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Iran's Sovereign Ratings Affirmed, with a 'Stable' Outlook

RATING ACTION

Capital Intelligence Ratings (CI Ratings or CI), the international credit rating agency, today announced that it has affirmed Iran's Long-Term Foreign and Local Currency Sovereign Ratings at 'BB-' and its Short-Term Foreign and Local Currency Sovereign Ratings at 'B'. At the same time, the Outlook for Iran's ratings has been affirmed at 'Stable'.

RATING RATIONALE

The ratings reflect the relatively favourable short to medium-term economic and fiscal outlook following the lifting of international economic and financial sanctions relating to the country's nuclear programme. As a result, Iran has begun to gradually repatriate previously frozen external financial assets and export more hydrocarbons to a wider range of markets, thereby improving the country's medium-term economic growth prospects and increasing the central government's oil revenues. However, the ratings remain constrained by the uncertainty surrounding the tense relationship between Iran and the current US administration with regards to the lifted sanctions, as well as by the slow pace of fundamental reforms and high political and geopolitical uncertainties.

The Iranian economy is expected to continue its recovery in FYE 2018, underpinned by the growth of the hydrocarbon sector, a small rebound in other key sectors that receive financial support from the government (such as the petrochemical and construction sectors), and a pickup in domestic demand. Real output is estimated to increase by 3.8% in the fiscal year that ends in March 2018, up from an estimated 3.5% in FYE 2017. The outlook remains broadly favourable in the short to medium term with real GDP expected to grow by an average of 4% in FYE 2019-20. In March 2017 the Iranian parliament approved the sixth national development plan, which sets out the economic targets to be achieved over the next 5 years. The plan focuses on attracting investment and introducing full legal, banking, and economic reforms to reduce fundamental weaknesses. In CI Ratings' view, the plan could boost the medium-term outlook if reforms are implemented as planned and targets met.

Despite the recent volatility in the exchange rate associated with the uncertainty surrounding the US' commitment to the nuclear deal, the gap between the official exchange rate and the market rate has fallen further to around 17% as of June 2017, compared to a record high of 114% two years ago. Inflation has also declined, standing at 10% in FYE 2017, compared to a record high of 34.7% in FYE 2013, and is expected to stabilize at around 9% in FYE 2019-20.

Notwithstanding the positive macroeconomic developments, political and geopolitical uncertainties continue to hamper a speedier recovery. The uncertainty surrounding the latest US stance with regards to the nuclear agreement, as well as the Islamic Republic's foreign policy towards neighbouring Syria and Iraq, could spur a new bout of tension, increasing the ambiguity regarding the sustainability of the nuclear agreement. However, CI's view is that a possible US withdrawal from the nuclear agreement is not likely to affect the continuity of the nuclear agreement with European counterparts. Moreover, the impact on the Iranian economy is expected to be contained and limited mostly to capital inflows given the fact that Iran manages its foreign transactions in Euro and it relies on Asian markets for its trade. Additionally, geopolitical risk factors remain elevated in view of the ongoing conflicts in Syria, Iraq, and Yemen, in addition to the tense relationship with some key GCC member states, especially Saudi Arabia.

On the fiscal front, the public finances are expected to remain satisfactory. The structure of the budget is expected to continue improving due to policy reforms and efforts to broaden the tax base. The primary central government budget position is expected to return to surplus in FYE 2019, conditional on the implementation of planned fiscal consolidation measures and premised upon an increase in OPEC oil prices to an average of USD60 per barrel.

Iran's public debt remains low and official foreign assets remain sizeable, estimated by the International Monetary Fund (IMF) to be equivalent to around 22 months of imports of goods and services and around 16 times as high as external debt payments falling due in FYE 2018 (although there is still some ambiguity regarding the liquidity and usability of these assets).

The banking system remains undercapitalized and poses substantial contingent liabilities to the sovereign. Asset quality, capital adequacy, liquidity, and profitability have been adversely affected by the sanctions and rigid government credit policies. Outstanding government payments (arrears) are a challenge for corporates and banks.

Iran's sovereign ratings remain constrained by the heavy reliance on oil and by fundamental weaknesses in the economy, which have been aggravated by the long period of economic sanctions. It will take time and ongoing commitment to implement important structural reforms. The ratings are also constrained by continued government expenditure rigidity, as well as the weak financial system, institutional shortcomings (including limited disclosure of data), and complex internal politics.

OUTLOOK

The Outlook for the ratings is 'Stable'. This indicates that Iran's sovereign ratings are likely to remain unchanged within the next 12 months provided that key metrics evolve as envisioned in CI's baseline scenario and no other credit quality concerns arise.

CREDIT RATINGS

Foreign Currency		Local Currency		Outlook	
LT	ST	LT	ST	FC	LC
BB-	B	BB-	B	Stable	Stable

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The ratings have been initiated by Capital Intelligence. The issuer did not participate in the rating process. The information source used to prepare the credit ratings is public information. CI had access to the published fiscal and external accounts of the rated entity for the purposes of the rating, but did not have access to any other relevant internal documents. However, CI considers the quality of information available on the issuer to be satisfactory for the purposes of assigning and maintaining credit ratings. Capital Intelligence does not audit or independently verify information received during the rating process.

The rating has been disclosed to the rated entity and released with no amendment following that disclosure. Ratings on the issuer were first released in April 2007. The ratings were last updated in April 2017.

The principal methodology used in determining the ratings is the Sovereign Rating Methodology. The methodology, the meaning of each rating category, the time horizon of rating outlooks and the definition of default, as well as information on the attributes and limitations of CI's ratings, can be found at www.ciratings.com. Historical performance data, including default rates, are available from a central repository established by ESMA (CEREP) at http://cerep.esma.europa.eu.