

January 8, 2018

## **The Iranian Protests**

*(N.B. Due to Martin Luther King Jr. Day, our next report will be published January 22, 2018.)*

In early December, small protests developed in parts of Iran due to sharp increases in some food prices. By the last week of 2017, the protests had spread across the country and have continued into the New Year. In this report, we will discuss the current protests, comparing them to the unrest that developed in the wake of the 2009 elections in Iran. We will examine Iran's geopolitical position, focusing on the country's natural barriers that both protect it and increase the costs of power projection. We will analyze the possible impact of the protests and conclude, as always, with potential market ramifications.

### **The Protests**

Recent protests in Iran have left 22 dead and over 450 people incarcerated. These protests, though widespread, are fundamentally different from the 2009 "Green Movement." One important contrast is that the participants are not the same. The 2009 protests were a fight between competing elites as the "reformists" and "hardliners" were vying for power. The hardliners won. However, these terms should be used with great care. The hardliners are fairly obvious in their views, but the reformers were not "reformers" in the Western sense. They were as committed to the Islamic Revolution as the hardliners. The reformers were simply open to more social and market freedoms compared to the hardliners, but neither group was willing to

allow for full democracy. When Akbar Hashemi Rafsanjani<sup>1</sup> is considered a reformer, it is clear the differences between the two groups aren't all that great.

The current protestors, instead, are from the lower economic classes. In some respects, these protests reflect similar political issues recently seen in the West. These protestors are angry about the state of the Iranian economy. Officially, unemployment is 20%, but economists estimate that unemployment among Iranian youth is probably closer to 40%. Many of the protestors are from the underclass from the countryside who have moved to towns and cities in the hope of finding work only to find unemployment. This group has traditionally supported the regime. In 2009, they would have been opposed to the Green Movement. But, Iranian President Rouhani raised hopes of economic improvement after the nuclear deal that has, thus far, disappointed the masses. Not only are jobs scarce, but inflation remains elevated. The official data indicates that Iranian CPI rose to 9.6% in November compared to an 8.4% rise in October. These numbers appear rather benign compared to the 45% rate in the latter half of 2013. However, during this earlier period, the regime could blame poor economic conditions on Western sanctions. Now that most international sanctions have been lifted, the current state of the economy remains disappointing. One could argue that President Rouhani oversold the positive impact of lifting sanctions to foster support for the nuclear deal. In his defense, however, he probably assumed that Hillary Clinton would win in 2016 and continue the

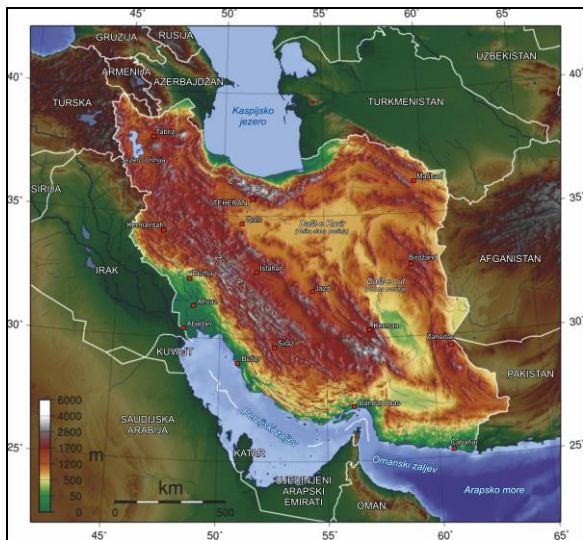
<sup>1</sup> See WGR, 2/6/2017, [Exit the Shark](#).

policies of Barack Obama, who seemed open to normalizing relations with Iran.

Reportedly, one of the catalysts for the protests was a leaked government budget that showed billions of dollars going to the clerical elite and the Iranian Republican Guard Corps (IRGC), while cutting social spending and raising subsidized fuel prices and educational tuition. In other words, money was being channeled to areas that help Iran project power and taken away from the common citizens. Another problem was simply bad luck. A bout of avian influenza struck Iran's poultry industry, leading to the death of thousands of birds. This outbreak has reduced the supply of both chicken and eggs and led to rising prices.

### Iranian Geopolitics

Iran's geopolitics are key to understanding the protests and the study of geopolitics usually begins with geography. Iran is a mountainous nation with an internal flatlands of salt and a few valleys.



(Source: Wikipedia Commons)

With the exception of lowlands on the border with Iraq and surrounding the Caspian Sea and Persian Gulf, Iran has a

rugged physical environment. The geophysical characteristics of Iran make it difficult to invade. History tends to confirm this idea. There is a reason that Alexander, who invaded Persia during 355-328 BC, is called “the Great.” The best way for Americans to understand this difficulty is to imagine a land army trying to march through the Rockies. Thus, Iran has been mostly safe from invasion and, if invaded, the invaders were usually spent due to the effort.<sup>2</sup>

At the same time, it is costly for Iran to project power. Running the economy in this hostile environment is expensive and funding forces to take territory further increases those costs. Throughout history, Persian empires used proxies to project power, just as Iran does today by co-opting the Iraqi government and through Hezbollah.

Over the past few years, Iran has found itself on the cusp of regional hegemony. It has mostly co-opted the Iraqi government in Baghdad. Shiite militias, which hold great power in Iraq, are beholden to Tehran. Islamic State is essentially defeated and much of the “heavy lifting” of eradicating the group was done by the U.S. and others. Bashar Assad remains in power in Syria (or what's left of it) and is allied with Iran. Hezbollah was not only an effective force in defeating Islamic State, but it was also key in supporting Assad. In addition, the experience of combat has arguably made Iran an even more formidable force in the region. Iran's support of the Houthis in Yemen is pressuring its primary rival in the region, Saudi Arabia, and recent missile attacks have put Riyadh on edge.

<sup>2</sup> It should be noted that Alexander the Great died five years after his conquest of Persia at the age of 32.

Given these successes, it is understandable why the government's budget would favor more resources for projecting power in the region. After all, Iran has been on a remarkable streak and pressing the advantage makes sense. However, diverting funds to support power projection, as the budget indicates, comes at the expense of the domestic economy and the most vulnerable members of Iranian society.

A common theme heard in the protests is the call for keeping resources at home to help the lower classes instead of expending those resources to project power. This viewpoint is not specific to Iran. Spending more at home was also a theme in the U.S. presidential elections, not only in 2016 but also in 2008 and 2000.<sup>3</sup>

### **The Impact of the Protests**

So, what happens next? The regime has been remarkably restrained so far. We believe this is because it recognizes that it really doesn't face much of a threat from the protests. Compared to the 2009 event, the protestors are not well-organized and they lack the resources to maintain the protests indefinitely because they are poor. The young protestors in 2009 were children of the elite who had resources and were well-versed in social media. Those protests were a threat to the hardliners but not the clerical regime. Most of those supporting the Green Movement didn't want to get rid of the rule of clerics, they just wanted less strict enforcement of social rules.

Although the current protests are a threat to Iran's power structure, at present, it is not a serious one. Since the protestors lack the resources to overthrow the regime, we

expect them to steadily diminish in the coming days. At the same time, the simmering anger has to be a concern for the regime. After all, such ire can be co-opted by revolutionary leaders. The Russian Revolution of 1917 shows how a small group of talented leaders can use widespread despair to foment revolution. The most rational response from Rouhani and Khamenei would be to rescind the aforementioned budget, take resources from the clerics and the IIRCG, raise subsidies and cap prices of key goods and try to improve the lot of the poor.

However, that choice will limit Iran's ability to project power just when it is on the cusp of winning—as noted above, Iran pretty much controls Baghdad, Islamic State is essentially defeated and Assad remains in power in Syria. A path to the Mediterranean is opening up and the budget is designed to take advantage of that. The protests might delay or undermine Iran's ability to become the regional hegemon in the Middle East. Or, the leadership can decide to stay the course and hope that an alternative leadership doesn't emerge.

Our expectation is that the lure of geopolitical power projection will be too enticing for the Mullahs to resist. As noted above, Iran's influence has expanded greatly. Compare Iran's situation to where it was prior to the Iraq War that removed Saddam Hussein from power. Prior to that event, Iran was mostly contained by Iraq and it struggled to maintain ties with Hezbollah. Syria was a less than reliable ally and sanctions constrained the economy. Now, it essentially has a land bridge to the Mediterranean Sea and can sell oil to the world. Iran's leadership knows that such moments don't come along all that often. In addition, Iran faces a hostile U.S. administration (replacing a friendlier one),

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<sup>3</sup> It's worth noting that President Bush argued against nation-building in his foreign policy positions and President Obama wanted to spend more at home.

which may cause problems. As a result, time may not be on the Mullahs' side and moving quickly to secure Iran's current advantage makes sense. In addition, the crown prince in Saudi Arabia is trying to implement sweeping reforms. If he succeeds, the kingdom will become a much more formidable rival. Thus, being able to provoke unrest during this delicate and complicated reform process in Saudi Arabia could increase the likelihood of Iranian regional hegemony.

Unfortunately for the Iranian leadership, the problems affecting the economy won't go away anytime soon and may, in fact, get worse. President Trump is considering new American sanctions on Iran which would likely hurt its economy. Of course, President Rouhani could blame the downturn on the new sanctions as such claims have pacified the lower classes in the past. Whether that tactic works in the wake of the budget revelations remains to be seen.

Finally, there is one other potential outcome. Iran, facing continued economic pressure,

may opt for a major conflict to create a distraction from its domestic problems. We view this as an unlikely path. Iran tends to operate covertly and has avoided open conventional wars. For example, it should be remembered that Iraq invaded Iran in 1980. Although the likelihood is low, it isn't zero, and it is something we will monitor this year.

### **Ramifications**

The primary market ramification for unrest in Iran is higher oil prices. History shows that the major oil producers are usually successful in overcoming obstacles to maintain oil flows but the threat to supply reduction remains. A secondary effect we will be watching is in cryptocurrencies. We have seen North Korea use these instruments to evade sanctions. If Iran believes new financial sanctions are coming, it would not be a major surprise to see a move to own various cryptocurrencies in a bid to evade restrictions.

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