# The Economic Implications of Iran's Economic Sanction Relief

**By Bruno Versailles**

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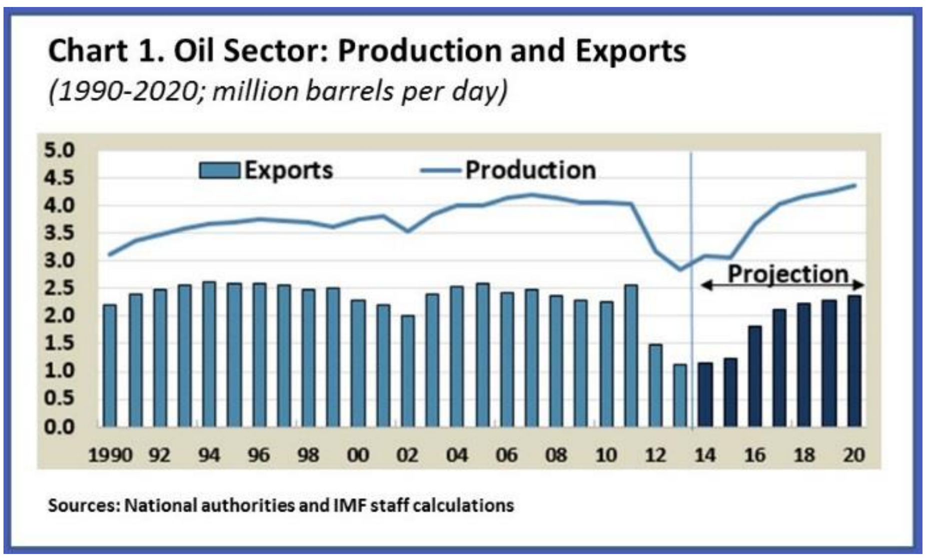
On July 14, 2015, Iran and the five permanent members of the United Nations Security Council (China, France, Russia, U.K., and U.S.) plus Germany signed the Joint Comprehensive Plan of Action (JCPOA) on Iran's nuclear program, paving the way for the relief of sanctions and Iran's re-integration into the world economy and was subsequently adopted by all parties on October 18, 2015. Sanctions were effectively lifted on January 16 after Iran had complied with its commitments under the Agreement. This easing of sanctions is expected to improve Iran's economic performance significantly, while the rest of the world is likely to benefit through lower oil prices and increased trade and investment opportunities.

Let us start with what the agreement actually says. The Joint Comprehensive Plan of Action is providing sanctions relief in the following three main areas, with concomitant benefits to the Iranian economy:




(i) Exports of oil and gas – a positive external demand shock to the Iranian economy;

(ii) Financial services, including restored access to the international payment system (SWIFT) – a positive terms-of-trade shock as it would imply a decline in the cost of external trade and financial transactions; and

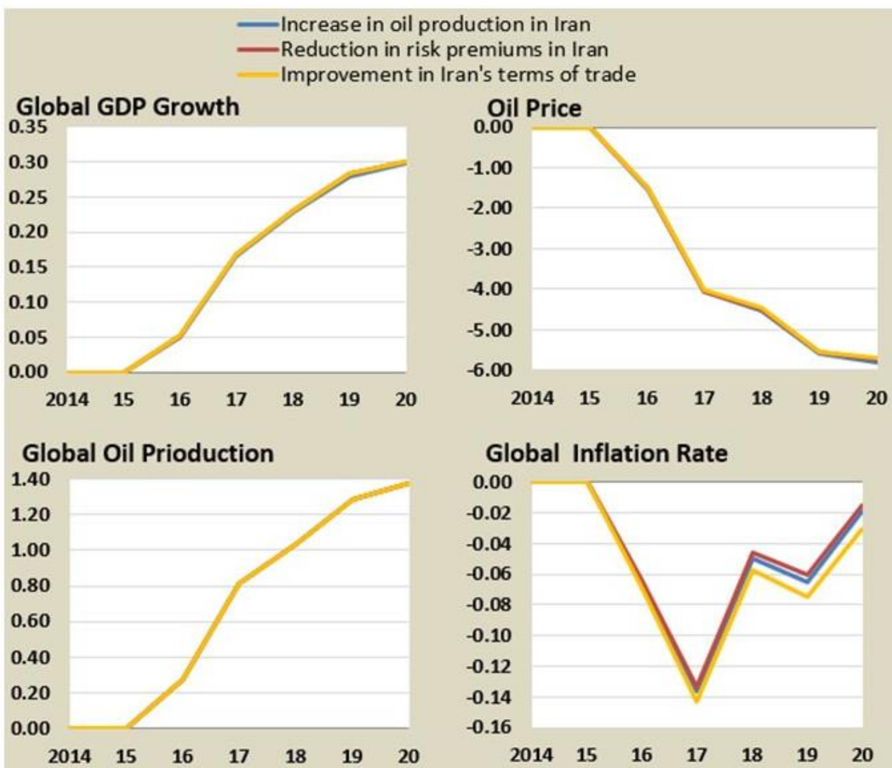
(iii) These direct effects should propel Iran's growth to over 4 percent, driven by the expected increase in oil production – estimated at 0.6 mbpd in 2016, increasing to 1.2 mbpd over the medium term (Chart 1).

Economic prospects would improve further, if the easing of the sanctions is accompanied by reforms to address structural vulnerabilities, such as weak corporate and bank balance sheets, government arrears, and high unemployment. In any event, macro-economic policies would need to be in line with the authorities' goals of low inflation, a competitive real exchange rate, and sustainably higher inclusive growth.

## Impact on the Global Economy

Global GDP is estimated to rise by about ¼ percent over the medium term, mainly owing to a decline in oil prices triggered by an increase in oil supply from Iran but also to an increase in non-oil trade with Iran. A gradual rise in Iran's oil production could amount to an increase of almost 1½ percent of global oil production by 2020, and is likely to drive global oil prices even lower (Chart 2). Declines in Iran's risk premium and trade costs are likely to have much smaller global and regional spillovers than the decline in oil prices. The magnitude of the oil price decline is highly uncertain, however. It depends on how quickly Iran is able to raise its oil production and how other oil suppliers respond. Under plausible assumptions the decline in oil prices could range from 5 to 10 percent over the medium term. This assumes that OPEC members do not compensate for an increase in Iran's oil exports by cutting their own oil production – consistent with recent OPEC announcements.

**Chart 2. Estimated Global Impact of Sanctions Removal**
*(percent difference)*

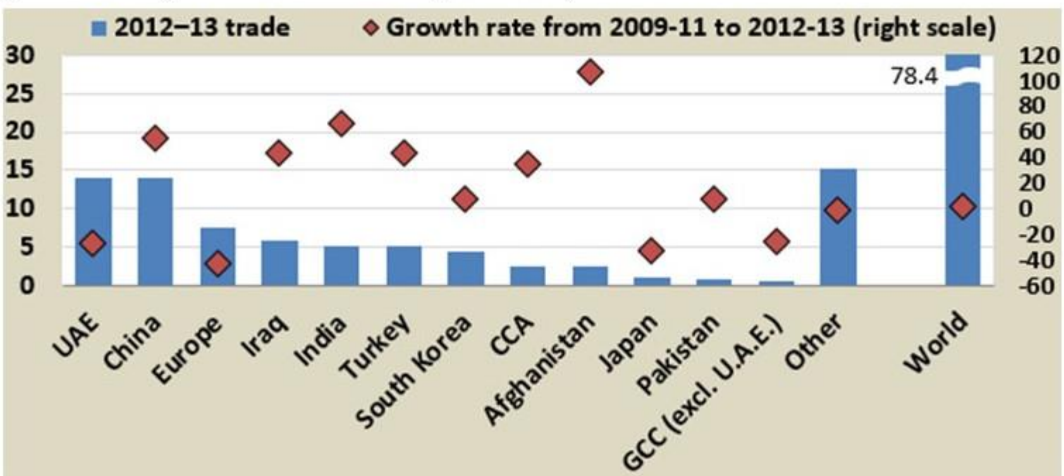



Source: IMF staff estimates

Non-oil trade between Iran and the rest of the world is currently limited but is expected to rise post-sanctions. This reflects the aforementioned lowering of transaction costs, but also growth in the rest of the world and Iran's expected economic acceleration. The latter implies an increase in Iranian imports by 50 percent between 2015 and 2020, worth an accumulated $525 billion, with ample opportunities for trading partners. For example, the lifting of the sanctions could add more than 1 percentage point to the United Arab Emirates' real GDP over the period 2016-18 just through higher non-hydrocarbon exports alone. Although moderating, economic growth in China and India is expected to remain strong, solidifying the position of these countries as increasingly important trading partners for Iran (Chart 3). Iran has already signed a preferential trade agreement with Turkey, while European countries, having seen their trade share diminish during the sanctions period, may regain access to the Iranian market. Finally, economic benefits to countries in the Caucasus and Central Asia are more likely to materialize over the long run, and will depend on whether they can become transit points for growing trade among China, India, Europe, Iran, and other countries in the region.

**Chart 3. Non-Hydrocarbon Trade 2012-13, and Growth in Trade From 2009–11 to 2012–13**

*(Billions of US dollars and percent)*




Sources: World Trade Atlas; and IMF staff calculations

Of course, assessing the potential impact of these effects is subject to a great deal of uncertainty. This fundamentally stems from the lack of comparable historical precedents and the conditional nature of sanctions removal, i.e., the possibility that sanctions will be reinstated if concerns arise regarding Iran's compliance. In addition, it remains unknown how quickly Iran will be able to ramp up its oil production, given the significant investment needs in its oil sector, and how other oil producers will respond.

Nevertheless, if sanctions are eased significantly and sustainably, Iran is likely to see a significant economic improvement in the years ahead, provided that sound macroeconomic policies and comprehensive structural reforms are implemented, and its trading partners and the world as a whole are likely to benefit through lower oil prices and increased trade and investment.

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