then we do see scope for such an agreement to materialise. It may also be that China and Russia see the continuation of partial restrictions on Iranian arms trade as beneficial to regional stability (in which they both have a stake). That being said, given elevated tensions both between the US and China and the US and Russia, it may well be that one or both sides decide there is insufficient political space currently for making any meaningful concessions towards the other.

If Embargo Expires With No Compromise, Will The US Trigger A UN Sanctions 'Snapback'?

The Trump administration has repeatedly threatened to trigger the JCPOA's snapback mechanism – re-imposing all UN sanctions lifted as part of the deal – should the embargo not be extended. However, the legality of such a move is in question, given that the US withdrew from the nuclear deal in 2018. Both China and Russia have publicly stated they do not consider the US to be in a position to trigger the mechanism, while the EU3 have indicated they strongly oppose such a move by the Trump administration. This raises the prospect of rising tensions and differing interpretations of UN resolutions on Iran among the Security Council members. The US could ultimately decide against the snapback option, perhaps in order to limit strains on the transatlantic relationship – instead retaliating by fielding further US sanctions on Iran. These would have limited practical implications for the Islamic Republic, but nonetheless serve to fuel Trump's 'maximum pressure' campaign. Equally, though, it is not difficult to imagine a scenario in which

TABLE: OVERVIEW OF UN RESOLUTIONS RELATING TO IRANIAN ARMS TRADE

Date	Resolution	Details
Dec-06	1737	Embargo on export to and import from Iran of certain items and technology potentially related to nuclear weapons.
Mar-07	1747	Embargo on export from Iran of all arms and related materials.
Jun-10	1929	Prohibits states from directly or indirectly supplying Iran with major conventional weapons (battle tanks, armoured combat vehicles, large calibre artillery, combat aircraft, attack helicopters, warships, certain missiles and missile launchers). Prohibits states from providing Iran with spare parts, training or other assistance related to obtaining, manufacturing or operating abovementioned weapons.
Oct-15	2231	Amends previous restrictions to allow supplies of major arms and related components and services to Iran, with specific approval from the Security Council. From October 2020, such specific approval for conventional exports to or from Iran will no be longer needed. From October 2023, specific approval for transfers of goods or technology to/from Iran that could contribute to delivery of nuclear weapons will no longer be needed.

Source: SIPRI, US Congressional Research Service, Fitch Solutions

Washington follows through on its threat. In turn, we could see the US push to enforce UN sanctions in the face of other Security Council members' objections. At worst, this could trigger a crisis in the Council that spans well beyond the Iran issue, weakening the institution at large and further complicating US ties with the rest of the international community. A third option would be for another Council member to trigger the snapback mechanism before the US, avoiding concerns over legality altogether. While unlikely, this is not beyond the realms of possibility, particularly in the context of Europe's recent criticisms over Iranian non-compliance with aspects of the nuclear deal.

Iran's Response To An Embargo Extension Or Added Restrictions On Its Arms Trade?

Tehran has stated it would not accept an extension of the embargo, considering this to be a breach of the fundamental terms of the nuclear deal. Iranian officials have warned such a move would trigger a retaliatory response, although they have not yet clarified what such a response might look like. It is likely, in our view, that Iran would continue to escalate non-compliance with the nuclear deal in a gradual manner – as it has done over the past year. Possible actions that would fit with this pattern would be further raising uranium enrichment levels or further limiting inspectors' access to Iranian nuclear sites. It is also possible that Tehran decides to leave the nuclear deal altogether, or even withdraw from the Non-Proliferation Treaty – though we highlight that this may not necessarily mean that its leadership will aggressively pursue a nuclear weapon in the near term (see below section). Finally, we could see Tehran respond indirectly to an extension of the embargo or other restrictions on its arms trade by escalating attacks on US assets or allies in the region, for example via its proxies or through interference with foreign vessels in the Gulf.

What's Next For US-Iran Relations?

Our core view is that both the US and Iran will defer major shifts in their strategies towards each other until after the US presidential elections in November. The Trump administration likely prefers maintaining its 'maximum pressure' campaign against Iran (which appears to have proven fairly popular with its domestic support base) but without sparking a major escalation in tensions during the re-election campaign. Meanwhile, given that US Democratic candidate Joe Biden has indicated he would re-enter the nuclear deal should he become president, it would make sense for Iran to hold off on major escalatory or conciliatory steps until the election outcome is clear. Nevertheless, strategic shifts on either side cannot be completely ruled out over the coming months, should either leadership for example seek to use such a move to distract from domestic issues, or Tehran attempt to weaken Trump's standing ahead of elections. Tit-for-tat attacks also have the potential to spiral 'out of control', bringing the two sides closer to the brink of war.

After US elections, the outlook is more unclear. In the event of a second term for Trump, Iran will have to decide whether to continue absorbing sanctions-induced economic pain, potentially for another four years, at the expense of rising potential for domestic unrest. Iran has proven resilient in the face of sanctions before, and its leadership could calculate that this is politically preferable to negotiating with Trump. However, in light of recent mass protests – which turned violent, and also involved elements of the regime's core rural, working-class support base – it may be more likely that Tehran opts for an eventual return to negotiations with the US to secure sanctions relief. While this would be positive for US-Iran relations in the medium term, we highlight that Tehran could seek to escalate tensions and instigate a 'crisis' ahead of fresh talks, in order to demonstrate the threat it poses to the US and US allies in the region, and thus enter negotiations from a position of perceived strength. This could take the form of regional attacks, or a rush to nuclear development, carrying major risks of provoking military confrontation. Meanwhile, should Biden come into office in 2021, then the path to entering negotiations would probably be substantially smoother. Nevertheless, amid growing opposition to Iran both among the US population and legislature – and also a tightening of hardliners' grip on Iranian state institutions and policymaking processes – the process of getting to a lasting deal may be complicated and drawn-out. A further complication is Iran's own presidential elections in the spring of 2021, which could usher in a hardline candidate that adopts a substantially more hawkish tone on foreign policy relative to the incumbent.

Long-Term Political Outlook

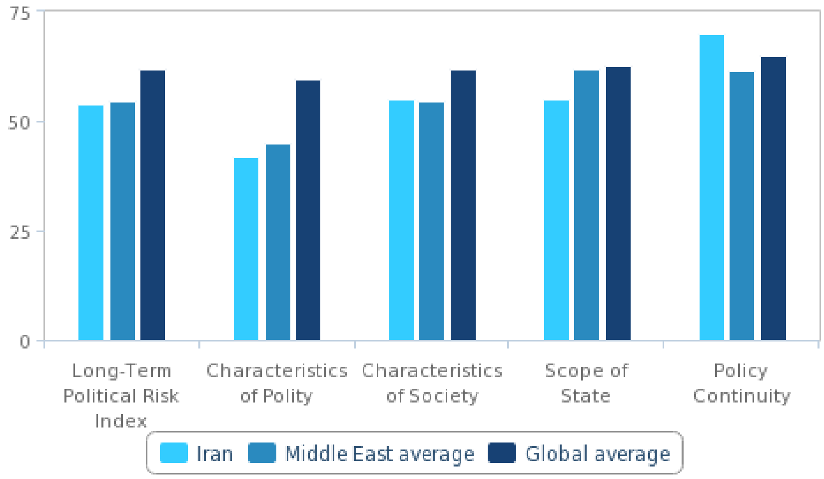
Hardliners Look Set To Maintain Control, But Power Struggle Likely

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, Revolutionary Guards and now parliament – 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' withdrawal.*

We expect Iran's hardliners to maintain their overall control of the country over the coming decade, although this does not completely 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. With regards to 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 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 be likely to affect its trade ties to Asia and Russia. Still, we cannot 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 & Components



Note: Scores out of 100; 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, while 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 80. 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, IRGC, Basij militia and intelligence service. While 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 125%, 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 for Iran is 54.1 out of 100. This low score implies that we have considerable doubts over 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, and more recently on fuel price hike protests in November 2019, 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.

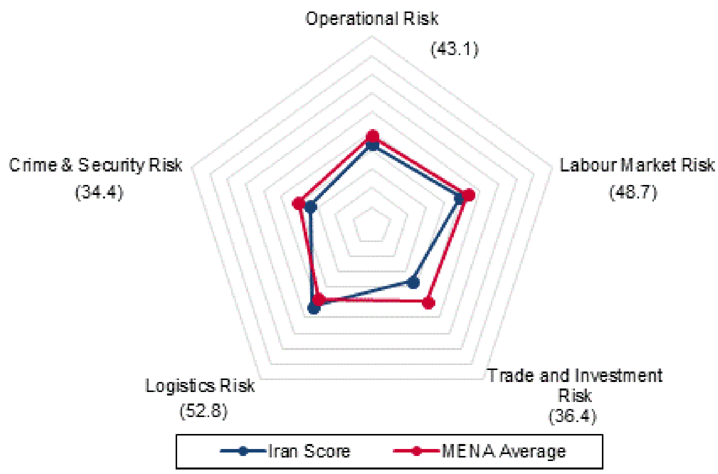
Military Takeover: Iran could conceivably experience a military coup or a creeping militarisation of political institutions over the coming decade. A sudden coup is unlikely unless Iran's political or economic environment deteriorated very sharply. This could occur as a result of an economic crisis followed 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.

Huge Business Potential Undermined By A Myriad Of Risks
Iran & Regional Average – Operational Risk Scores



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

Doing business in Iran will be increasingly difficult for Western firms following US President Donald Trump's decision to impose new sanctions on Tehran in January 2020. Increasingly frosty relations with the US, in combination with the impact of the Covid-19 pandemic has further isolated Iran from the international community and weakened its already challenging business environment. Further to this, Iran's heavy dependence on the hydrocarbons sector has put its economy in an extremely vulnerable position by the slump in global oil prices amid the Covid-19 outbreak. Businesses also face exposure to the risk of possible cyberwarfare and interstate conflict due to regional tensions. Additional risks include obstacles to trade, regulatory restrictions barring foreign participation in some sectors, onerous taxes, stringent labour laws, corruption, and weak rule of law as well as dominance by state-owned enterprises across key industries, such as banking. That being said, if sanctions are lifted, Iran holds significant investment opportunities in hydrocarbons, infrastructure and consumer-facing industries. Consequently, Iran has a low Operational Risk score of 43.1 out of 100, ranking in 12th position out of 18 states in the MENA region and 127th out of 201 countries globally.

TABLE: OPERATIONAL RISK

	Operational Risk	Labour Market Risk	Trade And Investment Risk	Logistics Risk	Crime And Security Risk
Iran score	43.1	48.7	36.4	52.8	34.4
MENA average	47.8	53.0	49.6	47.7	40.9
MENA position (out of 18)	12	10	12	9	12
MENA average	47.8	53.0	49.6	47.7	40.9
MENA position (out of 18)	12	10	12	9	12
Global average	49.6	50.2	49.5	49.3	49.2
Global position (out of 201)	127	109	147	83	150

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

Crime And Security (34.4/100): Businesses considering entering the Iranian market will be faced with a multitude of security threats, and strong and comprehensive precautionary measures are therefore essential, heightening operational costs. Iran's current foreign policy and historically hostile relations with the West have resulted in a number of interstate security risks, and tensions with regional powers Israel and Saudi Arabia are particularly high. Domestic and international terrorism is a concern, even though the risks from Islamic State have somewhat subsided. Iran's international isolation has also made it a hub for financial and cybercrime, and has facilitated the emergence of organised crime networks. Meanwhile, recent incidents, including the downing of a US drone by Iran in June 2019 and the US killing of a top Iranian general in January 2020, have further strained relationship between Washington and Tehran. This raises businesses exposure to the risk of possible armed interstate conflict.

Trade And Investment (36.4/100): Iran is essentially closed to foreign investment and trade, particularly with Western firms, despite holding huge business potential in its hydrocarbons, infrastructure, and consumer-facing industries. US President Donald Trump's decision to impose new sanctions on Tehran in January 2020 further damaged Iran's already troubled profile as an investment destination and the country will continue to be isolated by the larger international community for as long as sanctions are in place. This together with troubled relations with some regional neighbours, such as Saudi Arabia and Israel, leaves Iran with very limited trading partners. The wider operational environment will also remain difficult for foreign investors, with structural issues including the weak rule of law, widespread corruption, high tax burden and the heavy presence of state-owned enterprises that crowd out private sector investment. Further to this, Iran's heavy dependence on the hydrocarbons sector has put its economy in an extremely vulnerable position by the slump in global oil prices amid the Covid-19 outbreak.

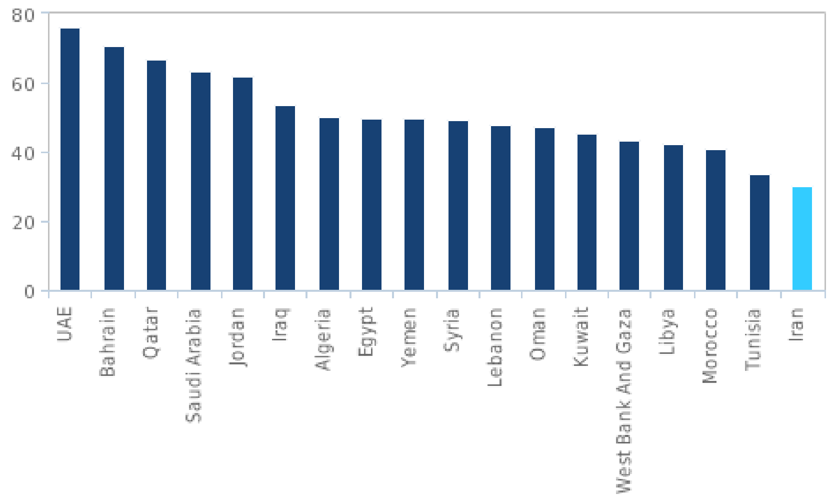
Labour Market (48.9/100): Iran's labour market potential will remain largely untapped due to both the impact of the sanctions regime and the presence of inflexible labour regulations, which are unlikely to be reformed. The labour market ostensibly offers considerable appeal to incoming firms, due to a large and well-educated youth population that is eager for employment. Nevertheless, rigid labour laws continue to pose difficulties in hiring and firing practices by protecting older workers in long-term employment and exacerbating the related issues of high youth unemployment and talent flight. Labour costs are increased by government-imposed worker benefits and minimum wages, while the lack of independent trade unions means that workers and employers are unable to easily negotiate wage increases or come to amicable agreements over disputes, undermining labour relations.

Logistics (52.8/100): Expected improvements to Iran's logistics network are now unlikely to materialise following the decision to reintroduce US secondary sanctions and with the potential breakdown of the nuclear deal. Much needed investment in the country's utilities and transport network will not be forthcoming, as international firms will avoid the risk of violating sanctions, and the Iranian government will find itself more fiscally constrained as oil exports dry up. Consequently, Iran will remain a logistics underperformer, due to the detrimental impact of sanctions on utilities and transport networks, as well as a number of structural issues including prevailing trade barriers, poor internet access and increasing water stresses.

Labour Costs

Stringent labour regulations, which harm both employers and workers, are a major drawback to investment in Iran, stifling labour market flexibility and increasing labour costs. The government imposes a rigid labour code that protects older workers in long-term positions and restricts hiring and firing practices. Independent trade unions are banned, but this does not allow greater flexibility for employers due to government-imposed worker protections, while unsanctioned strikes still take place. In addition, the minimum wage continues to rise to keep pace with inflation, reducing cost competitiveness on both a regional and global comparison, though it remains well below the living wage, meaning that further increases are likely. As a result, Iran receives the lowest score among its MENA peers and the ninth-lowest globally for the Labour Costs pillar, at 30.1 out of 100, highlighting the difficulties facing companies considering entering the Iranian market.

One Of The Most Uncompetitive Labour Costs Globally
MENA – Labour Costs



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

Latest Labour Costs Analysis:

- Attracting foreign workers to fill highly skilled or management level positions will become even more difficult following the reintroduction of US sanctions. Companies have struggled to persuade expatriate Iranians to return due to sustained concerns about poor living standards and restrictions on personal freedoms – issues that will also deter foreign nationals from relocating to Iran. Consequently, businesses will have to offer generous remuneration and benefits packages to entice foreign workers, adding to labour costs. Investors should also be aware that the proportion of foreign workers is generally capped at 20% of the workforce, meaning that investment in training and knowledge transfer for Iranian workers will be necessary.

Costs And Flexibility Of Labour

The costs associated with employing workers in Iran are higher than in most other states in the Middle East and North Africa (MENA) region, making the country an unappealing location for labour-intensive industries. This is largely due to the high rate of social security contributions which businesses must pay, mostly due to the requirement to subsidise health insurance for employees. In addition, there is a legally stipulated minimum wage which is higher than in most MENA states and workforce productivity remains poor, further reducing cost competitiveness. Other forms of remuneration for employees, including redundancy dismissal packages and overtime premiums, are also generous, adding further costs to business operations. Iran is therefore awarded a low score of 21.4 out of 100 for Costs of Employment, placing the country last regionally and third-last globally.

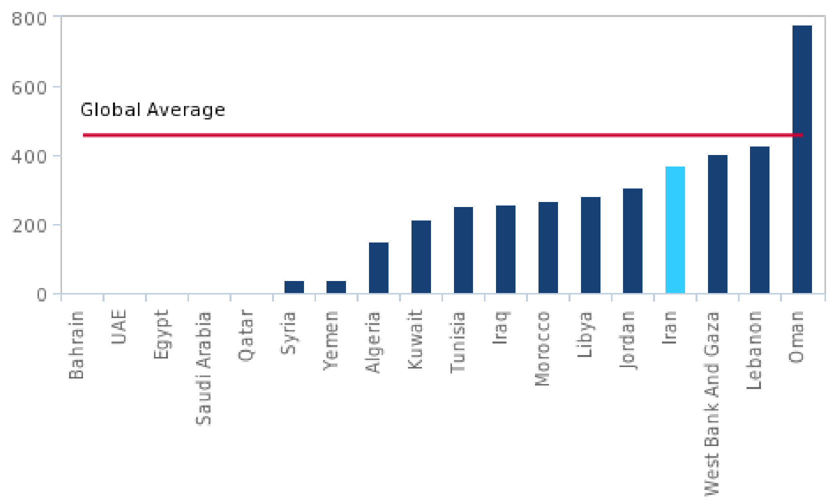
The labour market in Iran is heavily regulated by the government. Protections for older workers in long-term positions, including excessive mandated redundancy packages, reduce the flexibility of employers with regard to hiring and firing practices. These rigid regulations have combined with poor economic growth to result in a very high youth unemployment rate. In turn, this means a lack of vocational skills in the labour force and increased training requirements for new staff. In addition, high inflation places pressure on the government to maintain significant increases in the minimum wage, and although independent labour unions are not permitted, this causes difficulties for labour relations. Iran, therefore, receives a score of 38.8 out of 100 for Flexibility of Labour, placing it in 16th position out of 18 states in the MENA region.

Direct Labour Costs: The Iranian labour code stipulates social security payments, minimum wages and worker benefits which further add to labour costs and reduce the country's competitiveness. One of the most significant employment costs faced by businesses in Iran is the high rate of mandatory social security contributions, which are levied at 25.9% of workers gross salaries, among the highest rates regionally. This figure is primarily comprised of the monthly social security payments which must be made by businesses for each employee in order to cover their health and unemployment insurance and pension contributions. This adds significant extra costs for businesses employing a large labour force and places Iran at a competitive disadvantage compared to regional peers, particularly the Gulf states, which charge much lower mandatory social security contributions on private firms. Iranian workers are also afforded a regionally high allocation of paid annual leave, with legal stipulations for at least 24 days annually, the sixth highest in MENA. In addition, work at night is afforded a premium of an extra 35% of hourly pay, while work undertaken on the weekly rest day (typically Friday) or as overtime is paid a 40% increase on the hourly rate.

Further costs are incurred by the application of a mandatory minimum wage which is higher than many of Iran's regional peers and faces upward pressure due to inflation and high living costs. The labour code stipulates that a minimum wage will be fixed each year by the Ministry of Labour, taking into account different regions and economic sectors, as well as the rate of inflation and living costs. The minimum wage in Iran as applicable to a supermarket worker with one year of tenure was USD371.2 per month, the fourth highest in the region. There is strong pressure on the government to continue raising the minimum wage, as inflationary pressures have begun to rise, and the minimum wage remains below the living wage. Consequently, businesses employing lower-skilled workers can expect to face rising wage costs, despite limited upward pressure on wages generally as the labour market remains oversupplied.

Uncompetitive Wages Likely To Rise Further

MENA – Minimum Wages, USD/month (2020)



Source: World Bank 'Doing Business'. Note: As applicable to the worker assumed in the case study

Flexibility Of Labour Regulations: Employers in Iran face restrictive labour regulations which add to the overall cost of business operations and reduce the flexibility with which businesses are able to manage their workforce. The country's labour code provides for considerable rights and generous benefits for workers and stipulates a national minimum wage, all of which result in additional costs for businesses. Labour regulations are structured to protect older workers in long-term employment, essentially guaranteeing them a job for life. This causes huge distortions to the labour market by severely disadvantaging younger workers, making it more difficult to hire new staff or make redundancies, and restricting productivity. One of the major ways in which the government enforces this is through redundancy pay. The average redundancy package is 23.1 salary weeks, placing Iran on par with Yemen and the West Bank and Gaza in the MENA region, and representing among the most generous payments in the region. Nevertheless, the mandatory redundancy pay for workers with 10 years of tenure is even higher, at 43.3 weeks, offering long-term workers an undue level of job security which makes it extremely difficult for companies to make them redundant.

The rigidity of these labour regulations and protections for older workers has resulted in a dearth of employment opportunities for younger people during Iran's recent period of economic difficulty under the sanctions regime. The relative ease of making less experienced workers redundant, and the limited creation of new jobs in the struggling economy, has resulted in a youth unemployment rate which is even higher than the total official unemployment rate of 12.5%. There are two sides to this for companies entering the Iranian market. On the one hand, there is a large pool of well-educated young workers available for recruitment, with the saturated labour market helping to keep wages depressed. On the other hand, the lack of job opportunities has fuelled the brain drain which has seen Iran lose some of its most talented workers. In addition, the high unemployment rate means that those who stayed in the country will be lacking in relevant workplace experience and vocational skills, meaning that they will require further training which will add to employment costs for businesses.

Labour Unrest Risks: Though Iran has restrictive regulations on employers with regard to minimum wage, severance pay and paid annual leave, this has largely been enforced from the top down by the government, and there is very little worker protection in the form of unionisation. Although Iranian workers have, in theory, a right to form labour unions, there is in practice no officially sanctioned independent union system in the country. Workers are ostensibly represented by Islamic Labour Councils, which are approved by the state and lack the ability to effectively challenge employers or labour regulations. The right of workers to strike is generally not respected by the state, and since 1979 strikes have often been met by police action including arrests of participants and union leaders.

The absence of independent trade unions is not beneficial for labour relations. While strikes are less frequent due to the limited organisational abilities of workers, labour unrest still occurs as workers have voiced concerns over inflation, lack of job security in

TABLE: LABOUR REGULATIONS GOVERNING FLEXIBILITY OF WORKFORCE

Contracts	
Fixed-term contracts prohibited for permanent tasks?	No
Maximum length of a single fixed contract (months)	No limit
Working Week And Absences	
Maximum working days per week	6
Premium for overtime work (% of hourly pay)	40
Paid annual leave (average for workers with one, five and 10 years of tenure, in working days)	24
Paid or unpaid maternity leave mandated by law?	Yes
Minimum length of maternity leave (calendar days)	270
Redundancy	
Dismissal due to redundancy allowed by law?	Yes
Notice period for redundancy dismissal (average for workers with one, five and 10 years of tenure, in salary weeks)	0
Severance pay for redundancy dismissal (average for workers with one, five and 10 years of tenure, in salary weeks)	23.1

Source: World Bank 'Doing Business'

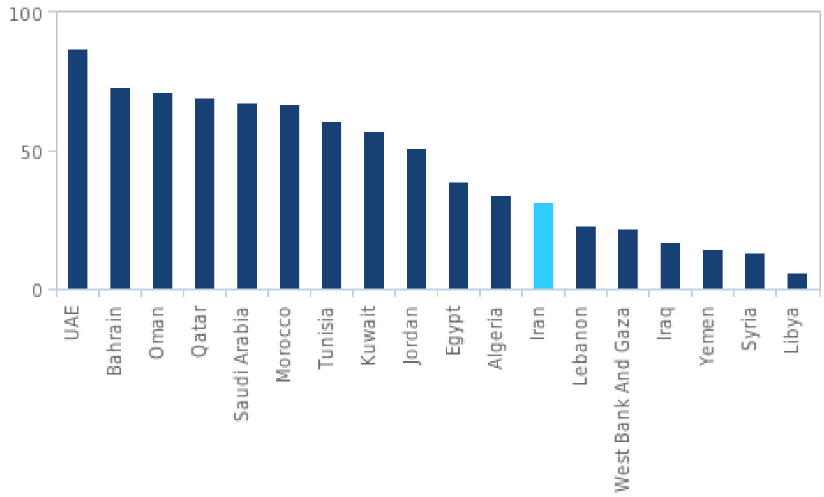
short-term contracts, and withheld salary payments. Since 2014, large-scale strikes have occurred in manufacturing plants, gas production facilities and mining sites, as well as in the public sector, with thousands joining marches in Tehran on May Day in 2015. Businesses are consequently not protected from the impact of strike action, and the absence of independent unions means there is no pressure valve for worker grievances to be addressed without recourse to strike action. This also means that it is more difficult for firms to negotiate amicable settlements to labour disputes. As a result, businesses face a higher risk of fractious labour relations and reduced workforce flexibility, which could lead to disruption to operations.

Legal Environment

Iran offers a generally poor legal and bureaucratic environment. Most daily transactions are affected by rampant corruption, which hinders the efficiency of administrative procedures and influences legal judgements. The rule of law remains somewhat oppressive, and foreigners must be aware of the country's conservative cultures and customs, as punishments for infringement can be severe. In addition, the protection of intellectual property rights remains inadequate, which will deter foreign investment in research-led industries such as the country's large pharmaceuticals sector. These factors remain largely unaffected by changes in the sanctions regime and will continue to present structural obstacles to foreign investors. Due to these considerations, Iran is ranked 12th out of 18 states regionally for the Legal Risks with a score of 31.8 out of 100.

Endemic Corruption And Bureaucratic Hurdles Deter Investors

MENA – Legal Risk



Note: 100 = Lowest Risk. 0 = Highest Risk. Source: Fitch Solutions Trade and Investment Risk Index.

Latest Legal Risk Analysis:

- The reintroduction of US secondary sanctions has likely increased the potential for corrupt activity in Iran as more transactions take place through back channels and the black market. The country's limited integration into the global economy and lack of international norms and oversight means that there is significant potential for corruption to occur, particularly with the large-scale presence of the armed forces throughout the economy. Businesses in the country are likely to be highly exposed to corruption, even if sanctions are lifted, necessitating extensive due diligence measures for new entrants to the market.

Bureaucratic Environment

Iran's culture of excessive red tape and bureaucracy is exemplified by the lengthy delays involved in operating commercial ventures, deterring entrepreneurship and investment in high-risk ventures. E-government development is also lacking, reducing the prospects for efficiency gains in administrative procedures and increasing the potential for delays and rent-seeking behaviour by officials. The government has made significant attempts to improve bureaucratic efficiency in order to increase the country's appeal to foreign companies once sanctions are lifted; however, many bureaucratic hurdles are unlikely to be removed completely, meaning that companies looking to enter the Iranian market should prepare for lengthy delays and difficulties in setting up operations. Iran, therefore, receives a low score of 39.6 out of 100 for its Bureaucratic Environment, placing it in 11th position regionally.

TABLE: BUREAUCRATIC PROCEDURES

Bureaucratic Obligation	Number Of Procedures	Time	Cost	Barriers To Business Operations
Opening a new business	10	73 days	1.1% of income per capita	• **High:** Iran stands extremely unfavourable globally with regard to the time required to initially set up a business, which is the seventh longest worldwide. • Investors will face unusual processes that take extremely long times to complete, such as notifying the Economic Code State Tax Affairs Organization (STAO) of the commencement of business activities and obtaining confirmation thereof, which takes 25 days; registering for VAT taking one month; and, among many others, enrolling workers in the social security program at the Iranian Labor Department and obtaining a workplace number taking 13 days. • Several government departments must be dealt with in this process, which not only makes the bureaucracy excessive but exposes investors to the risk of being solicited for bribes by unscrupulous public sector officials. This highlights the hidden bureaucratic risks that businesses may face in Iran as, although there is one department called the Companies Registration Office, there are several other government offices that must give approval before business operations can begin. • While the cost per capita income of starting a business is very low, it is by far outweighed by the convoluted, complex and inefficient processes that investors must navigate.
Registering a property purchase	6	31 days	3.8% of property value	• **Moderate:** Registering a new property purchase is a relatively efficient process in Iran and is broadly in line with the regional average of 26.6 days. • The cost is also competitive compared to both regional and OECD averages of 5.6% and 4.2% of the property value, respectively. • The longest step involves obtaining a social security clearance certificate, taking 20 days, followed by obtaining a tax clearance certificate from the Tax Affairs Organization which can be issued within a period of 12 days. • Many of the steps involve dealing with the Tax Affairs Organisation and / or the Real Estate Registration Department and can be done simultaneously, reducing overall times for investors. • This somewhat boosts Iran's attractiveness internationally for investors seeking to transfer real property deeds in the country, which can speed up the overall process of commencing commercial operations.
Obtaining construction permits	15	130 days	6.6% of warehouse value	• **Moderate:** Obtaining a construction permits is a time-consuming and costly overall, proving a barrier to investors looking to construct new premises, such as own warehouse or those in the real estate sector. • Nevertheless, this is still in line with MENA average of 123.6 days but highly competitive against OECD standards at 152.3 days. • The cost is also not very prohibitive relative to the regional average of 4.4% of warehouse value. • The major risk stems from the fact that many government departments must be dealt with, which exposes investors to the danger of being solicited for bribes. This carries high reputation damage risk and businesses can be fined hefty penalties.
Completing insolvency proceedings	na	4.5 years	15% of the estate	• **High:** The most significant bureaucratic delays for investors are experienced when closing a business through insolvency proceedings, the 13th longest time globally. • Although the liquidation process is generally much longer than other bureaucratic procedures, this is a particularly long delay which, combined with a low recovery rate of just 37.1 cents on the dollar, deters investment in high-risk ventures and stifles innovation.

na = not available. Source: World Bank 'Doing Business'

The Iranian government's heavy regulation of the economy means that businesses must deal with oppressive bureaucratic procedures which delay projects and stifle creativity and entrepreneurialism. In order to gain approval for procedures such as starting a new commercial venture, investors must deal with multiple government departments, often in person. This results in lengthy delays in terms of the time taken to complete paperwork and to gain approval from each office involved. It also increases the potential for businesses to be solicited for bribes in order to expedite the process, increasing costs and compliance risks and potentially leading to reputational damage. The cumbersome bureaucratic processes in Iran have resulted in 'Inefficient government bureaucracy' being named as the second most problematic factor for doing business in the country in the World Economic Forum's Global Competitiveness Index 2018-2019.

Meeting bureaucratic obligations will remain difficult despite the launch of the National Information Network in August 2016 – a closed nationwide intranet which is intended to offer online government services. Very limited government services are available to be completed online. Although this is expected to improve over the medium-long term, it remains unclear whether foreign investors will have access to the intranet and whether they will wish to use it given the potential security risks and government control of the system. Consequently, businesses are likely to continue facing a large amount of paperwork for all activities in Iran, forcing them to deal with multiple government departments in person and raising the risk that they will be solicited for bribes.

Legal Environment

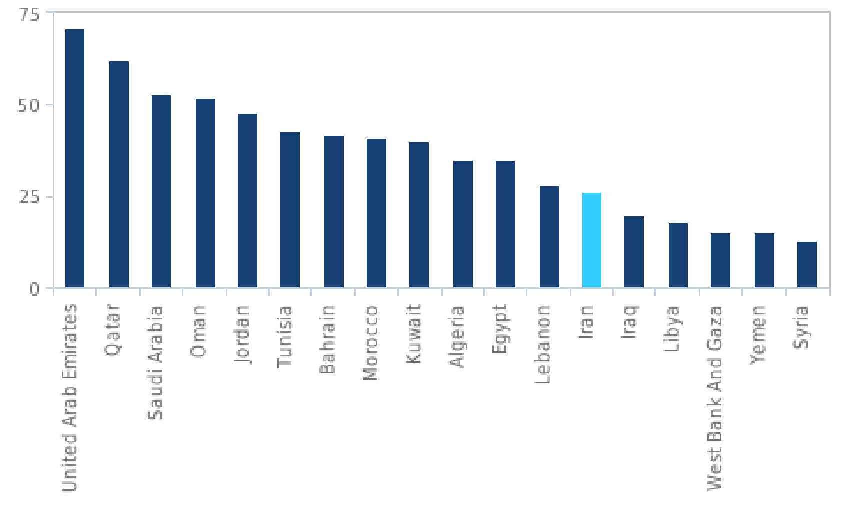
The rule of law in Iran is hamstrung by the endemic culture of corruption throughout the public and private sectors, and the limited ability of individuals and corporate entities to operate freely without fear of prosecution. The judiciary is essentially an arm of the executive, with the head of the judiciary appointed directly by the supreme leader. Legal processes are draconian and cases are frequently tried in closed courts. In addition, the protection of intellectual property remains poor even though Iran has been a member of the World Intellectual Property Organization (WIPO) since 2002. While the settling of commercial disputes can be efficient, we warn that corruption can be an issue and courts may be more likely to rule against foreign companies, particularly when involved in disputes with state-owned enterprises (SOEs). Overall, Iran therefore receives a low score for its Legal Environment, with 23.9 out of 100, placing it 12th out of 18 states in the MENA region.

Judicial System: The Iranian judiciary is an integral part of the religious establishment, with the head of the judiciary appointed by the supreme leader, and consequently the courts are not independent. Ostensibly, mechanisms for resolving contractual disputes are relatively straightforward, cheap and efficient. Overall, the process costs 19.3% of the claim, in contrast to the regional average cost of 24.7% of the claim, and the entire process takes an average of 505 days, as opposed to the regional average of 622 days. The bulk of the time is consumed by the trial and judgement, while the major portion of the cost goes towards attorney fees. However, as the Iranian government exercises a high degree of control over the judiciary, it is unable to act independently, increasing the risk of unfair judgements for foreign firms. The entrenched culture of corruption means that the dispute resolution process is, in practice, likely to be heavily influenced by bribes and close connections between involved parties and the establishment. As a result, foreign businesses will likely find considerable barriers to favourable dispute outcomes, especially if the defendant person or entity is an Iranian national.

Corruption: The major risks faced by companies in terms of Iran's rule of law are the possibility of unforeseeable costs in terms of necessary bribes or embezzled funds, reputational damage and legal costs as a result of being implicated in corrupt practices, as well as the potential legal action taken for outspoken or unfavourable viewpoints. Corruption is endemic in government and private business, and the country is ranked sixth lowest regionally in Transparency International's Corruption Perceptions Index 2019 with a low score of 26 out of 100. Under former president Mahmoud Ahmadinejad, massive corruption and mismanagement were allegedly commonplace, exacerbated by international sanctions and the widespread presence of parastatals and the IRGC in the economy. The latter in particular has facilitated the growth of corrupt practices through the use of front companies and money laundering in order to escape sanctions.

Culture Of Corruption Deters Foreign Investors

MENA – Transparency International Corruption Perceptions Index 2019



Source: Transparency International

Though corruption is perceived to be endemic, reported cases are few and far between due to the protection offered by powerful vested interests and the control of the government over the judiciary. Nevertheless, there have been some revelations in recent years which have indicated the scale of graft in the country, particularly since President Rouhani has pledged to crack down on corruption. In 2011, it was revealed that a network of banks, led by state-owned **Bank Melli**, embezzled some USD2.6bn, while tycoon Babak Zanjani was arrested in December 2013 on charges of stealing USD3bn worth of oil revenue, a crime for which he was convicted in March 2016. This level of corruption represents risk to investors in terms of hidden and unforeseeable costs, such as bribes, excessive delays and bureaucratic obstacles, as well as reputational damage if companies are discovered to have colluded in corrupt practices, even though this is necessary in order to do businesses. This will remain a major barrier to foreign investment even though sanctions have been lifted.

Despite lifting a ban on the Reuters news agency from operating in the country at the end of 2013, Iran retains a reputation of having one of the highest levels of censorship in the world. Vaguely worded laws allow for far-reaching interpretation and prosecution of infringements, as well as leading to high levels of self-censorship for fear of reprisals. Article 500 of the Iranian penal code rules against propaganda against the state but leaves 'propaganda' undefined. Similarly, an insult to religion is punishable by death, but 'insult' remains undefined. News agencies are also prohibited from quoting content from blocked websites or suspended newspapers, the Iranian cyberpolice actively monitors activity on social networks and popular websites, and Facebook is currently blocked for the Iranian public. This represents considerable risk to investors in that the government has large and arbitrary control over the Iranian media, limiting the ability to expose corruption and constraining advertising and marketing freedom.

Intellectual Property Rights: Despite its heavy-handed rule of law, membership of WIPO since 2002, and accession to several intellectual property treaties, including the Madrid and Lisbon Agreements regarding the registration of trademarks and origins, the enforcement and protection of intellectual property rights in Iran remains sub-standard. The country is still prevented from becoming a full member of the WTO due to the US having vetoed its accession on multiple occasions. Only Iranian works are protected in Iran unless an Iranian patent is applied for and granted, and Iranian works are often not protected outside Iran. This weak patent law often disadvantages Iran's pharmaceutical manufacturers in particular, who have no guarantee of exclusive ownership of their work. The government is attempting to introduce the country's first comprehensive intellectual property rights bill, which will establish tougher measures against copyright infringement. However, the poor protection of intellectual property rights will continue to deter investors in innovative and research-led industries, as their output is more likely to fall victim to counterfeiting.

Global Macro Outlook

The Worst Is Behind Us, But Emerging Markets Starting To Lag

We at Fitch Solutions have lowered our forecast for global growth again this month and now expect that global output will contract by 3.6% in 2020, compared with our previous forecast of 3.0% in May 2020. We made downward revisions in both developed and emerging markets (DMs and EMs respectively), with major revisions including Austria (now -4.0%), Denmark (-4.0%) and Japan (-5.2%) as well as India (-4.5%), Malaysia (-2.8%), Russia (-3.5%), Hungary (-4.6%), Saudi Arabia (-4.1%) and South Africa (-7.0%). We have revised up our forecast for Brent crude since May and now expect an average of USD40.0 per barrel (/bbl) in 2020, rising to USD49.0/bbl in 2021, compared with USD33.0/bbl and USD42.0/bbl previously.

Despite the weaker growth outlook for 2020, we still believe that the worst of the economic shock is now behind us. As more countries ease their lockdowns, economic activity should start to slowly recover, and we are already seeing this in the data for May. Various economic indicators have started to stabilise, and even bounce in May, albeit from very depressed levels, suggesting that economic momentum is only improving slowly. Higher frequency mobility data from **Google** paint a similar picture, with many countries seeing a slow increase in mobility trends compared to late March and early April. Moreover, US non-farm payrolls for May surprised on the upside, with the economy adding 2.5mn jobs and the unemployment rate falling from 14.7% to 13.3%. While the jobs report was certainly a positive surprise, it must be read with caution as the lockdowns make survey data less reliable.

TABLE: GLOBAL MACROECONOMIC FORECASTS (2019-2024)

		2019	2020e	2021f	2022f	2023f	2024f
Real GDP Growth (%)							
	US	2.3	-4.9	3.7	1.7	1.6	1.7
	Eurozone	1.3	-6.9	4.3	1.8	1.6	1.5
	Japan	0.7	-5.2	0.5	0.3	0.3	0.3
	China	6.1	1.1	6.0	5.4	5.4	5.4
	World	2.6	-3.6	3.9	2.9	2.9	2.9
Consumer Inflation (ave)							
	US	1.8	1.5	1.5	2.1	2.1	2.1
	Eurozone	1.3	0.6	1.3	1.7	1.9	1.9
	Japan	0.5	0.1	1.0	1.0	1.0	1.0
	China	2.9	3.5	2.2	2.3	2.3	2.3
	World	2.9	3.5	2.6	2.7	2.7	2.6
Interest Rates (eop)							
	Fed Funds Rate	1.50	0.00	0.00	0.25	0.50	1.00
	ECB Refinancing Rate	0.00	0.00	0.00	0.50	1.00	1.50
	Japan Overnight Call Rate	-0.10	-0.10	0.00	0.00	0.00	0.00
Exchange Rates (ave)							
	USD/EUR	1.12	1.05	1.10	1.12	1.14	1.15
	JPY/USD	109.01	108.00	107.00	107.50	107.00	106.50
	CNY/USD	6.91	7.15	7.20	7.23	7.25	7.30
Oil Prices (ave)							
	OPEC Basket (USD/bbl)	64.04	35.00	45.00	52.00	57.00	60.00
	Brent Crude (USD/bbl)	64.16	40.00	49.00	55.00	60.00	63.00

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

We expect that the global recovery will be very challenging, bumpy and uneven. Over the short term, ongoing protests in the US, combined with a pickup in the number of new cases in countries that are easing restrictions, could result in greater financial market volatility as well as a slower re-opening of businesses, which would not only delay the eventual recovery, but would also weigh further on corporate and household balance sheets.

Moreover, many large EMs such as India, Brazil and Russia have yet to control the spread of their first wave, suggesting that the economic contraction in these countries may last much longer than in DMs. Prolonged economic weakness could result in rising domestic political unrest in these countries as governments face backlash due to their handling of the outbreak. Over the medium term, electoral uncertainty ahead of the US elections in November, combined with rising US-China tensions, will also pose downside risks to global growth. In the US, the potential for a shift in policy towards a higher tax regime could weigh on businesses that are still

TABLE: DEVELOPED MARKETS – REAL GDP GROWTH, % y-o-y

	2019e	2020f	2021f	2022f
Developed Markets Aggregate Growth	**1.7**	**-5.1**	**3.4**	**1.7**
G7	1.7	-5.6	3.5	1.6
Eurozone	1.3	-6.9	4.3	1.8
EU-27	1.5	-6.5	4.2	1.9
Selected Developed Markets				
Australia	1.8	-1.9	2.3	2.6
Austria	1.6	-4.0	1.6	1.5
Belgium	1.4	-2.8	1.1	1.2
Canada	1.6	-5.4	2.9	1.9
Czech Republic	2.4	-6.0	4.8	1.9
Denmark	2.4	-4.0	3.5	2.0
Finland	1.0	-3.8	2.0	1.4
France	1.3	-8.6	4.6	1.4
Germany	0.6	-5.0	2.9	1.6
Hong Kong	-1.2	-7.0	0.9	1.2
Ireland	5.5	-3.2	4.6	5.0
Italy	0.3	-13.7	11.4	2.8
Japan	0.7	-5.2	0.5	0.3
Netherlands	1.7	-3.0	1.4	1.4
Norway	1.1	-6.2	5.3	1.6
Portugal	3.5	-8.0	6.0	1.4
Singapore	0.7	-2.8	2.6	2.7
South Korea	2.0	-0.3	3.7	2.5
Spain	2.0	-7.5	2.5	1.9
Sweden	1.3	-3.0	3.7	2.0
Switzerland	1.0	-6.0	4.3	2.8
Taiwan	2.7	0.5	1.7	2.7
UK	1.4	-7.7	4.5	1.6
US	2.3	-4.9	3.7	1.7

e/f = estimate/forecast. Source: Fitch Solutions struggling, while a continued rise in tensions with China could result in renewed tariffs, which could hurt businesses and consumers in the world's two largest economies.

Developed Markets

Economic growth lost further traction across DMs in Q220, when we believe the economic impact of the Covid-19 pandemic will be most felt. To reflect this, we have cut our 2020 DM growth forecast by 0.3 percentage points (pp) to -5.1%. Risks to our growth outlook, however, still remain skewed to the downside. A second wave of infections, a slower-than-expected normalisation of labour market conditions and/or an ill-timed withdrawal of government support measures are some of the downside risks that we flag. Taiwan is the only DM economy for which we are still forecasting positive (albeit downwardly revised) growth this year (from 1.9% to

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

	2019e	2020f	2021f	2022f
Emerging Markets Aggregate Growth	**3.8**	**-1.5**	**4.7**	**4.6**
Latin America	**0.8**	**-5.4**	**2.2**	**2.5**
Argentina	-2.2	-5.2	2.0	2.9
Brazil	1.1	-6.5	2.0	2.4
Mexico	-0.1	-7.1	1.8	2.0
Middle East And North Africa	**0.6**	**-3.0**	**3.7**	**4.4**
Saudi Arabia	0.3	-4.1	2.8	3.1
UAE	2.9	-5.8	4.1	2.5
Egypt	5.6	2.6	3.6	5.4
Sub-Saharan Africa	**2.6**	**-3.4**	**2.9**	**3.6**
South Africa	0.2	-7.0	2.0	1.8
Nigeria	2.3	-3.9	0.8	1.8
Emerging Asia	**5.6**	**0.1**	**5.9**	**5.4**
China	6.1	1.1	6.0	5.4
India*	4.2	-4.5	5.7	6.0
Indonesia	5.0	-1.3	4.7	4.7
Malaysia	4.3	-2.8	5.7	4.6
Philippines	5.9	-2.0	7.4	6.1
Thailand	2.4	-4.0	3.6	3.0
Emerging Europe	**2.4**	**-3.4**	**3.5**	**3.0**
Russia	1.3	-3.5	2.7	2.1
Turkey	0.9	-3.4	4.3	4.8
Hungary	4.9	-4.6	4.0	2.5
Romania	4.1	-4.4	3.0	2.3
Poland	3.8	-4.0	3.4	2.6

*e/f = estimate/forecast; *Fiscal years ending March 31 (2019 = 2019/20). Source: Fitch Solutions*

0.5%). The pandemic's impact on DM economic momentum is evident in the latest string of still-poor, high-frequency data releases. For example, German industrial production in April fell by its sharpest rate since 1991, dropping by 25.0% y-o-y. Likewise, retail sales tumbled by some 21.6% y-o-y in the US, as the slowdown continued into April and rising unemployment began to bite. That said, part of the decline in sales was attributable to the lockdown, which prevented high-street shopping. We expect a gradual pickup (or at least, a milder decline) in sales as mobility restrictions are eased and eventually fully lifted. On a more positive note, a rebound in purchasing managers' indices in May (which, however, have remained in contractionary territory) points to an upward shift from a trough, supporting our view that most of the economic fallout from the pandemic may be behind us.

Meanwhile, tensions between China and the US have risen further following China's criticism of the Trump administration's handling of the mass unrest in the US over police brutality towards African Americans. Bilateral relations were already deteriorating this year over the two countries' mutual criticisms of their managing of the Covid-19 crisis. Against this backdrop, US President Donald Trump is likely to regard China's criticisms as interference in US internal affairs. If Trump promotes the narrative that the US protests are beneficial to China, this would put China squarely back in the centre of the president's re-election campaign. In Europe, post-Brexit talks remain without significant progress as the UK and the EU are still divided on key contentious issues, including a level playing field for fisheries. At the same time, Prime Mininster Boris Johnson is refusing to request an extension of the UK's transition period (which expires on December 31 2020) to allow more time for negotiations. Johnson will have time until the end of June to request an extension. While our core view remains that the two sides will reach a limited trade deal in 2020, we flag that risks of a de-facto no-deal have risen in recent weeks.

Emerging Markets

We became more bearish towards EMs in May and have deepened our 2020 aggregate EM GDP forecast from a fall of 0.6% to a contraction of 1.5%. This more pessimistic outlook is mostly due to growing evidence that India's economy will contract quite sharply, from a previous expectation of positive growth. However, we have also made further downward revisions to other major markets such as Russia, South Africa and Malaysia. Despite these latest downward revisions, the risks to our forecast are still weighted to the downside. Our operating assumption is that the ongoing Covid-19 pandemic deals a painful, but short-lived, shock to EMs, as was the case in China and seems likely in Europe. But the continued rise in infections in countries such as Brazil, Russia and India suggests that disruptions may last longer in EMs, with the quarter-on-quarter contractions potentially lasting for the entire year. EMs now make up the majority of new cases, and there is a risk that the disease will become endemic in poorer EMs where the authorities are not able to contain it.

Emerging Asia: Outperformance Fading

We retain our view that Emerging Asia will be the EM region that manages to escape a contraction in output, at least at the aggregate level, and largely due to China, which is one of the few countries that will not see a full-year contraction in output in 2020 (1.1% growth). Having suffered from the first wave of the virus, China's economy looks set to bounce back faster than elsewhere. That said, we now think that activity across the region as a whole will essentially stagnate, whereas we had previously expected tepid growth of 1.0%. This revision to Asian growth is mostly due to our more pessimistic view of India's economy, though we also revised down our forecast for Malaysia.

Emerging Europe: Consensus Has Overshot

We have lowered our GDP forecasts across much of emerging Europe this month, but are still less pessimistic than the very bearish consensus. We think that stimulus in Russia will help the country weather the storm better than most expect. Russia is one of only a few countries where our forecasts are more than a full percentage point above the consensus collected by Bloomberg (-3.5% vs

-4.8%). At Fitch Solutions, we also hold above-consensus views on growth in Turkey and the Czech Republic, though we are more pessimistic than most about the growth prospects for Poland. In general, we think that the contraction will be worst in Central Europe, where economies are tightly integrated into Western European supply chains. Economies further east – such as Russia, Turkey and Bulgaria – will probably fare slightly better, at least in so far as activity falling at a gentler pace.

Middle East And North Africa: Region Faces Multiple Crises

Despite raising our 2020 average Brent crude from USD33/bbl to USD40/bbl, we retain the view that most economies in the Middle East And North Africa (MENA) region will struggle this year. Despite our recent revision, we do not think that oil prices will return to the levels seen in 2018 over the duration of our forecast period. We have lowered our 2020 growth forecasts for Saudi Arabia (-2.7% to -4.1%) and the UAE (-4.5% to -5.8%). Both countries will be forced to embark on painful fiscal austerity, and will face declining revenues from their large travel and tourism sectors. Our biggest revision, however, was in one of MENA's smaller economies. We now expect that Lebanon's GDP will fall by 10.6% this year as a result of the country's escalating balance of payments crisis, which may require IMF intervention.

Sub-Saharan Africa: Key Economies Slowing, Worst Yet To Come

The latest activity data support our view that Sub-Saharan African (SSA) economies will perform very poorly this year. In Nigeria, GDP growth slipped from 2.6% in Q4 to 1.9% y-o-y in Q120, and we expect a full-year contraction of 3.9%. Activity data in South Africa have also been very poor, with mining activity halving in April, and we have revised down its GDP growth to -7.0% this year. Meanwhile, in East Africa, a growing swarm of locusts threatens to further disrupt agricultural sectors in Kenya and Ethiopia. While SSA has so far reported fewer Covid-19 cases than other regions, this may be the result of a lack of testing. Despite denials from officials, many observers are blaming this month's sudden death of Burundian President Paul Nkurunziza on Covid-19. This has added to fears that the virus is more widespread than officials are letting on.

Latin America: Region Takes Europe's Place As Covid-19 Epicentre

Latin America is now the region suffering the worst effects of the Covid-19 pandemic, and we forecast GDP in the region to fall by 5.4% in 2020. The situation in Brazil, where the federal government has been unwilling to impose strict lockdown measures, is particularly worrying, and we forecast a sharp decline in GDP of 6.5%. We are more pessimistic about Latin America than any other region, given the damage done to the services sector, particularly tourism. In addition, we think that all three of the region's largest economies will rank among the five worst-performing major EMs in 2020.

Note: *Our Country Risk forecasts are updated frequently; as a result, the views and forecasts in this section may not match those in other sections of the report.*

Index Tables

	Short-Term Political	Trend	Regional Rank	Global Rank
United Arab Emirates	86.7	=	1	8
Oman	81.3	=	2	17
Qatar	81.0	=	3	18
Kuwait	77.5	=	4	29
Bahrain	73.8	=	5	42
Saudi Arabia	72.9	=	6	49
Morocco	69.4	-	7	60
Iran	**59.6**	**=**	**8**	**110**
Egypt	57.1	=	9	124
Jordan	56.7	-	10	127
Tunisia	56.7	=	10	127
Algeria	44.2	=	12	162
Lebanon	38.5	-	13	172
Iraq	35.4	=	14	175
West Bank and Gaza	32.1	-	15	180
Syria	28.8	+	16	182
Libya	26.7	=	17	183
Yemen	18.8	=	18	187

Regional ave 55.4/Global ave 61.9/Emerging markets ave 58.5

	Long-Term Political	Trend	Regional Rank	Global Rank
United Arab Emirates	78.4	=	1	31
Jordan	71.1	=	2	54
Oman	70.6	-	3	58
Qatar	70.1	=	4	61
Morocco	69.9	=	5	63
Tunisia	68.4	=	6	70
Kuwait	66.4	=	7	75
Egypt	58.7	=	8	108
Algeria	56.7	=	9	116
Saudi Arabia	55.9	=	10	120
Lebanon	55.2	=	11	124
Bahrain	54.2	-	12	130
Iran	**54.1**	**=**	**13**	**131**
West Bank and Gaza	39.7	=	14	171
Iraq	39.6	=	15	172
Yemen	29.4	=	16	181
Syria	23.7	=	17	184
Libya	20.2	=	18	187

Regional ave 54.6/Global ave 61.8/Emerging markets ave 57.1

	Short-Term Economic	Trend	Regional Rank	Global Rank
Saudi Arabia	56.3	+	1	51
Kuwait	54.8	-	2	57
Egypt	51.0	=	3	68
United Arab Emirates	47.5	-	4	77
Qatar	44.6	+	5	90
Lebanon	41.9	-	6	102
Iran	**41.7**	**-**	**7**	**104**
Algeria	40.6	-	8	111
Iraq	39.8	=	9	118
Morocco	36.7	-	10	146
Oman	35.2	=	11	150
Syria	35.2	-	11	150
Yemen	34.0	-	13	157
Tunisia	31.3	=	14	166
Bahrain	30.4	-	15	168
Jordan	30.0	-	16	170
Libya	28.1	=	17	174
West Bank and Gaza	27.9	-	18	175

Regional ave 39..3/Global ave 46.5/Emerging markets ave 42.4

	Long-Term Economic	Trend	Regional Rank	Global Rank
Saudi Arabia	61.6	=	1	52
United Arab Emirates	61.5	+	2	53
Kuwait	59.4	-	3	59
Egypt	57.2	+	4	69
Qatar	53.3	+	5	80
Algeria	50.8	+	6	98
Morocco	48.1	-	7	112
Iran	**47.6**	**=**	**8**	**115**
Lebanon	47.5	-	9	116
Oman	45.7	=	10	124
Jordan	44.4	-	11	130
Bahrain	43.4	-	12	137
Iraq	42.8	=	13	142
Tunisia	41.1	=	14	152
West Bank and Gaza	36.4	-	15	169
Libya	35.8	+	16	170
Syria	33.3	-	17	176
Yemen	31.7	+	18	179

Regional ave 46.8/Global ave 52.8/Emerging markets ave 48.6

TABLE: IRAN – MACROECONOMIC DATA AND FORECASTS

	2019e	2020f	2021f	2022f	2023f	2024f	2025f	2026f	2027f	2028f	2029f
Nominal GDP, USDbn	525.6	628.1	649.4	660.2	726.1	799.1	873.4	951.2	1,040.9	1,132.4	1,228.6
Nominal GDP, EURbn	469.2	598.2	590.4	589.5	636.9	694.9	752.9	820.0	897.3	976.2	1,059.2
GDP per capita, USD	6,339	7,477	7,637	7,675	8,348	9,092	9,838	10,612	11,509	12,415	13,362
GDP per capita, EUR	5,659	7,121	6,943	6,852	7,322	7,906	8,481	9,149	9,922	10,703	11,518
Real GDP growth, % y-o-y	-7.0	-4.1	2.5	7.1	6.0	4.7	4.3	4.3	4.4	4.2	4.2
Private final consumption, % of GDP	48.7	49.5	48.9	47.1	46.8	47.0	47.3	47.6	47.9	47.8	47.6
Private final consumption, real growth % y-o-y	-4.2	-3.6	1.5	3.4	4.2	4.0	4.0	4.0	4.0	3.0	3.0
Government final consumption, % of GDP	14.1	14.5	14.3	14.0	13.9	13.9	13.9	13.9	14.0	14.2	14.4
Government final consumption, real growth % y-o-y	-3.5	-2.2	2.0	4.9	4.0	3.5	3.5	3.5	4.0	4.5	5.0
Fixed capital formation, % of GDP	12.1	9.0	8.1	7.3	6.8	6.7	6.5	6.5	6.4	6.3	6.2
Fixed capital formation, real growth % y-o-y	-4.0	-14.5	1.3	3.0	4.0	5.0	5.0	5.0	5.0	5.0	5.0
Population, mn	82.91	83.99	85.03	86.02	86.98	87.89	88.77	89.62	90.43	91.21	91.95
Consumer price inflation, % y-o-y, ave	28.0	25.0	14.0	10.0	10.0	8.0	7.0	6.0	6.0	6.0	6.0
Lending rate, %, ave	15.0	13.0	10.0	8.0	8.0	8.0	7.0	7.0	7.0	7.0	7.0
Exchange rate IRR/USD, ave	42,000.00	42,000.00	47,500.00	55,000.00	57,500.00	58,250.00	58,750.00	59,000.00	59,000.00	59,250.00	59,750.00
Exchange rate IRR/EUR, ave	47,045.42	44,100.00	52,250.00	61,600.00	65,550.00	66,987.50	68,150.00	68,440.00	68,440.00	68,730.00	69,310.00
Budget balance, USDbn	-24.9	-35.8	-36.8	-37.0	-39.9	-42.0	-44.0	-45.8	-47.7	-48.7	-48.4
Budget balance, % of GDP	-4.7	-5.7	-5.7	-5.6	-5.5	-5.3	-5.0	-4.8	-4.6	-4.3	-3.9
Goods and services exports, USDbn	74.0	58.4	61.5	67.6	72.1	76.3	80.7	84.9	89.0	93.3	97.8
Goods and services imports, USDbn	65.2	64.1	67.5	72.5	76.3	79.7	83.3	86.3	89.3	91.8	94.3
Balance of trade in goods and services, USDbn	8.7	-5.7	-6.0	-4.9	-4.2	-3.5	-2.7	-1.3	-0.3	1.5	3.5
Balance of trade in goods and services, % of GDP	1.7	-0.9	-0.9	-0.7	-0.6	-0.4	-0.3	-0.1	0.0	0.1	0.3
Current account balance, USDbn	9.2	-5.3	-5.5	-4.4	-3.6	-2.9	-2.0	-0.7	0.4	2.2	4.2
Current account balance, % of GDP	1.8	-0.8	-0.8	-0.7	-0.5	-0.4	-0.2	-0.1	0.0	0.2	0.3
Foreign reserves ex gold, USDbn	106.6	90.6	87.9	91.4	95.0	98.8	102.8	106.9	111.2	115.6	120.3
Import cover, months	16.7	16.4	16.3	15.7	15.5	15.5	15.4	15.5	15.5	15.7	0.0

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

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