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Iran's Economy To Sink Even Faster This Year Than Last

Simon Constable

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U.S. sanctions are squeezing the life out of the Iranian economy, and the malaise is likely to get even worse.

“We expect the contraction to deepen,” states a recent report by Garbis Iradian and his team at the Washington D.C.-based think tank, the Institute of International Finance.

How bad? In the current fiscal year, which ends in March, the Islamic Republic's economy will likely shrink by 7.2%, that's even worse than the already-dire 4.6% drop the prior year, according to the report.

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Institute of International Finance

The immediate and pressing problem comes from the U.S. sanctions that curtailed exports of oil. That has deprived the government of vital revenues.

These exports dropped from 2.8 million barrels a day in May 2018 to a paltry 400,000 recently, the IIF says. In other words, energy exports are down a staggering 86% over the period.

Crunch time for government budget

Ultimately, that reduction in petroleum exports will pinch government spending. The forthcoming budget, which starts March 20, will be “very tight,” the IIF report says.

Put bluntly, the country's leaders will have to impose a period of brutal austerity as well as borrow as best they can. And they'll have to do that amid civil unrest across the country.

The effect of the sanctions adds stress to an already mismanaged socialist-style economy.

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“It's a state-managed, state-run economy and that makes it very vulnerable,” says Steve Hanke, professor of applied economics at The Johns Hopkins University, and head of the troubled currencies project at the Cato Institute.

Put another way, Iran gets run in a similarly incompetent way to the centrally planned economies of the Soviet Union, which eventually disintegrated in 1991.

Currency stable, for now

Meanwhile, there is one small spot of economic brightness. Recently, the value of the Iranian Rial, the country's currency, has stabilized. In turn, that has helped curtail the runaway inflation that blighted the economy recently.

The official, or government-decided exchange rate has remained relatively stable at 42,000 Rials per dollar for the past couple of years. But the free market rate, which better reflects reality, has been in something of a free fall for most of that time.

As recently as late April 2018, one dollar would fetch 56,500 Rials in the free market. By mid-November last year, a greenback would get you 123,800 Rials. In other words, the Rial would get you less than half the amount of dollars than it did less than two years ago.

That's a lot of devaluation, which has led to massive inflation. Hanke, who is the leading expert on inflation and troubled currencies, says Iran's inflation hit a recent annualized peak of 399% in October 2018. He calculates the inflation rate using the free market exchange rate and the costs of a basket of goods.

Last December something changed amid the protests and the assassination of Iran's leading General Qassem Soleimani. The Rial stopped falling. It has hovered around 135,000 since mid-December.

"What the market is saying that the Iranians will keep inflation under control," Hanke says.

Although he declines to forecast what will happen next, Hanke estimates the country's current inflation at around 20%. That's still high, but nothing like the previous levels.