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Recent Economic Developments in Iran

A Quarterly Report



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Notes

Note 1: In this Report the growth rate of a variable means the percentage change of that variable during the period under review, or at the point under discussion, from the similar period or point in the preceding year. As such, “the growth rate of oil revenues in the first quarter of 1396” indicates the percentage change in oil revenues between the first quarter of 1395 and the first quarter of 1396.

Note 2: Iran follows the Persian Calendar, a solar calendar in which years start on the first day of spring and end on the last day of winter. The four quarters of the year correspond exactly to the four seasons. The current Persian year is 1397 that started on March 21, 2018, and ends on March 20, 2019. The third quarter of 1396 (referred to as 1396Q3), fall of 1396, roughly corresponds to the fourth quarter of 2017 in the Gregorian Calendar (2017Q4).

The following table provides an easy reference while reading this Report.

1395Q4 = 12/21/2016 – 03/20/2017, roughly **2017Q1**

1396Q1 = 03/21/2017 – 06/21/2017, roughly **2017Q2**

1396Q2 = 06/22/2017 – 09/22/2017, roughly **2017Q3**

1396Q3 = 09/23/2017 – 12/21/2017, roughly **2017Q4**

1396Q4 = 12/22/2017 – 03/20/2018, roughly **2018Q1**

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<http://en.middleeastbank.ir/page/economic+developments+in+iran>

Iran's Economy at a Glance

	1395Q3	1395Q4	1395	1396Q1	1396Q2	1396Q3	1396Q4
Labor Force Participation & Unemployment Rates (percent)							
Participation (10 Years and Over)	38.9	38.9	39.4	40.6	41.0	40.1	-
Unemployment (10 Years and Over)	12.3	12.5	12.4	12.6	11.7	11.9	-
Unemployment (Youth Aged 15-24)	30.4	28.1	29.2	28.8	27.3	28.4	-
Real Growth Rates of GDP and its Subsectors at Constant 1390 Prices (percent)*							
Gross Domestic Product (GDP)	16.8	12.9	12.5	4.5	4.8	1.0	-
Oil	77.7	47.1	61.6	5.9	5.7	-7.3	-
Agriculture	5.0	4.4	4.2	3.9	4.2	4.1	-
Manufacturing and Mining	4.1	6.4	2.2	4.2	5.3	4.2	-
Services	6.0	4.9	3.6	3.9	4.1	3.1	-
GDP (Excluding Oil)	5.4	5.6	3.3	4.1	4.5	3.6	-
Gross Fixed Capital Formation	-9.5	3.1	-3.7	-1.9	1.4	4.0	-
Oil (thousand barrels per day)							
Production	3,963	3,909	3,761	3,880	3,867	3,833**	-
Export	2,426	2,316	2,224	2,344	2,367	-	-
Inflation Rates (percent)							
Growth Rate of Consumer Price Index (1395=100)	8.9	10.5	9.1	11.4	8.8	9.3	8.8
Growth Rate of Producer Price Index (1390=100)	5.2	8.8	5.0	8.9	9.9	11.2	10.2
Balance of Payments (USD millions)							
Oil Exports	15,070	15,875	55,752	14,166	15,736	-	-
Non-Oil Exports	7,078	7,811	28,226	7,176	7,200	-	-
Imports of Goods	16,761	18,879	63,135	16,283	17,269	-	-
Goods Account (Net)	5,387	4,807	20,843	5,059	5,667	-	-
Non-Oil Goods Account (Net)	-9,135	-10,851	-33,521	-8,814	-9,708	-	-
Current Account	3,225	4,473	16,388	3,723	3,718	-	-
Capital Account	-3,298	-4,154	-18,288	-1,338	-4,956	-	-
Change in Foreign Reserves	-231	209	-7,666	-1,585	-3,968	-	-
Foreign Exchange Rates (USD/IRR daily average)							
In Free Market	36,987	38,581	36,487	37,494	38,236	40,719	45,548
In Interbank Market	31,845	32,380	31,458	32,445	32,900	34,800	36,842
Monetary and Credit Aggregates (end of period, IRR trillions)							
Monetary Base (M0)	1,704.7	1,798.3	1,798.3	1,851.9	1,964.9	1,995.5	-
Central Bank Claims on Banks	1,047.9	996.9	996.9	1,013.7	1,097.1	1,130.7	-
Central Bank Claims on Public Sector (Net)	233.1	202.6	202.6	282.0	292.2	279.9	-
Liquidity (M2)	11,848.6	12,533.9	12,533.9	13,149.1	13,899.5	14,453.1	-
Money (M1)	1,540.7	1,630.3	1,630.3	1,674.1	1,682.4	1,737.4	-
Sight Deposits	1,213.0	1,237.0	1,237.0	1,307.0	1,337.7	1,385.8	-
Non-Sight Deposits (Quasi-Money)	10,307.9	10,903.6	10,903.6	11,502.0	12,217.1	12,715.7	-
Government Budget and Fiscal Position (IRR trillions)							
Total Revenues	473.5	892.7	2,202.7	426.1	590.5	579.2	-
Tax Revenues	221.9	359.7	1,014.7	181.9	249.3	252.6	-
Oil Revenues	176.8	316.9	738.8	188.9	257.8	193.0	-
Other	74.8	216.1	449.1	55.3	83.5	133.6	-
Total Expenditures***	488.2	912.4	2,491.2	600.8	596.9	783.4	-
Current Expenditures	449.2	670.0	2,070.2	548.8	526.1	560.3	-
Development Expenditures	36.0	262.7	421.0	8.2	70.0	224.0	-
Budget Balance	-14.7	-19.7	-288.6	-174.7	-6.4	-204.3	-
Tehran Stock Exchange (end of period)							
Overall Index (TEDPIX)	80,123	77,230	77,230	78,736	85,832	95,509	96,290
Financial Index	151,049	131,865	131,865	130,664	129,604	134,057	119,176
Industrial Index	67,466	66,100	66,100	67,681	74,823	74,078	86,082
Market Capitalization (IRR trillions)	3,374	3,220	3,220	3,201	3,396	3,946	3,847

Source: Central Bank of Iran (CBI), and Statistical Centre of Iran (SCI), various reports

* Based on CBI reports at basic prices

** According to OPEC reports from direct sources

*** The difference between the data on sum of current and development expenditures and total expenditures in a given quarter is due to the fact that revolving funds are not settled in each quarter but only at the end of the year.

1. Real Sector

Preliminary estimates of the Central Bank of the Islamic Republic of Iran (CBI) indicate an economic growth rate of 3.4 percent in the first nine months of 1396. During this period, the total value added of economic activities recorded IRR10,986 trillion, out of which 13.3 percent pertained to the oil sector. Following its 61.6 percent real expansion in 1395, the oil sector's value added growth rate started decelerating at the beginning of 1396 and after 11 consecutive quarters of growth, the sector contracted in the fall by 7.3 percent. Low rates of expansion, or even contraction, of the oil sector are expected to persist in subsequent quarters and adversely affect the overall economic growth. As a result of these developments in the oil sector, Iran's GDP growth rate fell from 4.7 percent in the first half of 1396 (1396H1) to only 1.0 percent in the fall of 1396 (1396Q3).

Out of that 3.4 percent GDP growth rate, the services sector with its 54.2 percent share of the GDP, accounted for 1.8 percentage points and the manufacturing and mining sector for 1.1 percentage points. Within manufacturing and mining, "construction" hit positive growth rates in both 1396Q2 and 1396Q3 following 10 successive quarters of contraction and registered 0.8 percent increase in value added in the first nine months of the year. Finally, oil and agriculture sectors each constituted 0.3 percentage points of the economic growth in the period under review. Table 1 presents growth rates of various sectors of the economy in 1395 as well as the first three quarters of 1396.

Table 1- Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)

	1395		1396			
	Q1 to Q3	Year	Q1	Q2	Q3	Q1 to Q3
Agriculture	4.2	4.2	3.9	4.2	4.1	4.1
Oil	67.1	61.6	5.9	5.7	-7.3	1.3
Manufacturing and Mining	0.8	2.2	4.2	5.3	4.2	4.6
Mining	-0.7	2.1	3.7	1.5	0.8	1.9
Manufacturing	6.0	6.9	4.4	6.0	3.9	4.7
Electricity, Gas, and Water	5.1	6.8	8.3	6.3	7.1	7.2
Construction	-15.3	-13.1	-3.5	3.1	1.4	0.8
Services	3.1	3.6	3.9	4.1	3.1	3.7
GDP (at basic prices)	12.4	12.5	4.5	4.8	1.0	3.4
Non-Oil GDP (at basic prices)	2.5	3.3	4.1	4.5	3.6	4.1

Source: Central Bank of Iran, Summary of Iran Economic Developments in Real Sector, the first nine months of 1396

According to preliminary CBI estimates of demand-side variables during the first nine months of 1396, real gross domestic expenditures rose by 3.1 percent.¹ In 1396Q3, real private consumption that comprised almost half of the total expenditures contracted by 3.2 percent while real public consumption expanded by 7.7 percent. Gross fixed capital formation reached IRR697 trillion in that quarter, equaling 18.7

percent of gross domestic expenditures. Capital formation in both machinery and construction at constant prices increased simultaneously in 1396Q3, a rare event in preceding periods. The 5.8 percent rise in real imports and 6.9 percent fall in real exports led to a significant decrease in net exports. Growth rates of gross domestic expenditures and its components in 1395 and the first three quarters of 1396 are demonstrated in Table 2.

Table 2- GDP Growth Rates from the Expenditures Side at Constant 1390 Prices (percent)

	1395		1396			
	Q1 to Q3	Year	Q1	Q2	Q3	Q1 to Q3
Private Consumption	3.0	3.8	4.1	3.2	-3.2	1.4
Public Consumption	5.5	3.0	2.6	4.1	7.7	4.8
Gross Fixed Capital Formation	-6.5	-3.7	-1.9	1.4	4.0	1.4
Machinery	5.7	5.6	-1.0	-0.8	4.4	0.9
Construction	-11.3	-7.4	-2.5	2.1	3.8	1.6
Export of Goods and Services	45.2	41.3	1.3	7.3	-6.9	0.4
Import of Goods and Services	6.2	6.1	14.9	8.2	5.8	9.2
GDP (at market prices)	12.5	13.4	4.2	4.6	0.5	3.1

Source: Central Bank of Iran, Summary of Iran Economic Developments in Real Sector, the first nine months of 1396

Besides the CBI, the Statistical Center of Iran (SCI) also published a report for national accounts in the first nine months of 1396, according to which the growth rates of GDP and non-oil GDP reached 4.4 percent and 4.7 percent, respectively.

Although the CBI and the SCI set an identical base year in their calculations, there are notable discrepancies between their published figures, specifically at subsection levels. For instance, in 1396Q3 the CBI reported a 7.1 percent expansion

1. In National Accounts Reports published by the CBI, basic prices are used to calculate GDP from the supply side, while market prices are employed to compute it from the demand side. Unlike in market prices, taxes and subsidies are not considered in basic prices, leading to different economic growth rates derived from each. The Statistical Center of Iran uses only the former for national accounts computations and, therefore, the economic growth rates derived from both supply and demand sides are the same.

for the provision of water, electricity, and natural gas, whereas the SCI reported a 13.0 percent contraction. Similarly, the CBI and the SCI recorded respective growth rates of -3.2 percent and +7.4 percent for private consumption. These disagreements also appeared in figures for imports. While the CBI calculated a positive growth for imports, the SCI computed a downward trend. Another considerable point was related to the revision the SCI makes to figures in the preceding published reports. Although only the latest years' data in any report are usually provisional, even the figures for the year 1391 were revised in

Energy

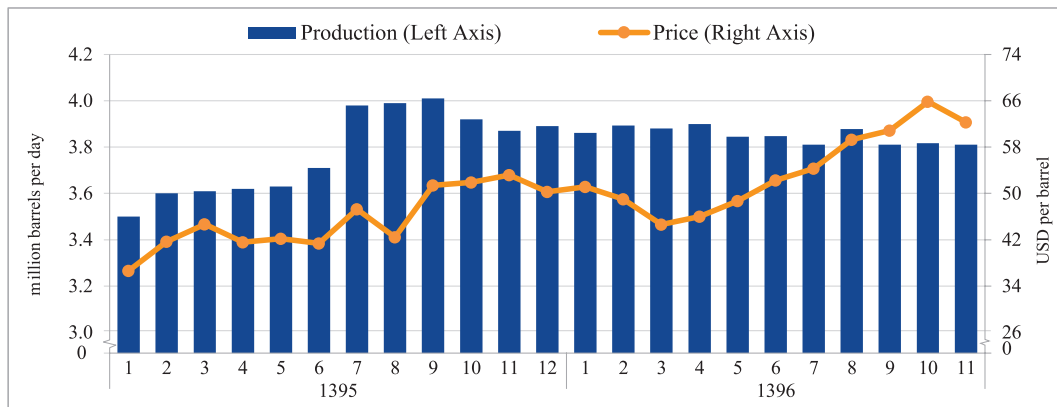
In the first 11 months of 1396, Iran's monthly crude oil production was relatively stable, amounting to between 3.8 and 3.9 million barrels per day (bpd). On the basis of the latest OPEC reports from direct sources, average daily crude oil production registered 3.8 million bpd in 11/1396, 60 thousand barrels below that in 11/1395. According to the latest CBI report, during 1396H1 Iran's oil exports, including crude oil and net export of oil products,

the recent report published in 12/1396. Peculiarly, the economic growth of 1395 that had been estimated at 10.8 percent by the SCI was then revised to 12.5 percent, the exact estimate that had been published by the CBI.

As for GDP growth rate projections, the International Monetary Fund (IMF) forecast it at 4.3 percent in 1396 and 4.0 percent in 1397. Iran's Parliament Research Center also projected the 1396 growth rate at 4.4 percent, comprising of 3.8 percent for agriculture, 3.1 percent for oil, 4.1 percent for manufacturing and mining, and 5.3 percent for services.

registered 2.3 million bpd, 13.1 percent above that in 1395H1. Even though the volume of oil exports would not be predicted to increase much in 1396H2, its value would be expected to climb, given the rise in oil prices in that period. Iran's heavy oil price rose to USD62.3 per barrel in 11/1396 from USD44.6 in 03/1396, indicating 17.1 percent growth compared to 11/1395. Figure 1 depicts developments in the production and price of Iran's crude oil.

Figure 1- Iran's Average Daily Crude Oil Production and Average Price of Heavy Crude Oil*



Source: OPEC monthly reports, available at: http://www.opec.org/opec_web/en/publications/338.htm

*OPEC statistics are based on Gregorian Calendar years and their conversions into Persian Calendar years are only approximate.

Housing

The Tehran housing market came out of recession in 1396Q3 and experienced further growth in 1396Q4. The average price of residential units grew faster than that of other goods categories and its number of transactions also increased. Due to the unavailability of up-to-date and reliable data on the country's housing market, the available information on Tehran's housing market is used as a proxy in this section.

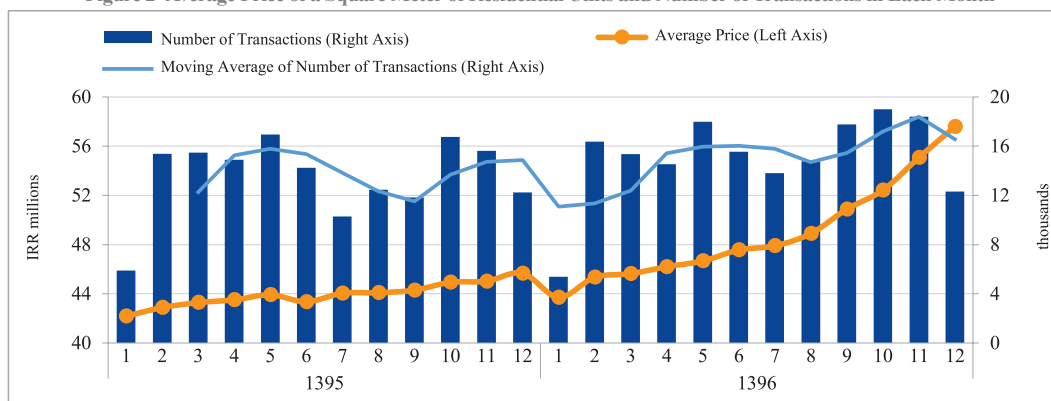
During 09/1396 to 11/1396, the point-to-point growth rate of average housing price experienced its highest levels since the beginning of 1393. The average price of a square meter of residential units hit IRR55.1 million in 11/1396, implying considerable growth rates of 5.1 percent and 22.3 percent relative to the preceding month and the same month a year earlier, respectively. Housing price continued its upward trend in 12/1396, when the average price of a square meter of residential units increased by 4.6 percent compared to the preceding month, recording IRR57.6 million. Furthermore, the number of transactions was higher than that in preceding years. In 09/1396, this number expanded by 50.2 percent relative to 09/1395 and by 20.4 percent relative to 08/1396, registering 17,776 transactions.

The number of transactions increased to 19,004 in 10/1396 which was uncommon even during the prior boom periods. In 11/1396 transactions reached 18,392 which was quite high, although slightly lower than in 10/1396. Finally, in the last month of 1396, the number of transactions recorded 12,307 which was 0.5 percent higher than that of 12/1395, although historically fewer deals are made in the last month of a year. Figure 2 depicts the development of average price and number of transactions in Tehran housing market.²

Besides the relative increase in average price and number of transactions, some developments were observed on the supply side. As reported by the CBI, real private investment in buildings, which was continuously contracting since the beginning of 1392 except for two quarters, experienced 5.5 percent growth in 1396Q2. This growth was mainly due to completed and semi-finished buildings, and investment in newly-started building projects declined even in terms of current prices. Considering the noticeable growth in the number of construction permits issued in 1395H2, investment in newly-started building projects would be expected to rise in 1396H2.

2. Due to the time-consuming process of buying a house and the relatively small number of recorded transactions in each month, their comparison among short intervals, e.g., monthly intervals, lacks precision. As a result, Figure 2 illustrates three-period moving averages of transaction numbers as well.

Figure 2- Average Price of a Square Meter of Residential Units and Number of Transactions in Each Month



Source: Central Bank of Iran, Developments in the Housing Market in Tehran, various issues

Labor Force

Most labor market indicators show some improvements in 1396Q3 compared to the same quarter a year earlier. The unemployment rate in this quarter fell by 0.4 percentage points to reach 11.9 percent, while the economic participation rate rose by 1.2 percentage points to register 40.1 percent. It was the thirteenth consecutive quarter in which the economic participation rate registered a positive point-to-point growth rate. One of the most significant drivers of the continuous increase in this rate was the graduation of those who had continued their formal education in preceding years as a means of postponing their entrance into the labor market. During the year ending 1396Q3, the net added labor supply was 972 thousand, leading to

an increase of 958 thousand in the number of employed and 14 thousand in the number of unemployed. In 1396Q3, 23.3 million individuals were employed and 3.1 million individuals who were able and willing to work could not find a job. The unemployment rate among the youth has been historically more than other age groups. One out of four jobseekers among the population aged 15-29 was unsuccessful to find a job in 1396Q3. Moreover, around 2.5 million individuals, comprising 10.8 percent of the total employed, were unable to find a job entailing more than 44 hours of work per week, although they were able and willing to. Table 3 presents the main labor market indices in 1395 and 1396.

Table 3- Labor Market Indices for the Population Aged 10 and Over

	1395					1396		
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3
Economic Participation Rate (percent)	39.5	40.4	38.9	38.9	39.4	40.6	41.0	40.1
Unemployment Rate (percent)	12.2	12.7	12.3	12.5	12.4	12.6	11.7	11.9
Unemployment Rate for the Population Aged 15-29 (percent)	24.9	26.7	26.4	25.5	25.9	26.4	24.4	25.0
Share of the Underemployed (percent)	8.5	9.5	11.3	10.9	10.3	10.2	9.2	10.8
Number of the Employed (1000 people)	22,604.7	23,031.6	22,373.4	22,342.4	22,588.1	23,308.4	23,827.2	23,331.2
Number of the Unemployed (1000 people)	3,149.7	3,337.4	3,127.7	398.8	3,203.4	3,367.0	3,156.1	3,141.7

Source: Statistical Center of Iran, Summary results of the labor force survey, various issues

Regarding the sectoral distribution of the employed, the services sector was the largest and its share was growing. For instance, shares of services in the employed population in 1392Q3 and 1394Q3 were 48.0 percent and 49.8 percent, respectively, and rose to 50.1 percent in 1396Q3. From 1392Q3 to 1396Q3, the number of the employed increased by 2.5 million, out of which 1.7 million joined this sector. Meanwhile, share of manufacturing sector in the employed population was 417 thousand. Therefore, most newly employed individuals were absorbed by services.

With respect to gender classification, labor market indices in Iran have often been worse for women. During the past decades, the

unemployment rate of women was higher and their economic participation rate was lower than those for men. These trends, however, have improved recently. From 1392Q3 to 1396Q3, the economically-active population increased by 3.2 million with equal shares for men and women, while the population of the employed grew by 2.5 million, consisting of 1.1 million men and 1.4 million women. This implied an increase in men's unemployment rate from 8.5 percent to 10.1 percent and a decrease in that of women from 20.3 percent to 19.1 percent during those four years. The participation rate for both gender groups climbed, with a faster rate of increase for women. This rate rose from 11.3 percent to 15.9 percent for women and from 62.1 to 64.1 for men in the period under review.

2. Prices and Inflation

The point-to-point consumer price index (CPI) inflation rate that had risen to 10.0 percent at the end of 1396Q3, started a downward

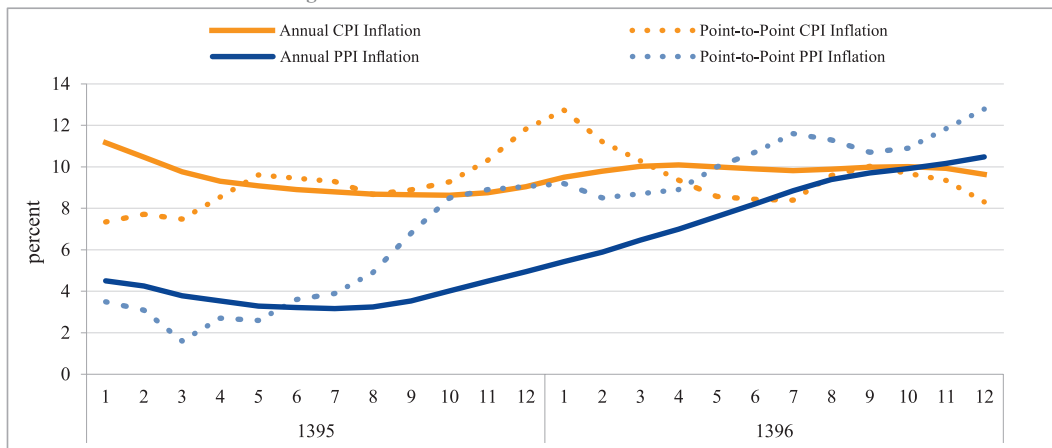
trend in winter and registered 8.3 percent at the end of the year. The average annual inflation rate at the end of each month fell to 9.6

percent at the end of 1396, registering a single-digit end-of-year inflation rate for the second consecutive year.

The point-to-point producer price index (PPI) inflation rate that had been continually increasing since the end of 1396Q3, rose to 12.8 percent in 1396Q4. Given the delayed effect of PPI inflation rate on

CPI inflation rate, the downward trend of the latter is expected to stop or even reverse course in the early 1397. As shown in Figure 3, the point-to-point PPI inflation rate since the beginning of 1396Q2 has been above that of the CPI, indicating faster rise in cost of production factors than in retail prices.

Figure 3- CPI and PPI Inflation Rates in 1395 and 1396



Source: Central Bank of Iran, Reports of Consumer Price Index and Producer Price Index, various issues

The point-to-point inflation rate of tradable goods started to rise in the early fall of 1396 and reached 10.2 percent in 11/1396. This rise could be partly attributed to the considerable IRR's depreciation against major foreign currencies in the fall and winter, disqualification of some import items from receiving foreign exchange at preferential "official" rates, and the rise in global prices of some consumption goods in fall. The point-to-point inflation rate of non-tradable goods also started to rise from the early fall of 1396 and reached 9.2 percent in 11/1396.

In winter, out of the 12 major groups in the consumption basket of goods and services, "Foods and Beverages" experienced the

highest drop while "Tobacco" recorded the highest rise in their point-to-point inflation rates. Given the high weight of the former group in the consumption basket, its 7.3 percentage points drop was the main contributor to the decline in the point-to-point CPI inflation rate in that period. The point-to-point inflation rate in "Housing, water, electricity, gas and other fuels" group, that has the highest weight in the basket, also fell by 0.3 percentage points during that period. Table 4 exhibits the point-to-point CPI inflation rates in the major groups of the consumption basket of goods and services during fall and winter of 1396.

Table 4- Point-to-Point Inflation Rates of the Major Groups in the Consumption Basket (percent)

	Weight in the Basket	Q3			Q4		
		07/1396	08/1396	09/1396	10/1396	11/1396	12/1396
Overall	100.00	8.4	9.6	10.0	9.7	9.4	8.3
Housing, water, electricity, gas and other fuels	37.05	7.4	8.4	9.2	8.8	8.8	8.9
Food and Beverages	25.51	11.4	13.9	14.3	13.7	11.5	7.0
Transport	8.90	5.9	5.6	6.7	6.4	6.8	7.5
Health	7.83	7.9	8.4	8.5	8.5	8.7	8.5
Clothing and Footwear	4.62	5.5	5.0	4.9	4.9	5.4	6.0
Household Equipment and Routine Household Maintenance	4.33	8.3	8.4	8.5	8.2	8.8	9.3
Miscellaneous Goods and Services	3.17	9.6	9.8	11.4	11.6	12.7	13.4
Communication	2.30	7.2	7.1	6.8	0.8	1.7	2.1
Recreation and Culture	2.07	10.9	9.6	8.9	10.0	11.4	12.1
Education	2.03	8.2	8.3	13.9	14.1	14.1	14.1
Restaurants and Hotels	1.82	11.9	12.1	12.3	11.8	11.5	11.3
Tobacco	0.37	0.4	0.7	0.9	1.1	1.8	18.0

Source: Central Bank of Iran, Consumer Price Index Reports, various issues

Given the upward trend of the point-to-point PPI inflation rate in preceding months, the downward trend of the point-to-point CPI inflation rate is expected to stop, or even reverse course, in early

1397. The IMF also projected Iran's annual inflation rate to rise to 12 percent in 1397.

3. Balance of Payments

Having reached their recent highs in 1395Q3, both oil production and exports declined a little to reach an average of, respectively, 3.9 and 2.3 million bpd in the subsequent three quarters.³ In 1396H1, crude oil production and oil exports increased by 7.9 percent and 13.1 percent, respectively. On the other hand, the average price of Iran's heavy crude oil in international markets jumped by approximately 17.6 percent in 1396H1 and registered USD48.6. The upward trend of Iran's crude oil price that had started in 10/1394 speeded up beginning in 03/1396 and reached USD60.9 per barrel in 09/1396, the highest price recorded since 02/1394. As a result, in 1396H1 oil exports rose by 20.5 percent to USD29.9 billion. Oil imports also grew by 4.9 percent to USD654 million and so the oil trade balance at the end of 1396H1

stood at USD29.2 billion, indicating 20.9 percent growth.

Non-oil exports rose by 7.8 percent in 1396H1 and reached USD14.4 billion while non-oil imports jumped by 22.4 percent to USD32.9 billion. Accordingly, non-oil trade balance deficit increased by 36.8 percent to USD18.5 billion. Consequently, the goods account balance surplus of current account at the end of 1396H1 stood at USD10.7 billion, indicating 0.7 percent growth. Putting it another way, oil exports' climb in 1396H1 coincided with great increase in goods imports, leading to a small change in goods account balance. Table 5 presents the current account balance and its subgroups from 1394Q1 to 1396Q2.

Table 5- Current Account Balance and Its Subgroups (USD millions)

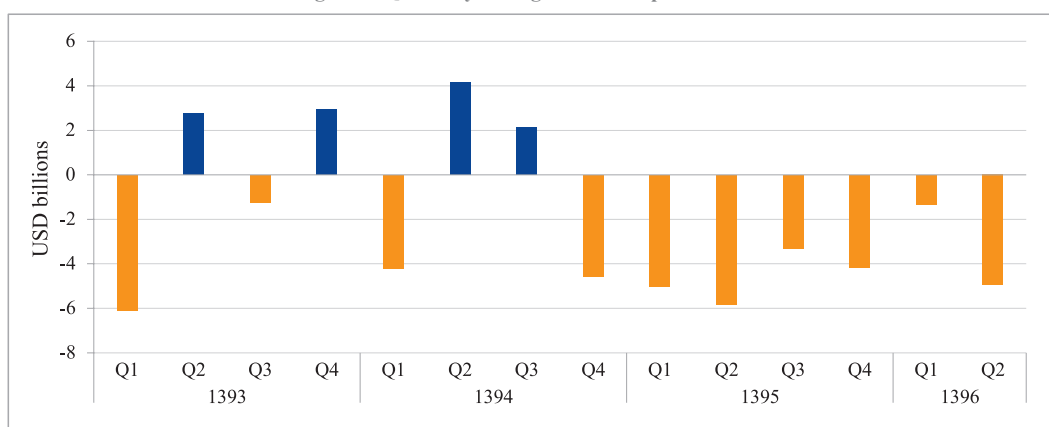
	1394				1395				1396	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4	Q1	Q2
Goods Account	4,778	2,765	4,258	377	6,522	4,127	5,387	4,807	5,059	5,667
Services Account	-1,206	-1,077	-759	-1,430	-1,610	-1,184	-2,428	-719	-1,713	-2,297
Income Account	237	360	189	-23	198	360	127	243	263	238
Current Transfers Account	138	142	128	139	121	156	139	142	114	110
Current Account Balance	3,947	2,190	3,816	-937	5,231	3,459	3,225	4,473	3,723	3,718

Source: Central Bank of Iran, Economic Trends, various issues

Data on the capital account points out to USD5.0 billion net capital outflow in 1396Q2, 14.8 percent below that in the same period a year earlier. The net capital outflow in 1396H1 added up to USD6.3 billion, indicating 41.9 percent decline. Figure 4 illustrates changes in net capital account from 1393Q1 to 1396Q2.

International reserves were estimated to have fallen by USD5.6 billion since 12/1395 to USD115 billion at the end of 1396Q2, taking into account changes in the current and capital accounts plus approximately USD6.7 billion in errors and omissions that include, among others, illegal goods transfers.

Figure 4- Quarterly Changes in Net Capital Account



Source: Central Bank of Iran, Economic Trends, various issues

As reported by Customs Administration, non-oil exports⁴ in the first 11 months of 1396 amounted to USD41.7 billion, indicating a 5.0 percent growth. Natural gas condensates valued at USD6.3 billion, liquefied natural gas at USD2.5 billion, liquefied propane at USD1.3 billion, methanol at USD1.1 billion, and light crude oil except gasoline at USD1.0 billion were the major exported items in the period under review. Total exports of petrochemicals in this time span fell by 4.0 percent to around USD14.2 billion.

Besides, natural gas condensates exports decreased by 5.4 percent. China, UAE, Iraq, Turkey, and South Korea were the main exports destinations in the period under review, comprising respective shares of 19.7 percent, 14.1 percent, 13.4 percent, 9.3 percent, and 9.1 percent in Iran's total exports. During this period, exports to South Korea rose by 41.0 percent and to China by 11.3 percent, while exports to UAE fell by 14.0 percent compared to the same period of the preceding year.

3. In this section, oil exports correspond to crude oil exports plus net exports of oil products. Furthermore, the value of oil imports and exports represents the sum of crude oil value, oil products, natural gas, natural gas condensates, and liquids.

4. It excludes crude oil, fuel oil, paraffin, and suitcase trade.

During the first 11 months of 1396, goods imports rose by 23.6 percent to USD47.7 billion. Auto parts valued at USD1.6 billion, cattle feed corn at USD1.4 billion, rice at USD1.0 billion, soybean at USD838 million, and 1500-2000cc motor vehicles at USD739 million were the main imported items, in that order. The

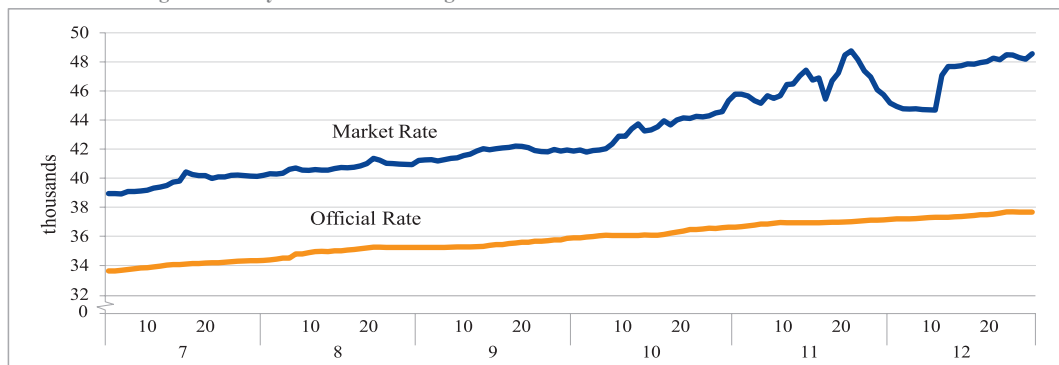
highest levels of imports were from China, UAE, South Korea, Turkey, and Germany with respective shares of 24.2 percent, 18.4 percent, 6.9 percent, 6.0 percent, and 5.5 percent of total import. Notably, imports from UAE expanded by 50.7 percent in this period.

4. Foreign Exchange Market

The Iranian foreign exchange market was much more volatile in the winter of 1396, than in its four preceding quarters. The USD/IRR free market exchange rate, following an upward trend that had started in the early summer of 1396, surpassed 40,000 in the second week of the fall and did not return to that threshold. It approached 50,000 in the middle of the winter

and was hovering around 48,300 in the remainder of the year. The average free market USD/IRR exchange rate in 1396Q4 was around 12 percent higher than in 1396Q3 and 18 percent higher than in 1395Q4. Figure 5 depicts the daily USD/IRR exchange rates during 1396H2.

Figure 5- Daily USD/IRR Exchange Rates in Free Market and Its Official Rate in 1396H2



Source: Central Bank of Iran; Financial Informing Network

The authorities stated that the upward trend in the fall was temporary and due to the increased seasonal demand for foreign exchanges. However, this trend continued and even speeded up in the winter and led to increased speculative demand as manifested by the formation of long queues in front of the exchanges.

In order to rein in the USD/IRR exchange rate, the CBI stepped in and increased its injection of foreign currencies into the market in the middle of the winter and had the police shut down some of the unauthorized exchanges. In the aftermath of these practices, the USD/IRR exchange rate fell below 46,000 for a few days but again surged to close to 50,000 in the late 11/1396. In response, the CBI offered a package for controlling the market which consisted of three options including the sale of one-year certificates of deposits at 20 percent interest rate for two weeks, selling foreign exchange-based securities, and fore-selling of gold coins with six- and 12-month maturities. Among those options, the first was the most appealing to individuals. In line with these practices, order registration with USD was banned in late winter. Following the implementation of CBI's package in the late 11/1396, foreign exchange fluctuations diminished and the USD/IRR exchange rate fell below 45,000. However, some exchanges were reluctant to trade at these lower rates. This did not last long and eventually the USD was traded at

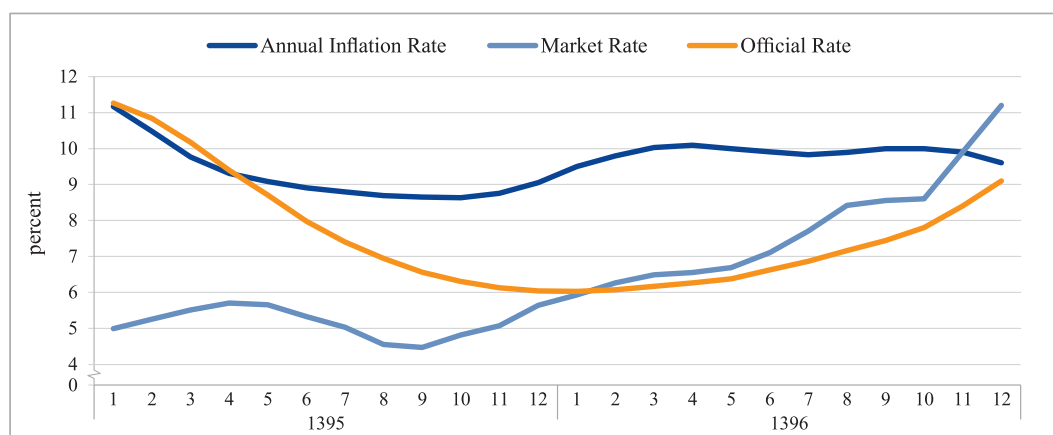
different decreed⁵ and market rates. The gap between the two rates was as high as IRR3,000 and served as a source of rent for the ones who could buy at the former rate. Eventually, in the last week of 1396, the CBI raised the decreed rate close to the market rate in order to eliminate this rent.

The official USD/IRR exchange rate that had been considerably raised by the CBI from the early summer of 1396 surpassed 37,000 by the end of the year. However, as the free market rate grew much faster than that of the official market, the gap between the two that had reached around 16 percent at the end of the summer, widened to even exceed 25 percent. Therefore, the implementation of the long promised exchange rate unification appeared even more unlikely than before.

The PPI inflation rate continued its upward trend of the past few months. Given the lagged effect of PPI on CPI, the latter is expected to rise in the early 1397. If the CBI does not let the USD/IRR exchange rate to rise in line with the difference between the domestic and international inflation rates, the real value of IRR will rise and worsen the competitiveness of domestically produced goods. Figure 6 depicts the annual inflation rate alongside the growth rates of the USD/IRR exchange rates in free and official markets.

5. The decreed rate is the rate at which the CBI sold USD to some exchanges and required them to sell them to customers with a IRR100 spread.

Figure 6- Annual Inflation Rate and Growth Rates of USD/IRR Exchange Rates in the Free Market and the Official Market



Source: Central Bank of Iran; Research calculations

5. Monetary and Credit Aggregates

Latest statistics on sources of the monetary base indicated that in 10/1396, CBI's net claims on public sector experienced a 4.6 percent fall while its net foreign assets, claims on banks, and net other items increased by 4.7 percent, 7.6 percent, and 9.6 percent, respectively. Statistics on the monetary base components in different quarters of 1395 and 1396, as well as in the first month of the winter in these two years, are presented in Table 6.

CBI's net foreign assets were the main driver of the growth in monetary base in 10/1396. Moreover, due to the increase in CBI's claims on non-public banks and non-bank credit

institutions in the year ending in 10/1396, CBI's claims on banks expanded by 7.6 percent, serving as yet another signal to the CBI for Iran's banking system reform. Despite the 55.3 percent fall in CBI claims on commercial banks and 27.4 percent fall in its claims on public specialized banks, CBI claims on non-public banks and non-bank credit institutions grew by 97.3 percent, accounting for 57 percent of CBI claims on banks at the end of 10/1396, 25 percentage points up from that a year earlier. The 18 percent upswing in CBI claims on banks between 12/1395 and 10/1396 was the main contributor to the monetary base expansion during this period.

Table 6- Monetary Base Components (end of period – IRR trillions)

	1395			1396				10/1396 to 10/1395	
	Q3	10/1395	Q4	Q1	Q2	Q3	10/1396	Growth Rate (percent)	Share in Growth (percentage points)
Monetary Base	1,704.7	1,798.7	1,798.3	1,851.9	1,964.9	1,995.0	2,095.3	16.4	16.4
CBI Net Foreign Assets	1,898.2	1,881.6	1,924.6	1,853.9	1,874.4	1,913.8	1,970.8	4.7	4.9
CBI Net Claims on Public Sector	233.1	228.8	202.6	282.0	292.2	279.9	218.2	-4.6	-0.6
CBI Claims on Banks	1,047.9	1,092.0	996.9	1,013.7	1,097.1	1,130.7	1,174.8	7.6	4.5
Other Items (Net)	-1,474.5	-1,403.7	-1,325.8	-1,297.7	-1,298.8	-1,329.4	-1,268.5	9.6	7.6

Source: Central Bank of Iran, Selected Economic Indicators, various issues

The liquidity at the end of 10/1396 amounted to IRR14,631 trillion, out of which money accounted for IRR1,800 trillion and quasi-money for the rest. Liquidity expanded by 1.2 percent during 10/1396 alone, as money expanded by 4 percent and quasi-money by 1.0 percent. Nonetheless, the 16.7 percent growth of liquidity in the first 10 months of 1396 was 0.9 percentage points below that in the same period the year before. Quasi-money that was expanding faster than money in 1396H1 reversed course from the beginning of fall and caused the M2 money multiplier to increase in 10/1396.⁶

The M2 money multiplier rose to 7.0 at the end of 10/1396,

registering a 7.7 percent growth. The decline in the ratio of notes and coins with the public to total deposits, along with that of banks' excess reserves (deposits with the CBI) to total deposits, led to an increase in M2 money multiplier. Among money components, notes and coins with the public expanded by 10.5 percent and sight deposits by 21.8 percent, and were respectively responsible for 0.3 and 2.1 percentage points of the liquidity growth. Table 7 demonstrates statistics on M2 money multiplier and liquidity components from 1395Q3 to 1396Q3, and in 10/1396.

6. High interest rates have led to an extraordinary growth in non-sight deposits with banks. An increase in the ratio of quasi-money to money, besides other factors, detracts from the quality of liquidity and affects the velocity of money. Huge growth rates of liquidity notwithstanding, the perpetual quality loss of banking system assets has resulted in credit crunch through lowering the quality of liquidity.

Table 7- M2 Money Multiplier and Liquidity Components (end of period – IRR trillions)

	1395			1396				10/1396 to 10/1395	
	Q3	10/1395	Q4	Q1	Q2	Q3	10/1396	Growth Rate (percent)	Share in Growth (percentage points)
Liquidity	11,848.6	11,966.0	12,533.9	13,149.1	13,899.5	14,453.1	14,631.2	22.2	22.2
Money	1,540.7	1,509.7	1,630.3	1,647.1	1,682.4	1,737.4	1,801.6	19.3	2.4
Notes and Coins with the Public	327.7	324.1	393.3	340.1	344.7	348.6	358.1	10.5	0.3
Sight Deposits	1,213.0	1,185.6	1,237.0	1,307.0	1,337.7	1,385.8	1,443.5	21.8	2.1
Quasi-Money	10,307.9	10,456.3	10,903.6	11,502.0	12,217.1	12,715.7	12,829.6	22.7	19.8
M2 Money Multiplier	7.0	6.5	7.0	7.1	7.1	7.2	7.0	7.7	-

Source: Central Bank of Iran, Selected Economic Indicators, various issues

CBI report on the interbank market in the first 11 months of 1396 indicated a steady increase in the scope of the market in terms of value and quantity. It showed that 34,859 daily deals with an average value of IRR207 trillion have been recorded in the interbank market, expressing a respective growth of 19.8 percent

and 88.2 percent in volume and value. These numbers implied that measures undertaken by the CBI deepened the interbank market. There were 30 active banks and credit institutions in this market in the period under review. Table 8 compares major items of the interbank market in the first 11 months of 1395 and 1396.

Table 8- State of the Interbank Market in the First 11 Months of 1395 and 1396

	First 11 Months of 1395	First 11 Months of 1396	11/1396	Changes from the first 11 months of 1395 to the same period of 1396
Number of Active Members	31	30	29	-3.2 percent
Number of Deals	29,091	34,859	3,637	19.8 percent
Average Value of Daily Deals (IRR trillions)	110	207	338	88.2 percent
Value-Weighted Average of Overnight Interest Rates (percent)	18.6	18.7	18.1	0.1 percentage points
Value Share of Overnight Deals (percent)	97.4	98.4	99.1	1.0 percentage points
Value Share of Deals Spanning Two Days or More (percent)	2.6	1.6	0.9	-1.0 percentage points

Source: Central Bank of Iran, Report on the interbank market state in the first 11 months of 1396

Examination of the interbank market deals in the first 11 months of 1396 indicated that 98.4 percent of the value of daily deals pertained to overnight deals, a finding consistent with short term financing in the market. The upward trend of monthly value weighted average interest rates in the interbank market reversed course in 05/1396 and reached 18.1 percent in 11/1396.

According to the latest report of Shaparak⁷, in 09/1396 the ratio of total value of transactions to liquidity⁸ was 10.4 percent, 0.7

percent above that in 08/1396. This ratio was following an upward trend since 01/1392, increasing from 6.6 percent in that month to 10.6 percent in 09/1396. Meanwhile, the ratio of notes and coins with the public to liquidity underwent a downward trend in the period under review from 6.0 percent to 2.4 percent. Extensive use of electronic payment tools, among other factors, explained the decline in the latter ratio; a descent that would be expected to be continued.

6. Government Budget and Fiscal Position

Performance in the First 10 Months of 1396

Tax revenues that had contracted in 1396H1 started to grow in the second half of the year and rose by 6.8 percent in the first 10 months of 1396, although that is still contraction in real terms. Tax revenues were 18.3 percent below the legislated amount in the Budget Law. Other current revenues also rose by only 5.3 percent to equal 62.2 percent of the legislated amount. Current expenditures grew by 14.8 percent during these 10 months and reached 85.1 percent of the legislated amount. Small rise in current revenues together with the considerable increase in current expenditures caused the operating balance deficit to climb by 28.0 percent to IRR757.0 trillion in the first 10 months of 1396. Oil revenues grew by 46.0 percent in those 10 months but still covered only 75.2 percent of the legislated amount. Development expenditures also rose by 80.0 percent to IRR299.8 trillion, equaling only half of the

legislated figure.

Overall, in the first 10 months 1396 government revenues rose by 19.1 percent and government expenditures by 20.4 percent, causing the budget deficit to rise by 27.7 percent and reach IRR335.1 trillion. In addition to this deficit, the government spent IRR272.1 trillion on acquisition of financial assets, resulting in the rise in disposal of financial assets to IRR607.2 trillion. Disposal of financial assets in which issuance of government debt securities accounted for the highest share, was 34.9 percent above the legislated amount. The financial burden of the acquisition of financial assets grew by 244.8 percent. Although the upper bound for the balance of government debt as share of GDP had been set at 40 percent in the “Law on the Sixth Five-Year Economic,

7. Electronic Card Payment Network System (SHAPARAK) is a platform which brings together payment service providers (PSP) and their POS terminals in a highly integrated system and by advocating central management and monitoring functionality will promote efficiency, effectiveness and security of card payment network.

8. This ratio is an index representing the influence of electronic payment industry on easing the economic transactions.

Cultural, and Social Development Plan for 1396-1400”, the actual figure was estimated at 45 percent, not as big as in more advanced countries, calling for a long-term debt management plan.

Up to the date this report was finalized, the government debt was rising and seemingly the government had no plan for settling its old debts and moving towards budget surplus. Besides, as the prospect

for oil prices does not look bright, higher budget deficits due to the fall in the share of oil revenues in government budget seemed plausible. Oil, that accounted for much of the total government revenues in the preceding few years, covered about 39.5 percent of the government’s total revenues in the first 10 months of 1396. Table 9 exhibits the government fiscal performance in 1396.

Table 9- The Government Fiscal Performance in 1396

	Q1		Q2		Q3		First 10 Months		Performance of the first 10 months of 1396 compared to the legislated amount (percent)
	Amount (IRR trillions)	Growth (percent)	Amount (IRR trillions)	Growth (percent)	Amount (IRR trillions)	Growth (percent)	Amount (IRR trillions)	Growth (percent)	
Revenues	426.1	66.8	590.5	1.7	579.2	22.3	1,819.8	19.1	74.1
Tax Revenues	181.9	-1.6	249.3	0.4	252.6	13.8	797.7	6.8	81.7
Other Current Revenues	54.5	107.0	82.1	-36.9	132.9	80.1	300.4	5.3	62.2
Oil Revenues	188.9	333.2	257.8	27.9	193.0	9.2	718.5	46.0	75.2
Other Disposal of Non-Financial Assets	0.8	13.5	1.4	40.9	0.7	-30.0	3.1	-12.9	7.2
Expenditures	600.8	44.4	596.9	-11.5	783.4	60.5	2,154.9	20.4	79.0
Current Expenditures	548.8	48.8	526.1	-9.6	560.3	24.7	1,811.4	14.8	85.1
Development Expenditures	8.2	489.0	70.0	-42.2	224.0	523.0	299.8	80.0	50.1
Budget Balance	-174.7	8.9	-6.4	-93.2	-204.3	1,288.0	-335.1	27.7	124.3
Operating Balance	-356.2	75.8	-195.6	11.1	-174.0	11.1	-757.0	28.0	113.2
Net Disposal of Non-Financial Assets	181.4	329.8	189.2	130.1	-30.3	-121.4	421.9	28.2	105.8
<i>Disposal of Financial Assets</i>	<i>184.4</i>	<i>11.7</i>	<i>68.9</i>	<i>-37.0</i>	<i>348.1</i>	<i>399.4</i>	<i>607.2</i>	<i>77.9</i>	<i>134.9</i>
<i>Acquisition of Financial Assets</i>	<i>9.7</i>	<i>111.4</i>	<i>62.4</i>	<i>302.8</i>	<i>143.9</i>	<i>162.1</i>	<i>272.1</i>	<i>244.8</i>	<i>150.5</i>

Source: Central Bank of Iran, Selected Economic Indicators, various issues

Note: The difference between sum of current and development expenditures and total expenditures is due to the fact that revolving funds were not yet settled.

Indirect taxes accounted for a large share of tax revenues in the first 10 months of 1396, unlike in the same period of 1395. The 8.6 percent contraction of tax revenues from legal entities led to a fall in its share of total tax revenues and was the main factor in 4.2 percent fall in direct taxes. Revenues from income tax and wealth tax grew slightly below the inflation rate. Among the subgroups of indirect taxes, revenues from tax on imports

rose by 30.1 percent and those from goods and services by 14.7 percent. Revenues from the value added tax that had become a major component of tax revenues in recent years, accounted for one-fourth of total tax revenues with 16.5 percent growth rate. Table 10 exhibits the components of tax revenues in the first 10 months of 1395 and 1396.

Table 10- Components of Tax Revenues

	First 10 Months of 1395			First 10 Months of 1396		
	Amount (IRR trillions)	Share (percent)	Growth (percent)	Amount (IRR trillions)	Share (percent)	Growth (percent)
Tax Revenues	746.9	100.0	28.4	797.7	100.0	6.8
Direct	385.1	51.6	23.9	368.8	46.2	-4.2
Legal Entities	245.4	32.9	23.3	224.2	28.1	-8.6
On Income	118.5	15.9	26.2	122.5	15.4	3.4
On Wealth	21.2	2.8	18.6	22.1	2.8	4.3
Indirect	361.8	48.4	33.6	428.9	53.8	18.5
On Imports	90.2	12.1	31.4	117.3	14.7	30.1
On Goods and Services	271.7	36.4	34.4	311.5	39.1	14.7
On Value Added	172.6	23.1	3.1	201.1	25.2	16.5

Source: Central Bank of Iran, Selected Economic Indicators, various issues

Budget Law of 1397

The parliament eventually passed the budget bill of 1397 in the late 1396 in a form that was considerably different from the proposed one. Total budget in the Budget Law of 1397 is 2.3 percent above that in the budget bill, but it is still only 6.1 percent above that in the Budget Law of 1396, which is less than the

expected inflation rate and so shows a decline in real terms. The legislated total general budget is 11.1 percent above that in the 1396 Budget Law and 4.3 percent higher than that in the budget bill. Table 11 exhibits the main figures of the 1397 Budget Law.

Table 11- Main Figures of the 1397 Budget Law

	Sources				Uses		
	1397 Budget Law (IRR trillions)	Growth Compared to the Bill (percent)	Growth Compared to 1396 Budget Law (percent)		1397 Budget Law (IRR trillions)	Growth Compared to the Bill (percent)	Growth Compared to 1396 Budget Law (percent)
Revenues	2,155.9	11.5	23.8	Expenditures	2,933.9	6.1	15.6
Disposal of Non-Financial Assets	1,075.6	0.9	-9.6	Acquisition of Non-Financial Assets	620.0	2.6	-13.1
Disposal of Financial Assets	630.4	-7.4	17.4	Acquisition of Financial Assets	307.9	-1.3	42.8
General Sources	3,861.9	4.9	11.4	General Uses	3,861.9	4.9	11.4
Dedicated Revenues	570.7	0.4	9.5	From the Dedicated Revenues	570.7	0.4	9.5
Total General Sources	4,432.6	4.3	11.1	Total General Uses	4,432.6	4.3	11.1
State-Owned Companies' Sources	8,391.2	3.1	4.8	State-Owned Companies' Uses	8,391.2	3.1	4.8
Sources of Budget	12,225.5	2.3	6.1	Uses of Budget	12,225.5	2.3	6.1

Source: Annual Budget Laws of the Country

In the late 1396, the official USD/IRR exchange rate was approximately 37,700. In 1396H1, the average daily net exports of oil, oil products and natural gas condensates amounted to approximately 2.4 million bpd. The price of Iran's oil was about USD60.9 a barrel at the end of 1396Q3. Accordingly, revenues from the exports of oil and oil products in 1396 should be about IRR1,076.0 trillion. In addition, as the official USD/IRR exchange rate should rise in 1397, it might be offset by the fall in the oil prices in that year. Oil revenues in the 1397 budget bill was IRR1,010.1 trillion which was lowered to IRR1,007.1 in the Budget Law.

Another amendment to the budget bill by the parliament was the inclusion of distribution of 4 million tons of free bitumen, up to IRR30 trillion in value, by the National Iranian Oil Company (NIOC) among various state-owned institutions, with the priority of settling their debts to bitumen producers. In the Budget Laws of the preceding years, the distribution of free bitumen was initially aimed at enabling contractors to complete their semi-finished projects. However, this practice was not only a source of economic rent, but also enabled the state-owned institutions that received free bitumen to use that for the settlement of their debts to contractors. On the contrary, sale of unneeded bitumen by contractors in the commodity exchange at lower prices would eventually cause the official bitumen exporters to incur losses. Even though the government had eliminated this practice in 1397 budget bill, the parliament again included it in the 1397 Budget Law.

Regarding the tax on salaries, the ceiling for tax exemption rose to annual income of IRR276 million in the Budget Law from IRR240 million in the budget bill. The pattern of salary taxation in the Budget Law was different from the one proposed in the budget bill. According to the Budget Law, the salary tax rate for employees with annual incomes above IRR276 million and below triple the legislated ceiling (LC) was set at 10 percent, above triple the LC and below quadruple the LC to 15 percent, above quadruple the LC and below sextuple the LC to be 25 percent, and above sextuple the LC to be 35 percent. However, in the budget bill the salary tax rate was proposed to be 10 percent for annual salaries

above IRR240 million and below quintuples this amount, and to be 20 percent for above quintuple this amount. Reporting part of the company's profits as payments to managers can be abused to evade taxes and this amendment helped eliminate the incentives for such practices.

The most important amendment to 1397 budget bill might be in the area of Subsidies Reform Plan. In the budget bill, it was proposed that the Organization of Targeted Subsidies become a subsidiary of the Ministry of Cooperatives, Labor, and Social Welfare. Therefore, the sources and uses of this organization could be included in the Budget Law and subject to auditing by the Supreme Audit Court of Iran. This proposal was rejected, but the sources and uses of Subsidies Reform Plan were legislated in the Law as presented in Table 12.

In the 1397 budget bill, the total uses of Subsidies Reform Plan were IRR370 trillion which were increased to IRR440 trillion by the parliament as a result of raising cash and non-cash subsidies to households from IRR230 trillion to IRR300 trillion. Although the government has aimed to gradually eliminate some recipients of cash subsidies in recent years, it has not been successful and cash subsidies accounted for 95 percent of uses of Subsidies Reform Plan up to the date this report was finalized. Currently, cash subsidies are paid to more than 76 million individuals, accounting for approximately IRR415 trillion of the uses of Subsidies Reform Plan. Previously, the government had been trying to identify well-off individuals and eliminate them from receiving cash subsidies. However, in the 1397 budget bill it decided to change its procedures and restrict cash subsidies to those identified as poor, hoping this practice to eliminate 33 million individuals from receiving cash subsidies. However, the parliament changed the bill to require the government to identify and eliminate 21 million well-off individuals from receiving cash subsidies. After reviews by the Guardian Council, it was mentioned in the Budget Law that the top-three income deciles, equivalent to 24 million individuals, should be eliminated from receiving cash subsidies, three million up from the legislated figure.

Table 12- Sources and Uses of Subsidies Reform Plan in 1397 Budget Law (IRR trillions)

Sources	Amount	Uses	Amount
Sale of oil products	572.4	VAT on oil products	50.0
Domestic sale of natural gas	176.0	14.5 percent share of the NIOC in the domestic sale of oil products	37.0
Exports and domestic sale of electricity	217.8	Cost of transportation, distribution and sale of oil products	72.8
Sale of water	22.2	Imports of oil products, 14.5 percent share of the NIOC in the exports of oil products, debts repayment of gas distribution plans, energy consumption optimization, productivity enhancement and energy intensity reduction	60.0
		cost of production, transfer, distribution and sale of natural gas	73.3
		CNG stations' fee	9.2
		CNG distribution charge	3.3
		VAT on CNG	2.7
		Cost of production, transfer, distribution, sale and purchase of electricity from private plants	212.3
		electricity imports	5.5
		Cost of production, transfer, distribution and sale of water	22.2
Uses of Subsidies Reform Plan			
		Cash and non-cash subsidies to the households	300.0
		Reduction of absolute poverty through increasing the payments to very low-income households	70.0
		Health sector	37.0
		Bread subsidy and guaranteed purchase of wheat	33.0
		Total	440.0
Total Sources	988.3	Total Uses	988.3

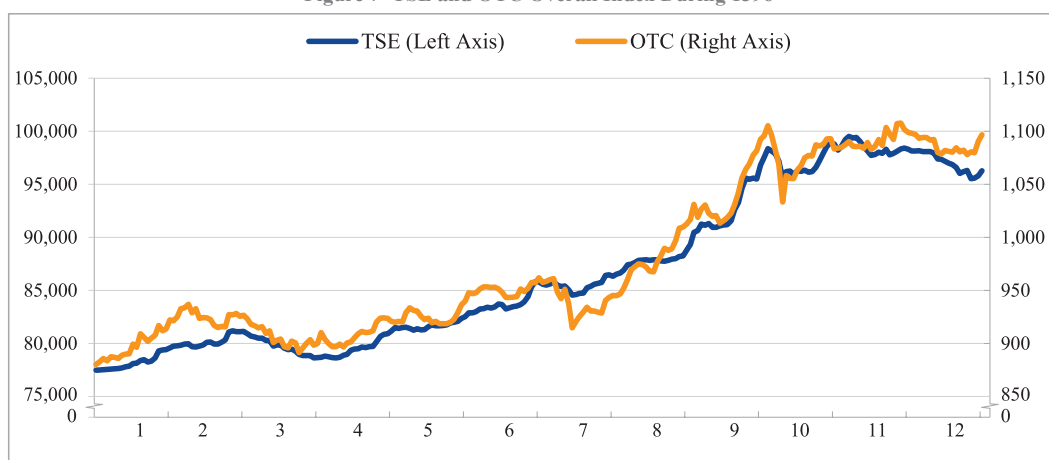
Source: The 1397 Budget Law

7. Capital Market

The overall index of the Tehran Stock Exchange (TSE) closed the year 1396 at 96,290, indicating 0.8 percent rise in winter and 24.3 percent in the year. Total value of transactions in equity market and debt market⁹ during 1396Q4 added up to IRR181.5 trillion and IRR24.3 trillion, with respective growths of 34.9 percent and 22.1 percent. The value of TSE transactions at the end of 1396 was IRR3,850 trillion. The rate of return in over-the-counter (OTC)¹⁰ market was slightly above that of the TSE's in 1396, with its

index closing the year at 1,097, showing 1.4 percent increase in winter and 24.6 percent in the year. Around one-third of the total IRR1,490 trillion OTC transactions pertained to various types of debt securities, including Islamic Treasury bills¹¹, participations bonds, Murabaha bonds, and mortgage-backed securities. These securities also comprised a significant part of OTC transactions. TSE and OTC overall indices are depicted in Figure 7.

Figure 7- TSE and OTC Overall Index During 1396

Source: <http://new.tse.ir> and <http://ifb.ir>

9. In TSE, equity market is isolated from the markets for options, future transactions, investment funds, and debt securities.

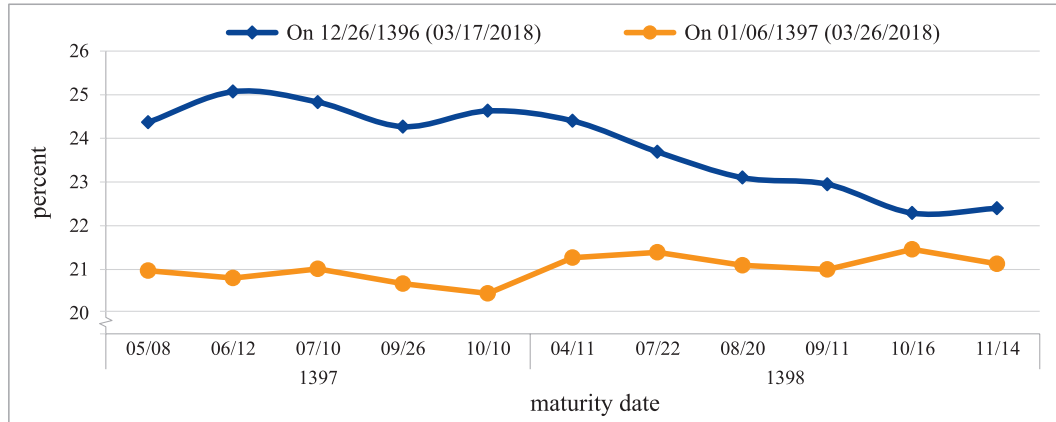
10. OTC in Iran is also known as "Fara Bourse".

11. The Islamic Treasury bills in Iran do not only mature in one year or less like the U.S. federal government Treasury bills, but also at dates between one to two years.

In 1396, Islamic Treasury bills valued at over IRR225 trillion were issued by the Ministry of Economic Affairs and Finance in 15 series with 11 different maturities aimed at settling government debts as called for in 1396 Budget Law. These securities were admitted in OTC with face value of IRR1 million. Hence their daily prices at the OTC market determined their rates of return through their respective maturities. The prices of Islamic Treasury bills started to decline sharply in the last week of 1396 and led to a considerable rise in the rates of returns of recently-purchased bills, even exceeding 25 percent in some cases. Rates of returns of these securities, which are considered

the least risky investment in Iran, revealed a sharp increase in the expected interest rates at the end of 1396, exacerbated by the usual end-of-year increase in demand for liquidity. According to the capital market regulations, the funds from selling shares or debt securities are only accessible after two working days. This led to an increase in the supply of these securities in the last days of the year and thus to a decline in their prices. This trend reversed course beginning on 12/27/1396. Figure 8 illustrates the rate of returns on Islamic Treasury bills issued in 1396 with different maturities, focusing on dates 12/26/1396 and 01/06/1397.

Figure 8- Yield Curves of Islamic Treasury Bills with Various Maturities, as Established on 12/26/1396 and 01/06/1397



Source: <http://new.tse.ir> and <http://ifb.ir>

8. Other Economic Developments

After passing the law on “combating the financing of terrorism” in Feb 2016, the Financial Action Task Force (FATF) announced a one-year suspension of counter-measures against Iran through a declaration in 04/1395 and the suspension was extended in subsequent meetings of the FATF, the last of those held in Feb 2018. However, the last declaration of the FATF noted that it would remain concerned with Iran’s terrorist financing risks as long as Iran had not implemented the required measures to address the deficiencies it had identified in the Action Plan. As indicated in the declaration, Iran should fully address its remaining action items, including adequately criminalizing terrorist financing, by removing the exemption for groups it had designated as “attempting to end foreign occupation, colonialism and racism”. Bills of “revising the law of combating the financing of terrorism” and “revising the law of anti-money laundering”

were submitted to the parliament in 08/1396 but were not passed by the time this Report was finalized. Identifying and freezing terrorist assets in line with the relevant United Nations Security Council resolutions; demonstrating the way in which authorities are identifying and sanctioning unlicensed fund transfer service providers; and ratifying and implementing the Palermo and TF Conventions and clarifying the capability to provide mutual legal assistance were among the remaining items Iran had been asked to fully address. Although the FATF declared that it would take further steps in June 2018, it called on its members and urged all jurisdictions to continue to advise their financial institutions to apply enhanced due diligence to business relationships and transactions with natural and legal persons from Iran. This advice deprived Iran of the full benefits the Joint Comprehensive Plan of Action had called for.

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