

## Talking point

### Iran nuclear agreement: Potential effects on the German economy

July 20, 2015

**If all goes well, the Iranian economy could begin to reintegrate into the world economy in early 2016. This harbours opportunities especially for Iran itself and its 80 million inhabitants. However, it is also likely to provide a moderate stimulus to world trade and German exports. In addition, increased Iranian oil production could dampen oil prices and thus support the growth of real income of German households.**

Despite all the warranted diplomatic caution, many politicians all over the world are hailing the agreement of Iran with the Group of Six after 13 years of negotiations as historic. It opens up opportunities to dismantle trade and financial sanctions step by step. The sanctions were introduced in 2006 and tightened in 2010, 2012 and 2013 to increase pressure on the Iranian government and slow down the progress of the Iranian nuclear programme. For a lifting of nuclear sanctions really to materialise, Iran has to fulfil exacting conditions (including capping the number of centrifuges for the enrichment of uranium, full access of IAEA inspectors to nuclear facilities). A respective confirmation by the IAEA is not expected until early 2016. Furthermore, the agreement still has to pass the sceptical US Congress. However, US President Obama – if need be by using his right of veto – is likely to succeed in gaining approval for the accord.

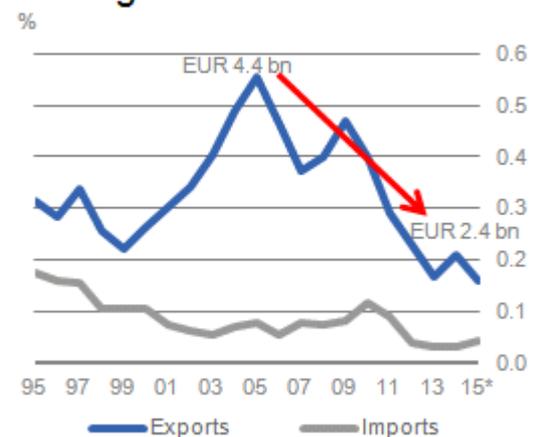
For Iran and its population, a lifting of the nuclear sanctions and its gradual reintegration into the world economy would open up considerable opportunities. After the sanctions were tightened in 2011 and, in particular, income from oil sales vanished, the country fell into recession. GDP fell by 6.6% in real terms in 2012 and by 1.9% in 2013. Last year's recovery (+3%) was moderate in comparison. Growth averaged 5.2% over the 10 years before the recession. Iran may hope for the release of frozen funds in the amount of EUR 100 bn. This could help to whip the languishing oil production sites back into shape and to generate export revenues to finance investments in the domestic economy.

The spillover effects on the global economy and the German economy should be moderate, though. With its roughly 80 million inhabitants, Iran accounts for only close to 1.1% of the world's population. At 1.2%, the share in global economic output is not much higher, either, and Iran's share in world trade is only just below 0.5%. On the basis of the ratio between the share in global GDP and the share in global exports of other countries, Iran's share in world trade could conceivably double.

#### German exporters all set

The primary transmission mechanism to the German economy is via exports. In the wake of the more restrictive sanctions and the Iranian recession, German exports had fallen from EUR 4.4 bn (2005) to below EUR 2 bn (2013). The share in German total exports therefore fell from 0.6% to 0.2%, and Iran dropped to only 50th place in the export market ranking (2005: 32nd). Machinery and vehicle exports, which more than halved from EUR 2 bn in 2010, suffered most. By contrast, German food exports to Iran actually rose in the last few years.

#### Strong decline in Iran's importance for German foreign trade



2015: Jan-April

Source: Federal Statistical Office



Germany is one of Iran's most important trading partners and is likely to benefit from the lifting of sanctions. Furthermore, a major investment backlog is likely to have accumulated in Iran, which in view of the specialisation of German exporters in this segment should also have a positive effect. The German vice chancellor and economics minister Gabriel already paid a visit to Iran with a small delegation of German companies. If German exports to Iran were to rise towards their previous peak, this would correspond to an increase of EUR 2 bn. The increase could even come to EUR 4.5 bn if Iran's export share were to rise back to 0.6%. In the latter scenario, German GDP growth could be stimulated by an increase of, say, a maximum of 1/4% – spread over several years.

This analysis only refers to goods trade, however. Trade in services has grown noticeably in importance over the last few years. Here, for instance German architecture firms could benefit from investment in infrastructure. On the other hand, China has strengthened its position in Iran perceptibly and is thus in a good starting position to benefit from the end of sanctions.

### Rising oil supplies support real incomes

The second effect of the deal on the German economy (which is attracting less public attention) could be to boost Iranian oil exports. According to the expectations of our Commodities team, Iran will be able to raise its production only gradually owing to the poor state of its production sites. By mid-2016, they expect a potential maximum increase of 400,000 b/d (~+14%), which could be repeated by 2020. Thus, our oil price forecast is subject to downward risks as increasing supplies coincide with moderately flexible demand. Deutsche Bank forecasts an average oil price of USD 60 per barrel of Brent in 2015 and USD 70 by 2016 in comparison to currently approx. USD 58.

Lower or less strongly rising oil prices leave more money in German households' wallets for other (domestic) goods and services. Technically speaking, lower energy prices dampen inflation and thereby support real disposable income. This effect is one of the main driving forces this year after last year's oil price drop and crucially contributes to our forecast that real private consumption is likely to rise by more than 2% in 2015. The effect of rising Iran production strongly depend on price reaction and the pace at which Iran is able to increase its oil production. Currently, Iran's share in global oil production is roughly 9% (2006: more than 13%).

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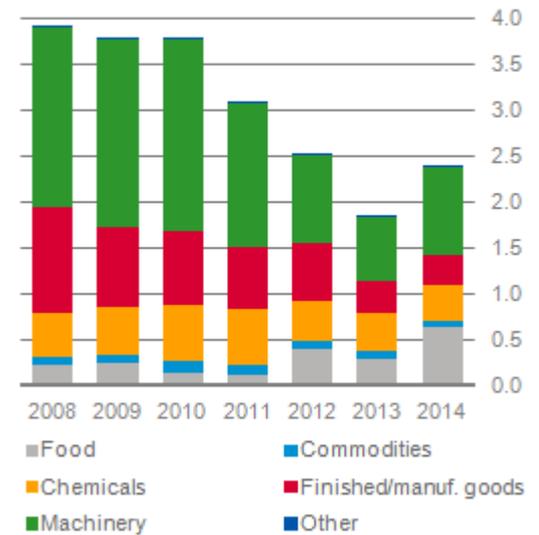
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## Machinery and chemicals main export products

EUR bn, German exports to Iran



Sources: Federal Statistical Office, Deutsche Bank Research

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