

## China-Iran: Close, but not cosy

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- Co-operation between China and Iran continues to develop following a 25-year agreement that was signed in March 2021.
- While oil is critical to bilateral relations, China's increasing control over independent refiners is likely to affect future trade links with Iran.
- Diplomatic ties are still strong, but they may be overstated by Iran; China is likely to pursue a neutral position in the MENA region.

### Diplomacy sailing on steady waters

Despite providing Iran with a lifeline in the face of US-imposed sanctions, China is wary of getting too close to the Islamic Republic.

- China is ready to open a consulate in Iran's strategically located Bandar Abbas (Hormozgan province).
  - Bandar Abbas is located on the Strait of Hormuz across from Oman.
  - There is already a strong Chinese economic presence in the Makran region, and it is set to grow.
    - The Makran region is a coastal area that covers Sistan province (Iran) and Balochistan province (Pakistan). China has already signed a 40-year multi-billion-dollar agreement with Pakistan to develop Gwadar port (Balochistan).<sup>2</sup>
    - The consulate will augment China's existing economic presence in the Chabahar Free Trade-Industrial Zone (a free trade area in Iran). It also signals that China is keen to expand its presence in order to support its coastal activity in the region.
  - Bandar Abbas is the home of the Iranian navy.
  - China and Iran have a history of conducting naval drills alongside Russia.
    - The last such drill was conducted in August 2021, with the next due to take place early this year.
    - Besides protecting crucial shipping links and deterring piracy, these drills are a show of diplomatic support to the international community.
    - China and Russia have both downplayed the political significance of these exercises, while Iran continues to publicise its ostensibly strong relations with both powers.
- While Sino-Iranian ties continue to take shape, they will not supersede China's relations with other regional players.
  - In 2020, China imported one third of its energy needs from GCC states. Most of this came from Saudi Arabia (15.5%), followed by Oman (7%), the UAE (5.5%) and Kuwait (5%).
  - As well as quietly supporting Iran during the Joint Comprehensive Plan of Action (JCPOA) negotiations,

Table 1 - Iran-China macroeconomic indicators<sup>1</sup>

		2020	2021e	2022f
Real GDP Growth (%)	Iran	3.4	2.5	2.0
	China	2.3	8.0	5.6
GDP Per Capita (Thousands)	Iran	9.9	12.7	13.2
	China	10.5	11.9	13.0
CPI Inflation (%)	Iran	36.4	39.3	27.5
	China	2.4	1.1	1.8
Fiscal Balance (% of GDP)	Iran	-5.7	-6.5	-7.3
	China	-11.2	-7.5	-6.8
C/A Balance (% of GDP)	Iran	-0.1	1.3	1.0
	China	1.8	1.6	1.5
Total Gov't. Gross Debt (% of GDP)	Iran	39.5	33.6	33.3
	China	66.3	68.9	72.1
Population (Millions)	Iran	84.1	85.0	85.8
	China	1.400	1.420	1.420

China is bolstering Saudi Arabia's missile defence systems.

- China has historically refused to take sides in the context of MENA rivalries, and is likely to pursue strong relationships with all regional players.
  - Tellingly, China refrained from publicising the 25-year agreement, while Iran's former president Hassan Rouhani (in office 2013-2021) made it a focal point of his media campaigns.
- Iran has been heavily influenced by China throughout the JCPOA process. Given that China is one of the few countries willing to do business with Iran in the face of US sanctions, it wields great leverage. Nevertheless, Chinese support is rarely demonstrated overtly.
  - Russia has adopted a far more public show of support for Iran, as evidenced by the active involvement of Mikhail Ulyanov, Russia's permanent representative to international organisations in Vienna.
  - The US recognises that China could be critical in terms of securing a resolution, and that it may lose patience with further Iranian intransigence.
    - For now, China is likely to continue providing Iran with discreet diplomatic cover.
- Iran's foreign minister, Hossein Amir-Abdollahian, is due to visit China this week, though his exact itinerary remains unclear.
  - The JCPOA talks will almost certainly be on his agenda. The outcome of any such discussions could influence the direction of the sluggish negotiations in Vienna.
  - Amir-Abdollahian has been in China at the same time as the foreign ministers of Bahrain, Kuwait, Oman and Saudi Arabia, along with the secretary general of the GCC. It is unclear whether Amir-Abdollahian met with his GCC counterparts during his trip.
    - These visits highlight a shift in global and regional dynamics, as MENA countries now appear to be addressing their geopolitical concerns with the help of China.
    - During previous such visits, China has made clear its preference for discussing security issues with all affected regional players.
  - Afghanistan represents another key element of Sino-Iranian relations.

<sup>1</sup> Arabia Monitor; IMF.

<sup>2</sup> See Arabia Monitor publication, "Russian Influence in MENA: Trump or Joker?" (March 2017)

- China's foreign minister, Wang Yi, has long advocated for Afghanistan's neighbours to co-operate in supporting the formation of a stable and inclusive government in Afghanistan.
- This foreign policy stance was demonstrated by the multiple recent visits conducted by China's special envoy for Afghan affairs, Yue Xiaoyong, to Iran, Pakistan, Qatar and Russia.

### Trade ties trump sanctions

China remains Iran's top trading partner. Even amid the maximum pressure sanctions imposed on Iran by the former US president Donald Trump (in office 2017-2021), China continued to stockpile Iranian oil.

- China's appetite for Iranian oil has been steady, especially during the past year.
  - The country went on a purchasing spree of Iranian crude last month after independent refiners were granted additional import quotas for 2021.
  - China imported almost 18M barrels of Iranian oil in November 2021, which is the equivalent of around 600k bpd.
    - This represents a 40% increase from October 2021 as well as the largest volume of oil imports since August 2021.
  - Crude purchases of Iranian and Venezuelan oil reached a three-year high in 2021, though this was not consistent across the year.
    - Imports of Iranian and Venezuelan crude throughout 2021 were 55% higher than in 2020.
- China's crackdown on independent refiners accounts for the fluctuations in crude imports, which may continue in the coming months.
- Independent refiners, known as 'teapots', are largely responsible for increasing crude demand in recent years and currently account for 24% of China's overall crude imports.
  - Many teapots have the flexibility to purchase cheap Iranian oil because they have not signed long-term deals with other Middle Eastern producers.
    - China has not officially imported Iranian crude since December 2020, with oil from the Islamic Republic often labelled as Omani or Malaysian.
- Since much of Iran's exports are contingent on quotas granted to independent Chinese refiners, smaller quotas may result in a reduction of Iranian imports.
  - Overall, an expanded refining capacity could help to offset these concerns. However, this would only be achieved in the medium-to-long term.
  - The sheer quantity of purchases in 2021 offset the caps imposed on independent refiners.
  - In addition, China is expected to decrease its purchases from all refiners until after the Lunar New Year (February 2022).
- In the past year, numerous Chinese businesses and individuals have been sanctioned by the US.
  - In early 2021, Iran was reportedly interested in buying 36 J-10C fighter jets from China. However, Iran was short of cash, and China was not ready to sign an oil-for-arms deal.
  - The risk of sustained US sanctions may explain China's reluctance to facilitate the arms deal.

Figure 2 - Chinese imports of Iranian oil<sup>2</sup>

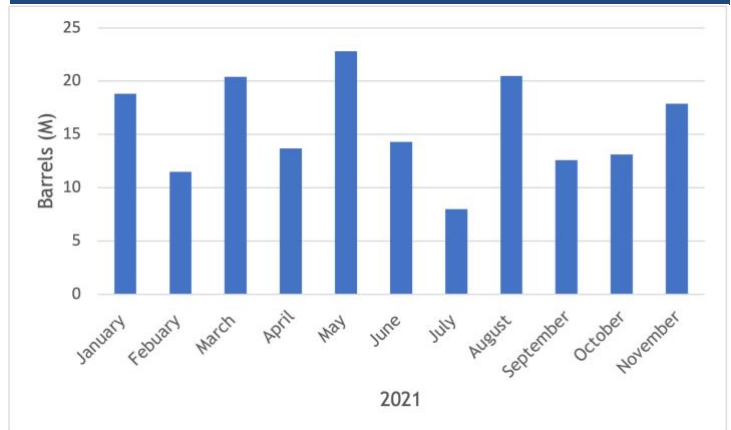


Figure 3 - Top export destinations of Iran (2021)<sup>3</sup>

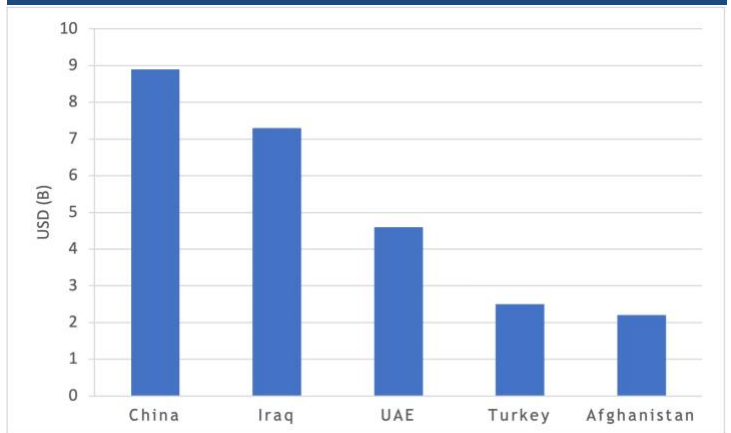
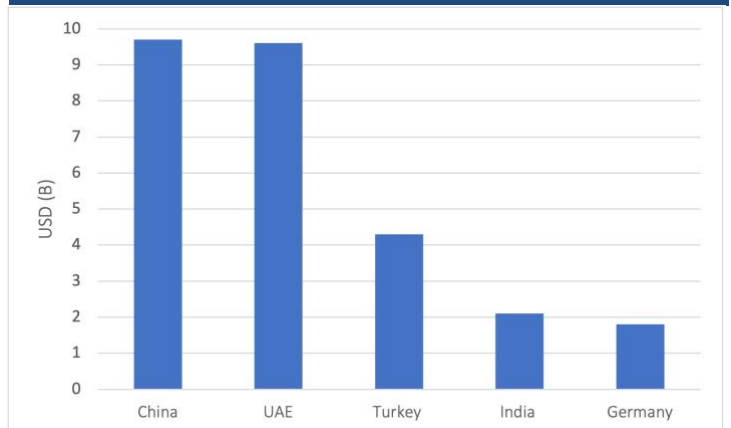


Figure 4 - Top import sources of Iran (2021)<sup>5</sup>



- Nevertheless, it is evident that both countries are exploring new areas of co-operation. Amid negotiations concerning the construction of a railway between Basra (Iraq) and Shalamcheh (Iran), the Islamic Republic is now suggesting that Iraq should use this railway to connect directly to China via Iran.
- In the SME sector, the Iran Small Industries and Industrial Parks Organization (ISIPO) and the Shanghai International Co-operation Association of Small and Medium Enterprises have launched a centre for co-operation. The centre will focus on developing closer relations between both countries' SMEs.

<sup>3</sup> Arabia Monitor; Kpler.

<sup>4</sup> Arabia Monitor; Islamic Republic of Iran Customs Administration.

<sup>5</sup> Arabia Monitor; Islamic Republic of Iran Customs Administration.



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