

11

Recent Economic Developments in Iran

A Quarterly Report

بانک خاورمیانه
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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 fourth quarter of 1396 (referred to as 1396Q4), winter of 1396, roughly corresponds to the first quarter of 2018 in the Gregorian Calendar (2018Q1).

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

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**

1397Q1 = 03/21/2018 – 06/21/2018, roughly **2018Q2**

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Iran's Economy at a Glance

	1395	1396Q1	1396Q2	1396Q3	1396Q4	1396	1397Q1
Labor Force Participation & Unemployment Rates (percent)							
Participation (10 Years and Over)	39.4	40.6	41.0	40.1	39.7	40.3	-
Unemployment (10 Years and Over)	12.4	12.6	11.7	11.9	12.1	12.1	-
Unemployment (Youth Aged 15-24)	29.2	28.8	27.3	28.4	29.2	28.4	-
Real Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)*							
Gross Domestic Product (GDP)	12.5	4.6	5.1	2.4	2.7	3.7	-
Oil	61.6	5.9	5.7	-3.3	-4.2	0.9	-
Agriculture	4.2	2.2	3.3	4.0	2.1	3.2	-
Manufacturing and Mining	2.2	4.6	5.5	4.5	5.5	5.1	-
Services	3.6	4.3	4.8	4.0	4.4	4.4	-
GDP (Excluding Oil)	3.3	4.3	4.9	4.2	4.8	4.6	-
Gross Fixed Capital Formation	-3.7	-1.8	1.4	4.1	1.2	1.4	-
Oil (thousand barrels per day)							
Production	3,761	3,880	3,867	3,836	3,811**	3,847**	-
Export	2,224	2,344	2,367	2,291	-	-	-
Inflation Rates (percent)							
Growth Rate of Consumer Price Index (1395=100)	9.1	11.4	8.8	9.3	8.8	9.6	10.5
Growth Rate of Producer Price Index (1390=100)	5.0	8.9	9.9	11.2	11.9	10.5	11.3
Balance of Payments (USD millions)							
Oil Exports	55,752	14,166	15,736	16,468	-	-	-
Non-Oil Exports	28,226	7,176	7,200	8,332	-	-	-
Imports of Goods	63,135	16,283	17,269	19,158	-	-	-
Goods Account (Net)	20,843	5,059	5,667	5,643	-	-	-
Non-Oil Goods Account (Net)	-33,521	-8,814	-9,708	-10,039	-	-	-
Current Account	16,388	3,723	3,718	3,473	-	-	-
Capital Account	-18,288	-1,338	-4,956	-5,499	-	-	-
Change in Foreign Reserves	-7,666	-1,585	-3,968	-3,078	-	-	-
Foreign Exchange Rates (USD/IRR daily average)							
In Free Market	36,487	37,494	38,236	40,719	45,548	40,552	60,365***
In Interbank Market (Official)	31,458	32,445	32,900	34,800	36,842	34,276	41,392
Monetary and Credit Aggregates (end of period, IRR trillions)							
Monetary Base (M0)	1,798.3	1,851.9	1,964.9	1,995.5	2,141.6	2,141.6	-
Central Bank Claims on Banks	996.9	1,013.7	1,097.1	1,130.7	1,310.4	1,310.4	-
Central Bank Claims on Public Sector (Net)	202.6	282.0	292.2	279.9	59.5	59.5	-
Liquidity (M2)	12,533.9	13,149.1	13,899.5	14,453.1	15,299.8	15,299.8	-
Money (M1)	1,630.3	1,647.1	1,682.4	1,737.4	-	-	-
Sight Deposits	1,237.0	1,307.0	1,337.7	1,385.8	-	-	-
Non-Sight Deposits (Quasi-Money)	10,903.6	11,502.0	12,217.1	12,715.7	-	-	-
Government Budget and Fiscal Position (IRR trillions)							
Total Revenues	2,202.7	426.1	590.5	579.2	-	-	-
Tax Revenues	1,014.7	181.9	249.3	252.6	-	-	-
Oil Revenues	738.8	188.9	257.8	193.0	-	-	-
Other	449.1	55.3	83.5	133.6	-	-	-
Total Expenditures****	2,491.2	600.8	596.9	783.4	-	-	-
Current Expenditures	2,070.2	548.8	526.1	560.3	-	-	-
Development Expenditures	421.0	8.2	70.0	224.0	-	-	-
Budget Balance	-288.6	-174.7	-6.4	-204.3	-	-	-
Tehran Stock Exchange (end of period)							
Overall Index (TEDPIX)	77,230	78,736	85,832	95,509	96,290	96,290	108,873
Financial Index	131,865	130,664	129,604	134,057	119,176	119,176	120,837
Industrial Index	66,100	67,681	74,823	74,078	86,082	86,082	98,476
Market Capitalization (IRR trillions)	3,220	3,201	3,396	3,946	3,847	3,847	4,213

Source: Central Bank of the Islamic Republic 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

*** Since 21/01/1397, the free market USD/IRR exchange rate has been calculated based on USD/EUR rate in the international currency market and EUR/IRR rate in Tehran's black market.

**** 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

According to the preliminary estimates of the Central Bank of the Islamic Republic of Iran (CBI), Iran's economy grew by 2.7 percent in winter and 3.7 percent in the year 1396 as a whole. The oil sector accounted for 14.4 of the total value added and grew by 0.9 percent in 1396. The point-to-point real growth rate of this sector experienced a downward trend to gradually fall from +5.9 percent in spring to -4.2 percent in winter and registered 0.9 percent real growth in the year. Other sectors enjoyed positive growth rates in winter and the non-oil GDP grew by 4.8 percent in that season. The highest growth rate belonged to "manufacturing and mining" with 5.5 percent rise, followed by 4.4 percent in "services" and 2.1 percent in "agriculture". Within manufacturing and mining, construction

experienced 1.2 percent rise and thus to register a positive growth rate for the third successive quarter. Manufacturing had a more stable seasonal growth rate, recording an overall 5.3 percent growth while mining experienced fluctuations and grew by 2.9 percent. Among subsectors of services, "social, personal, and household services" contracted in all seasons of the year and shrank by 3.8 percent in 1396 while "transportation, storage, and communications" bore the highest share in growth, both in winter and the year as a whole. In agriculture, the value-added of farm products in 1396 contracted by 0.7 percent whereas that of garden products and animal products expanded by 4.6 percent. Table 1 presents growth rates of GDP and its main components in 1395 and 1396.

Table 1- Growth Rates of GDP and Its Subsectors at Constant 1390 Prices as Well as Their Shares Based on Current Prices (percent)

	1395	1396				Share in 1396	
	Year	Q1	Q2	Q3	Q4		Year
Agriculture	4.2	2.2	3.3	4.0	2.1	3.2	9.8
Oil	61.6	5.9	5.7	-3.3	-4.2	0.9	13.5
Manufacturing and Mining	2.2	4.6	5.5	4.5	5.5	5.1	22.6
Mining	2.1	3.7	1.5	0.8	5.5	2.9	0.7
Manufacturing	6.9	5.0	6.4	4.4	5.4	5.3	12.4
Electricity, Gas, and Water	6.8	8.3	6.3	7.1	8.4	7.5	4.3
Construction	-13.1	-3.5	3.1	1.4	2.0	1.2	5.1
Services	3.6	4.3	4.8	4.0	4.4	4.4	56.2
Trade, Restaurant, and Hotel	6.2	6.6	5.7	2.6	4.4	4.7	13.1
Transportation, Storage, and Communications	6.7	5.6	8.0	6.4	8.1	7.1	10.3
Financial and Monetary Institutions Services	1.7	2.6	3.5	3.5	3.4	3.3	3.3
Real Estate, Specialized and Professional Services	1.8	4.0	4.2	3.9	4.7	4.2	14.1
Public Services	2.0	3.2	4.7	8.2	2.6	4.4	11.8
Social, Personal, and Household Services	0.1	-1.7	-3.3	-8.2	-1.9	-3.8	3.7
Non-Oil Gross Domestic Product (at basic prices)	3.3	4.3	4.9	4.2	4.8	4.6	86.5
Gross Domestic Product (at basic prices)	12.5	4.6	5.1	2.4	2.7	3.7	100.0

Source: Central Bank of Iran, Summary of Iran Economic Developments in Real Sector in 1396

According to preliminary CBI estimates of the GDP on the demand side, gross domestic expenditures rose by 2.9 percent in real terms in the fourth quarter and by 3.8 percent in the whole of the year 1396. Private consumption that had contracted by 1.5 percent in 1396Q3, expanded in 1396Q4 to bring about a rise of 2.5 percent in the year 1396, while public consumption increased by 2.1 percent in that quarter compared to 1395Q4. Gross fixed capital formation reached IRR994.0 trillion in 1396Q4, out of

which 36.0 percent was in machinery and the rest in construction. Its growth rates in winter and the whole year were 1.2 percent and 1.4 percent, respectively. Regarding trade, export of goods and services increased by 9.5 percent in real terms in 1396Q4 but their import climbed faster at 21.1 percent. Growth rates of gross domestic expenditure and its components in 1395 and 1396 are demonstrated in Table 2.

Table 2- Growth Rates of GDP and Its Subsectors on the Expenditures Side at Constant 1390 Prices as Well as Their Shares Based on Current Prices (percent)

	1395	1396				Share in 1396	
	Year	Q1	Q2	Q3	Q4		Year
Private Consumption	3.8	5.7	4.8	-1.5	1.0	2.5	47.6
Public Consumption	3.0	2.6	4.1	7.7	2.1	3.9	13.4
Gross Fixed Capital Formation	-3.7	-1.8	1.4	4.1	1.2	1.4	19.7
Machinery	5.6	-0.7	-0.6	4.6	5.5	2.5	7.4
Construction	-7.4	-2.5	2.1	3.8	-0.6	0.9	12.3
Export of Goods and Services	41.3	1.3	6.0	-9.0	9.5	1.8	24.9
Import of Goods and Services	6.1	16.4	10.2	6.2	21.1	13.4	23.8
Gross Domestic Product (at market prices)	13.4	3.5	6.1	2.4	2.9	3.8	100.0

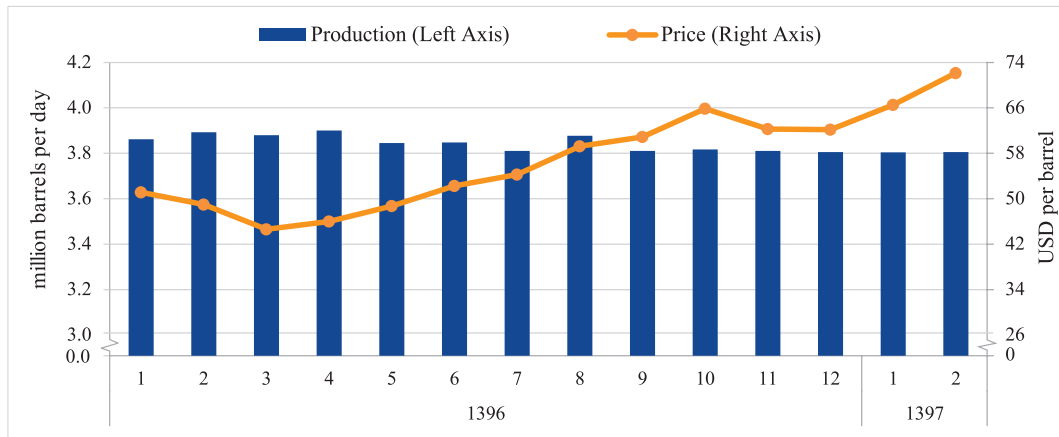
Source: Central Bank of Iran, Summary of Iran Economic Developments in Real Sector in 1396

Energy

On the basis of the latest OPEC reports, during the six months to 02/1397 Iran's crude oil production was relatively stable at around 3.8 million barrels per day (bpd). OPEC reports also indicate that average daily production during the first two months of 1397 was almost unchanged from the same period a year earlier. The price of Iran's heavy crude oil was climbing during most of the year

ending in 02/1397, rising from USD44.6 per barrel in 04/1396 to USD61.7 in 02/1397. According to unofficial statistics, Iran's average daily oil exports stood at around 2.5 million barrels in May 2018; 100 thousand barrels below that a month earlier. Figure 1 demonstrates developments in production and exports of Iran's crude oil.

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



Source: OPEC monthly reports

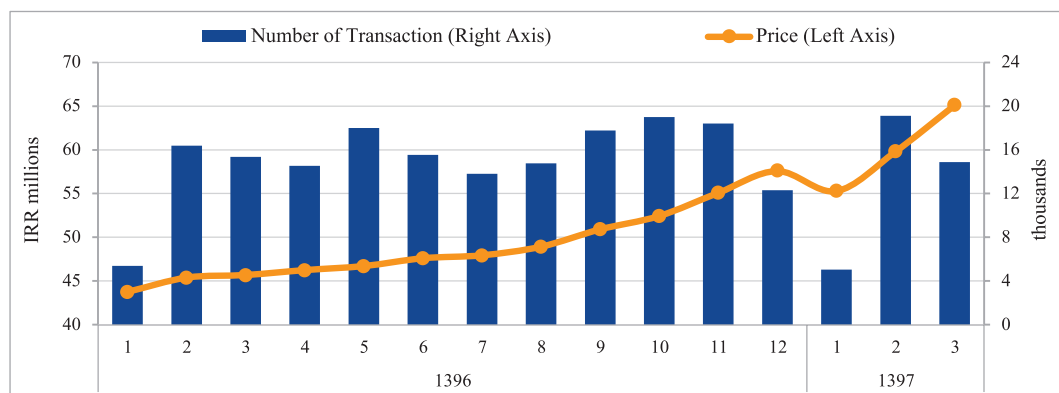
*OPEC statistics are based on Gregorian calendar years and their conversion into Persian calendar years are only approximate.

Housing

Price increases in the housing market outstripped that of consumer prices roughly as of the beginning of the second half of 1396 (1396H2). The average price of a square meter of residential units in Tehran hit IRR57.6 million at the end of 1396, implying 21.1 percent nominal growth from the end of summer. The number of transactions also rose sharply to over 18,000 a month in the first two months of winter. Price hikes led to increased investment and speculation demand, by those who were trying to maintain the value of their rial savings. On the other hand, the large amount of existing liquidity and its rapid growth kept the demand high despite the

price hike. The number of transactions in Tehran housing market decreased in the first month of 1397, corresponding to the New Year's holidays, but reversed course in the month after and exceeded 19,000 per month. Mostly due to the concurrence of Ramadan later in spring, those transactions slumped to below 15,000. However, the average price of a square meter of residential units in Tehran reached IRR65.1 million, showing 8.9 percent rise compared to the previous month and 45.8 percent compared to the same month a year earlier. Figure 2 depicts the developments of average price and number of monthly transactions in Tehran housing market.

Figure 2- Average Price of a Square Meter of Residential Units and Number of Monthly Registered Transactions in 1396 and the First Three Months of 1397



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

Due to the jump in the number of transactions coupled with large fluctuations in the economy, the increase in suppliers' prices accelerated, even though neither income nor bank facilities grew significantly during that period, implying continuous fall in

households' purchasing power. In the event, mostly speculators and investors enter the market, which may raise prices and drop the number of transactions.

Labor Force

The latest report of the Statistical Center of Iran (SCI) indicates improvements in certain labor market indicators in 1396Q4 from the corresponding quarter a year earlier. The economic participation rate rose by 0.8 percentage points to 39.7 percent, while the unemployment rate fell by 0.4 percentage points to 12.1. The unemployment rate of the population aged 15-29 also fell by 0.3 percentage points to 25.2 percent, which is an improvement although still quite high. Between 1395Q4 and 1396Q4, the number of active population rose by 683 thousand, resulting

from 23 thousand decrease in the number of unemployed and 706 thousand increase in the number of employed individuals. The share of underemployment, however, escalated during this period and reached 11.5 percent, corresponding to 2.6 million individuals who were working less than 44 hours per week even as they were willing and able to work longer hours. As shown in Table 3, the participation rate was 40.3 percent and the unemployment rate was 12.1 percent in 1396, both showing improvements from a year earlier.

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

	1395		1396				
	Q4	Year	Q1	Q2	Q3	Q4	Year
Economic Participation Rate (percent)	38.9	39.4	40.6	41.0	40.1	39.7	40.3
Number of Active Population (1000 people)	25,541.2	25,791.5	26,675.3	26,983.3	26,472.8	26,223.9	26,588.8
Unemployment Rate (percent)	12.5	12.4	12.6	11.7	11.9	12.1	12.1
Number of Unemployed (1000 people)	3,198.8	3,203.4	3,367.0	3,156.1	3,141.7	3,176.1	3,210.2
Unemployment Rate for the Population Aged 15-29 (percent)	25.5	25.9	26.4	24.4	25.0	25.2	25.3
Share of the Underemployed (percent)	10.9	10.3	10.2	9.2	10.8	11.5	10.4

Source: Statistical Center of Iran, Summary of the Labor Force Survey, various issues.

In 1396Q4 the number of employed population grew to 23.0 million, out of which 52.1 percent were employed in services, the largest sector of the Iranian economy. The considerable share of this sector in newly created jobs caused its share in employed population to increase since early 1390s. Concerning genders, males accounted for 82.7 percent of the employed and 81.2 percent of the economically active population in that quarter. The unemployment rate was 10.5 percent among men and 19.3 percent among women. Regarding the

provincial distribution of the labor market, in 1396Q4 the highest and the lowest participation rates belonged to North Khorasan and Sistan & Baluchestan provinces at 44.1 percent and 30.5 percent, respectively. Moreover, Kermanshah province experienced the highest unemployment rate at 22.6 percent, while Markazi province enjoyed the lowest rate at 7.5 percent. Meanwhile, the participation rate and the unemployment rate in Tehran province were 40.2 percent and 8.9 percent, respectively.

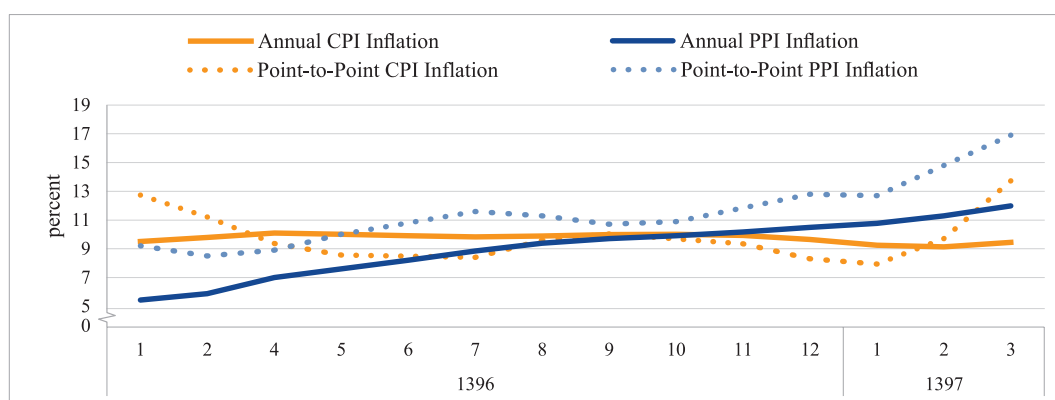
2. Prices and Inflation

The point-to-point consumer price index (CPI) inflation rate that had fallen below 10.0 percent and stayed there as of 10/1396, registered 7.9 percent in the first month of 1397, the lowest rate since 04/1395. However, due to the faster rise of the point-to-point producer price index (PPI) inflation rate in preceding months, the downward trend of point-to-point CPI inflation rate reversed course and increased to 13.7 percent by 03/1397. The average annual CPI inflation rate at the end of each month, which had recorded single-digit values since 11/1396 and was descending, changed course in 03/1397 and rose to 9.4 percent.

The point-to-point PPI inflation rate that had been continually

increasing since the end of 1396Q3, rose by 6.0 percentage points in 03/1397 to 16.9 percent, the highest rate recorded since 07/1393. Likewise, the annual PPI inflation rate continued its upward trend that had started in 1395H2 and attained 12.0 percent in 03/1397, its highest rate since 04/1394. The point-to-point CPI inflation rate had not exceeded the point-to-point PPI inflation rate since 05/1396, and their gap has widened in the first few months of 1397. Given the lagged effect of PPI inflation rate on CPI inflation rate, the latter is expected to increase faster in coming months. Figure 3 depicts point-to-point and annual CPI and PPI inflation rates from the beginning of 1396 to the end of 1397Q1.

Figure 3- CPI and PPI Inflation Rates from 01/1396 to 03/1397



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

The point-to-point CPI inflation rate of tradable goods rose by 2.6 percentage points in 02/1397 to 9.7 percent, while that of non-tradable goods increased by 0.5 percentage points to 9.7 percent from the end of 1396. The rise in point-to-point CPI inflation rate of tradable goods may be partly attributed to the depreciation of the Iranian rial.

Out of 12 major groups in the consumption basket of goods and services in 1397Q1, the point-to-point inflation rate in all groups

-except education- increased, with food and beverages recording the highest increase of 11.8 percentage points. Given that this group is the second largest in the consumption basket, the increase in point-to-point CPI inflation rate is largely due to the sharp increase in prices of food and beverages. Table 4 exhibits point-to-point CPI inflation rates in major groups of the consumption basket during 1396Q4 and 1397Q1.

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

	Weight in the Basket	1396			1397		
		10/1396	11/1396	12/1396	01/1397	02/1397	03/1397
Overall	100.00	9.7	9.4	8.3	7.9	9.7	13.7
Housing, Water, Electricity, Gas and Other Fuels	37.05	8.8	8.8	8.9	8.8	9.0	10.1
Food and Beverages	25.51	13.7	11.5	7.0	5.0	8.4	16.8
Transport	8.90	6.4	6.8	7.5	7.9	10.7	17.6
Health	7.83	8.5	8.7	8.5	8.6	8.9	10.9
Clothing and Footwear	4.62	4.9	5.4	6.0	5.9	7.6	9.8
Household Equipment and Routine Household Maintenance	4.33	8.2	8.8	9.3	10.5	14.3	16.4
Miscellaneous Goods and Services	3.17	11.6	12.7	13.4	14.8	17.4	20.5
Communication	2.30	0.8	1.7	2.1	2.4	5.5	10.1
Recreation and Culture	2.07	10.0	11.4	12.1	14.7	20.0	24.2
Education	2.03	14.1	14.1	14.1	14.1	14.1	13.7
Restaurants and Hotels	1.82	11.8	11.5	11.3	11.0	11.5	12.0
Tobacco	0.37	1.1	1.8	18.0	20.6	22.6	28.7

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

3. Balance of Payments

In the first nine months of 1396, the current account fell by 8.4 percent to USD10.9 billion. Goods account, the largest subgroup of the current account, increased by 2.1 percent to record USD16.4 billion in this period. The fall in the current account was mostly due to the considerable increase in the services account deficit that had declined by 25.8 percent and reached USD6.6 billion. Although no records of the services account components were available for the period under review, previous years' data point out to traveling, transportation, and construction services as major contributors to services import and export. Hence, export decrease or import increase of these services in the first nine months of 1396 played the main role in the expansion of services account deficit. The other subgroups of

the current account, the income account and the current transfers account, that comprised only a small part of the current account faced 12.5 percent rise and 18.0 percent fall, respectively. Going through the components of the goods account indicated growth rates of 16.3 percent in oil exports value and 19.0 percent in non-oil imports value in the period under review. Moreover, the value of non-oil exports increased by 11.2 percent to register USD22.7 billion. Therefore, the rise in non-oil imports value coupled with the growth in oil exports value prevented a sizeable change in goods account. The expansion in oil exports value was owing to increases in both exports volume and oil prices. Table 5 presents the current account balance and its subgroups from 1395Q1 to 1396Q3.

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

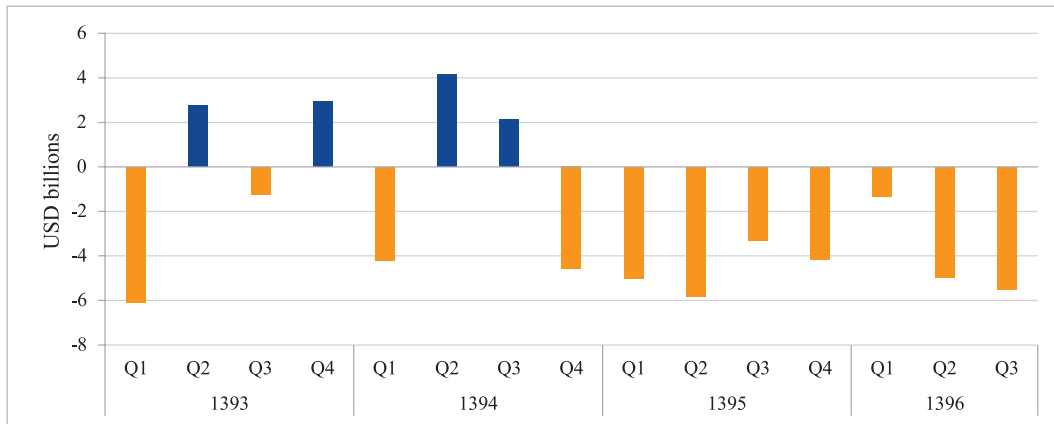
	1395				1396		
	Q1	Q2	Q3	Q4	Q1	Q2	Q3
Goods Account	6,522	4,127	5,387	4,807	5,059	5,667	5,643
Services Account	-1,610	-1,184	-2,428	-719	-1,713	-2,297	-2,557
Income Account	198	360	127	243	263	238	270
Current Transfers Account	121	156	139	142	114	110	117
Current Account Balance	5,231	3,459	3,225	4,473	3,723	3,718	3,473

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

The capital account experienced 16.6 percent fall in its deficit in the first nine months of 1396. Figure 4 illustrates changes in net capital account from 1393Q1 to 1396Q3. It is said that part of the capital account deficit is due to capital flight. In 1396H2, rumors about the possibility of US unilaterally withdrawing from the Joint Comprehensive Plan of Action (JCPOA) led to jumps in foreign exchange rates and possibly some capital flight, although

no hard data are available on that. Overall, the balance of payments statistics indicate that foreign reserves fell by USD8.6 billion during the first nine months of 1396 to reach USD112.1 billion, including USD7.7 billion in errors and omissions. In effect, foreign reserves that had been falling since 1395 declined at a faster rate in 1396.

Figure 4- Quarterly Changes in Net Capital Account



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

Non-oil exports in the first two months of 1397 amounted to 18.8 million tons and USD7.7 billion in value, indicating 4.8 percent and 21.9 percent growth rates, respectively. Despite a fall in the weight of petrochemicals and natural gas condensates, their export values increased by 1.2 percent and 10.5 percent, respectively, thanks to their international price increases. Nonetheless, the key factor in rise in the value of non-oil exports was the increase in export value of “other goods” by USD1.3 billion. The main exported items were “natural gas condensates” valued at USD1.0 billion, “liquefied propane” at USD335 million, “light crude oil except gasoline” at USD247 million, “polyethylene film grade” at USD232 million, and “gas oil and hydrocarbon gas liquids” at USD203 million. China, the UAE, Iraq, Afghanistan, and India were the main export destinations, comprising respective shares of 18.8 percent, 17.7 percent, 15.0 percent, 7.5 percent, and 6.0 percent in Iran’s total exports value. During the first two months of 1397, the share of exports value to China fell from

22.2 percent to 18.8 percent, while UAE’s share increased from 14.9 percent to 17.7 percent compared to the same period in the preceding year.

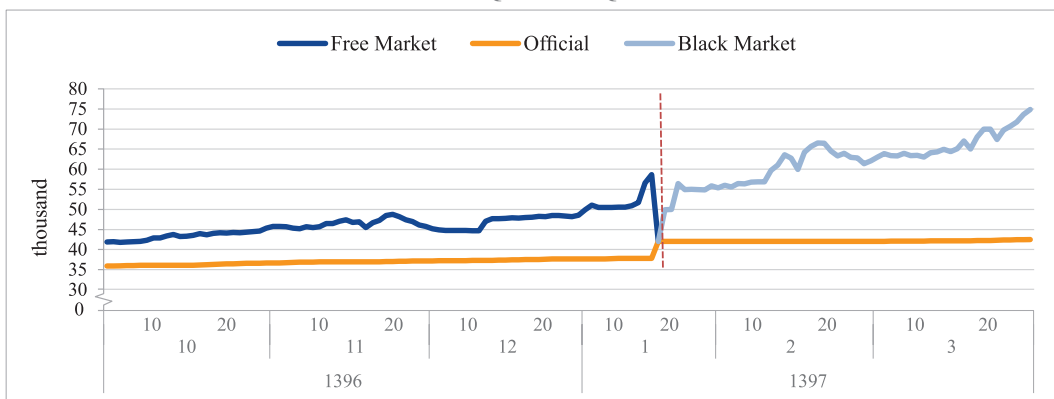
Non-oil imports in the first two months of 1397 amounted to 5.3 million tons and USD6.8 billion in value, indicating 2.1 percent and 0.5 percent growth rates, respectively. “Auto parts” valued at USD333 million, “cattle feed corn” at USD296 million, “soybean” at USD248 million, “rice” at USD184 million, and “machinery and apparatus parts” at USD144 million were the main imported items, in that order. The highest levels of imports were from China, the UAE, South Korea, Germany, and Turkey with respective shares of 25.5 percent, 14.5 percent, 6.2 percent, 5.3 percent, and 5.2 percent of Iran’s total imports. Notably, during the first two months of 1397, the share of imports from China rose by 3.1 percentage points while that of the UAE declined by 2.9 percentage points from the same period of the preceding year.

4. Foreign Exchange Market

The USD/IRR free market exchange rate in 1397Q1 maintained its upward trend that had started in the early summer of 1396. This rate surpassed 50,000 in the first workdays of 1397 and exceeded 56,000 by the third week of the year. Following this sharp rise, the government announced its new official rate at

IRR42,000 in the late evening of 20/01/1397 and declared any purchase at higher rates illegal – which of course led to the emergence of a black market for currency exchanges. Figure 5 depicts the daily USD/IRR exchange rates during 1396Q4 and 1397Q1 in various markets.

Figure 5- Daily USD/IRR Exchange Rates in the Free Market and Black Market*, as Well as Its Official Rate in 1396Q4 and 1397Q1



Source: Central Bank of Iran; Financial Informing Network

*Due to the halt in announcing free market USD/IRR exchange rates since 21/01/1397, the rate has been calculated based on USD/EUR rate in the international currency market and EUR/IRR rate in Tehran’s black market. These rates are distinguished from the market rate with a different color.

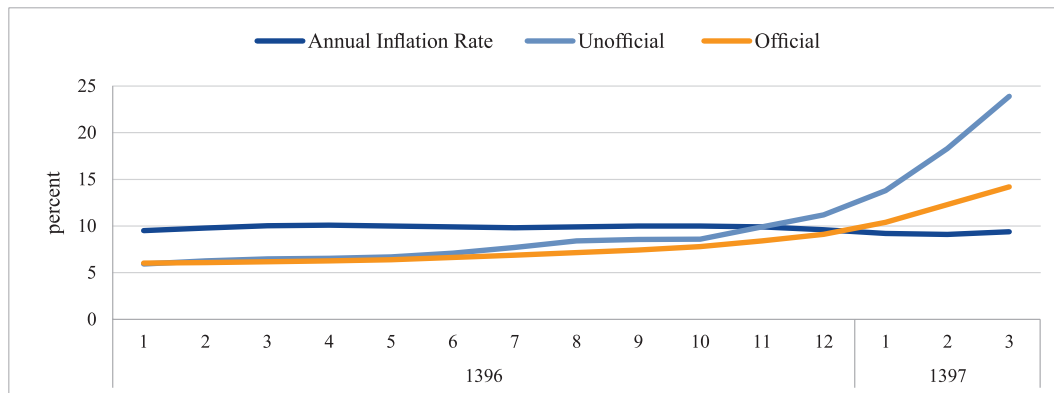
Soon after the 20/01/1397 declaration of the new official exchange rate, CBI issued several announcements according to which all individuals, legal entities, and currency exchange brokers were prohibited from any deals in banknotes and/or outside the banking system, and goods whose imports were declared eligible for receiving foreign exchange at the official rate were divided into 33 categories. Individuals were forbidden from exchanging notes and were limited to keep notes up to the equivalent of EUR10,000, and deposit the remainder within a few days in a bank foreign exchange account. All that really happened was the government abruptly raised the official USD/IRR exchange rate from its previous level of 38,000 to the new rate of 42,000 for the importation of a wider variety of goods and services, but the free foreign exchange market got more restricted. On the other hand, all importers who were allowed to enjoy the official rate were required to register their import needs through an online system called NIMA. Moreover, exporters were required to sell their foreign currencies in the same system at the official rate. The only exceptions were exporters to Iraq and Afghanistan. Strictly speaking, requiring businessmen to register in NIMA at the official rate was a way of subsidizing importers of goods and services and taxing exporters. As a result of the ban on any deal via notes and/or outside the banking system, the currency exchange brokers were actually removed from

the free market. A bit later, the CBI assigned USD at the rate IRR38,000 to certain essential items and authorized currency exchange brokers were allowed to resume their activities but only through NIMA while still being prohibited from dealing in foreign currency notes.

Following declaration of the so-called exchange rate unification policy, the USD/IRR rate in the black market fell slightly to 50,000, but escalated again after a few days and recorded approximately 60,000 on 18/02/1397, just before US government announced its decision to withdraw from the JCPOA. After that announcement, the black market rate reached as high as 66,000 by 22/02/1397, but reversed course and registered 63,000 at the end of 02/1397. This rate experienced huge fluctuations in the third month of 1397 and varied from 63,000 to 74,000.

The official USD/IRR exchange rate rose from 42,000 in the beginning of the so-called exchange rate unification to 42,500 at the end of 03/1397. In 1397Q1, the average USD/IRR free market exchange rate rose by 30.0 percent compared to 1396Q4, and by 59.0 percent compared to 1396Q1. Figure 6 depicts monthly inflation rates alongside the growth rates of the USD/IRR exchange rates in unofficial and official markets from the beginning of 1396 to the end of 1397Q1.

Figure 6- Monthly Inflation Rates and Growth Rates of USD/IRR Exchange Rates in Unofficial Market and Official Market



Source: Central Bank of Iran; Research calculations

5. Monetary and Credit Aggregates

At the end of 1396, monetary base stood at IRR2,141.6 trillion and liquidity at IRR15,299.8 trillion, indicating 19.1 percent and 22.1 percent growth rates, respectively, in that year. Since the details of these statistics have not yet been published, the remainder of this section will be on the basis of statistics at the end of 11/1396.

In 11/1396, all components of the monetary base contributed

in the same direction to raise this aggregate. CBI net claims on public sector, its net foreign assets, and its claims on banks increased by 29.2 percent, 8.1 percent, and 1.1 percent, respectively, while net other items fell by 5.8 percent. Statistics on monetary base components in the first three quarters of 1395 and 1396, as well as in the second month of winter in these two years, are presented in Table 6.

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

	1395				1396				11/1396 to 11/1395	
	Q1	Q2	Q3	11/1395	Q1	Q2	Q3	11/1396	Growth Rate (percent)	Share in Growth (percentage points)
Monetary Base	1,585.2	1,655.1	1,704.7	1,734.1	1,851.9	1,964.9	1,995.0	2,039.6	17.6	17.6
CBI Net Foreign Assets	1,876.6	1,859.4	1,898.2	1,880.9	1,853.9	1,874.4	1,913.8	2,033.2	8.1	8.8
CBI Net Claims on Public Sector	238.9	325.3	233.1	185.1	282.0	292.2	279.9	239.1	29.2	3.1
CBI Claims on Banks	895.1	942.2	1,047.9	1,154.9	1,013.7	1,097.1	1,130.7	1,167.1	1.1	0.7
Other Items (Net)	-1,425.4	-1,471.8	-1,474.5	-1,486.8	-1,297.7	-1,298.8	-1,329.4	-1,399.8	-5.8	5.0

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

For the year ended 11/1396, CBI's net foreign assets were the main driver of upswing in monetary base, whose share in growth was 8.8 percentage points.¹ In contrast, CBI claims on banks bore the least contribution to the expansion of monetary base, recording the share of 0.7 percentage points in its growth. Despite the 72.0 percent fall in CBI claims on commercial banks and 26.1 percent decline in its claims on specialized public banks, CBI claims on non-public banks and non-bank credit institutions grew by 68.0 percent, accounting for 58.3 percent of its claims on banks at the end of 11/1396, 23.2 percentage points up from that a year earlier. Poor balance sheets of a number of these banks and credit institutions, as well as high real interest rates, were among the main contributors to this climb.

Liquidity at the end of 11/1396 amounted to IRR14,896.4 trillion, out of which money accounted for IRR1,853.1 trillion and quasi-money

for the rest. Liquidity expanded by 1.8 percent during 11/1396 alone, as money expanded by 2.8 percent and quasi-money by 1.7 percent. Due to the faster expansion of liquidity than monetary base in the year ending in 11/1396, the M2 money multiplier at the end of 11/1396 increased to 7.3. The decline in the share of notes and coins with the public in total deposits, coupled with the decrease in the ratio of banks' excess reserves (deposits with the CBI) to total deposits, led to the increase in M2 money multiplier. Among money components, notes and coins with the public expanded by 13.5 percent and sight deposits by 24.0 percent, which were, respectively, responsible for 0.3 percentage points and 2.4 percentage points of the liquidity growth. Table 7 demonstrates statistics on M2 money multiplier and liquidity components in the first three quarters of 1395 and 1396, as well as in the second month of winter in these two years.

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

	1395				1396				11/1396 to 11/1395	
	Q1	Q2	Q3	11/1395	Q1	Q2	Q3	11/1396	Growth Rate (percent)	Share in Growth (percentage points)
Liquidity	10,595.0	11,227.1	11,848.6	12,110.9	13,149.1	13,899.5	14,453.1	14,896.4	23.0	23.0
Money	1,364.4	1,480.3	1,540.7	1,522.6	1,647.1	1,682.4	1,737.4	1,853.1	21.7	2.7
Notes and Coins with the Public	311.6	329.2	327.7	321.7	340.1	344.7	348.6	365.3	13.5	0.3
Sight Deposits	1,052.8	1,151.1	1,213.0	1,200.9	1,307.0	1,337.7	1,385.8	1,487.8	24.0	2.4
Quasi-Money	9,230.6	9,746.8	10,307.9	10,588.3	11,502.0	12,217.1	12,715.7	13,043.3	23.2	20.3
M2 Money Multiplier	6.7	6.8	7.0	7.0	7.1	7.1	7.2	7.3	4.3	-

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

Total outstanding deposits in banks and credit institutions grew by 7.5 percent in 12/1396, compared to a month earlier, to register IRR16,464.0 trillion -- the highest recorded monthly growth. The next largest value for monthly deposits growth was registered in 04/1392. That time, as the new government took office, economic agents' expectations for decreasing inflation rate and less volatility in financial markets made deposit accounts more attractive. The same information was extracted using the average annual growth rate of bank deposits, where the average annual point-to-point growth rate in 12/1396 was 5.8 percentage points above that in a month earlier.

Outstanding facilities extended by banks reached IRR12,587.1 trillion in 12/1396, indicating 9.2 percent rise from the preceding month. This expansion was much higher than 1.9 percent monthly

growth in 11/1396. The ratio of extended facilities to deposits (less reserve requirement) amounted to 85.4 percent in 12/1396, registering 1.5 percentage points increase from a month earlier.

According to the latest report of Shaparak², the value of total transactions in 11/1396 expanded by 4.8 percent compared to 10/1396. Considering the 1.8 percent increase in liquidity during the period under review, the ratio of total value of transactions to liquidity³ recorded 10.8 percent, 0.3 percentage points above that in 10/1396. Moreover, more than 1.6 billion transactions were processed in 02/1397, which indicated 13.7 percent rise in number and 49.1 percent real growth in value, compared to 01/1397. The rise in the number of cardholders and in the tendency of using different payment methods instead of using banknotes were among the main factors of the aforementioned growth.

1. In the period under review, foreign assets of the CBI grew by 17.0 percent, while its foreign exchange liabilities increased by 28.0 percent.

2. 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.

3. This ratio is an index representing the effectiveness of electronic payment industry on easing economic transactions. It is the share of liquidity paid electronically.

6. Government Budget and Fiscal Position

Based on the performance in the first 10 months of 1396, the Plan and Budget Organization estimates the general budget sources in that year to be IRR3,099 trillion, corresponding to 89 percent of the legislated figure. The estimated performance levels of current revenues, disposal of non-financial assets, and disposal of financial assets were, respectively, IRR1,687 trillion, IRR858 trillion, and IRR554 trillion. Besides, on the side of budget uses, current expenditures, acquisition of non-financial assets and acquisition of financial assets were assessed at IRR2,361 trillion, IRR459 trillion, and IRR278 trillion, respectively.

Tax revenues that had contracted in the first half of 1396, started to grow in the second half and rose by 7.6 percent in the first 11 months of 1396, although it still constitutes contraction in real terms. Tax revenues were 14.0 percent below the legislated amount in the Budget Law. Other current revenues also rose by only 4.1 percent to equal 63.0 percent of the legislated figure, while current expenditures grew by 15.6 percent during those 11 months and covered 88.3 percent of the legislated amount. Small rise in current revenues together with the considerable increase in current expenditures rose the operating balance deficit by 30.1 percent to IRR842.4 trillion in the first 11 months of 1396, which is around 6 percent of the country's GDP. This reveals that excluding oil revenues and development expenditures, current budget deficit of

the government exceeded that of many developed and developing economies. The budget deficit in the EU member countries averaged 1.0 percent of their GDP in 2017 and this ratio for the US is reported at 3.4 percent.

Oil revenues grew by 38.0 percent in the period under review, but still covered only 78.6 percent of the legislated figure. Development expenditures also rose by 70.1 percent to IRR316.3 trillion, equaling even less than half of the legislated level.

Overall, in the first 11 months of 1396 total government revenues rose by 17.2 percent and total government expenditures rose by 20.1 percent, causing the budget deficit to rise by 42.2 percent and reach IRR331.3 trillion. In addition, the government spent IRR289.1 trillion on acquisition of financial assets, culminating in the rise in the disposal of financial assets to IRR620.4 trillion. Irregular issuance of government debt securities had been experienced before and led to considerable rise in financial burden due to the repayment of these securities. In the period under review, acquisition of financial assets, that includes government debt repayments, grew by 256.7 percent and recorded a 25.5 percent increase from the legislated figure. New US sanctions have created uncertainties regarding oil revenues, and budget deficits are expected to increase. Table 8 exhibits the government fiscal performance in 1396.

Table 8- The Government Fiscal Performance in 1396

	Q1		Q2		Q3		First 11 Months		Performance of the First 11 Months of 1396 Compared to the Legislated Figures (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	2,083.4	17.2	77.2
Tax Revenues	181.9	-1.6	249.3	0.4	252.6	13.8	921.8	7.6	86.0
Other Current Revenues	54.5	107.0	82.1	-36.9	132.9	80.1	334.2	4.1	63.0
Oil Revenues	188.9	333.2	257.8	27.9	193.0	9.2	824.0	38.0	78.6
Other Disposal of Non-Financial Assets	0.8	13.5	1.4	40.9	0.7	-30.0	3.4	-7.3	7.3
Expenditures	600.8	44.4	596.9	-11.5	783.4	60.5	2,414.7	20.1	80.7
Current Expenditures	548.8	48.8	526.1	-9.6	560.3	24.7	2,064.2	15.6	88.3
Development Expenditures	8.2	489.0	70.0	-42.2	224.0	523.0	316.3	70.1	48.1
Budget Balance	-174.7	8.9	-6.4	-93.2	-204.3	1,288.0	-331.3	42.2	112.0
Operating Balance	-356.2	75.8	-195.6	11.1	-174.0	11.1	-842.4	30.1	114.8
Net Disposal of Non-Financial Assets	181.4	329.8	189.2	130.1	-30.3	-121.4	511.1	23.2	116.7
<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>620.4</i>	<i>97.6</i>	<i>125.5</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>289.1</i>	<i>256.7</i>	<i>145.6</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 part of tax revenues in the first 11 months of 1396. A 9.1 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 a 4.6 percent fall in direct taxes. Revenues from income tax and wealth tax grew less than the inflation rate. On the other hand, among the subgroups of indirect taxes, revenues from tax on imports rose by 23.2 percent and

those from goods and services by 17.8 percent. Revenues from the value-added tax that has served as a major component of tax revenues in recent years, grew by 26.0 percent and accounted for almost one-fourth of total tax revenues in the period under review. Table 9 exhibits the components of tax revenues in the first 11 months of 1395 and 1396.

Table 9- Components of Tax Revenues

	First 11 Months of 1395			First 11 Months of 1396		
	Amount (IRR trillions)	Share (percent)	Growth (percent)	Amount (IRR trillions)	Share (percent)	Growth (percent)
Tax Revenues	856.4	100.0	31.1	921.7	100.0	7.6
Direct	422.5	49.3	22.7	403.0	43.7	-4.6
Legal Entities	267.9	31.3	21.9	243.6	26.4	-9.1
On Income	130.9	15.3	26.3	134.5	14.6	2.7
On Wealth	23.6	2.8	13.8	25.0	2.7	5.7
Indirect	433.9	50.7	40.3	518.7	56.3	19.5
On Imports	142.8	16.7	61.0	175.9	19.1	23.2
On Goods and Services	291.1	34.0	32.0	342.8	37.2	17.8
On Value-Added	186.5	21.8	3.4	224.9	24.4	20.6

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

In the first nine months of 1396, the government sold IRR274.8 trillion in Islamic securities in order to finance its budget deficit. Disposal of state-owned companies and last years' payment returns had only small contributions of 4.7 percent and 0.7 percent and led to respective revenues of IRR28.3 trillion and

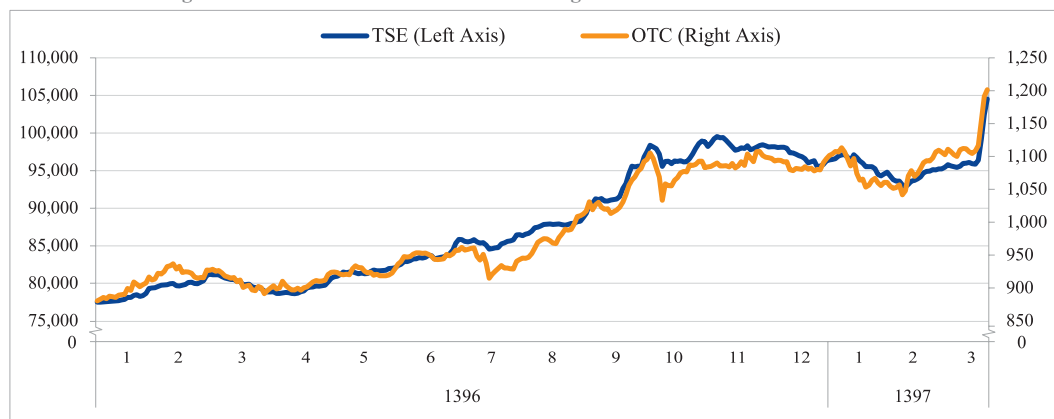
IRR4.1 trillion for the government. The "other" subgroup of the disposal of financial assets, which consisted mainly of the National Development Fund resources and the Treasury's revolving fund, made up 48.9 percent of the total financing of budget deficit and amounted to IRR294.1 trillion.

7. Capital Market

The overall index of the Tehran Stock Exchange (TSE) was quite erratic during 1397Q1 and after almost two and a half months came back to its initial value at the beginning of the quarter. And then, in less than 10 workdays at the end of that quarter, the index soared by 12.9 percent and reached 108,873. The daily price hike of some companies' shares was so great that based on the rules of Securities and Exchange Organization, their trade was frozen. Metal, mineral and petrochemical industries were the main contributors to the growth of the overall index over this period. After causing sharp price rises in housing, automobile, and gold markets, the huge

amount of liquidity might have moved to equity market, especially in equity of industries whose earnings are in foreign currencies. The other part of the capital market, Over the Counter (OTC), had almost the same experience as the TSE. Wild fluctuations in the first two and a half months of the quarter neutralized each other, the index rose by 8.3 percent in the last week of 1397Q1 and closed the quarter at 1,242. The market capitalization of OTC at the end of 1397Q1 was IRR1,641 trillion. TSE and OTC overall indices are depicted in Figure 7.

Figure 7- TSE and OTC Overall Index during 1396 and the First Three Months of 1397



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

8. Other Economic Developments

After the US announced his decision to withdraw from the JCPOA, uncertainties about future oil revenues and access to the international banking system injected uncertainties into the Iranian economy. Iran exports around 2.6 million bpd of oil and natural gas condensates. China, India, and South Korea are the main customers and roughly 600 thousand are destined to Europe. Analysts believe that these US sanctions would be less detrimental to Iran's economy than the previously imposed ones due to the lack of global consensus and opposition of other countries to US

withdrawal from the JCPOA. The Institute of International Finance has projected Iran's average oil export to drop by 300 thousand bpd in 2018.

Effective May 8, 2018, the US established a 180-day and a 90-day wind-down period for certain activities involving Iran. Following the 180-day wind-down period, the US government would reimpose a number of sanctions that were lifted pursuant to the JCPOA, including sanctions on Iran's port operators, and shipping

and shipbuilding sectors; sanctions on oil-related transactions with the National Iranian Oil Company, Naftiran Intertrade Company, and National Iranian Tanker Company, including the purchase of oil, oil products, or petrochemical products from Iran; sanctions on transactions by foreign financial institutions with the CBI and some Iranian financial institutions; sanctions on the provision of specialized financial messaging services to the CBI and some Iranian financial institutions; sanctions on the provision of underwriting services, insurance, or reinsurance; and sanctions on Iran's energy sector. Moreover, after the 90-day wind-down period, the US government would re-impose a number of sanctions that were lifted pursuant to the JCPOA, including sanctions on the purchase or acquisition of US dollar banknotes by the government of Iran; sanctions on Iran's trade in gold or precious metals; sanctions on the direct or indirect sale, supply, or transfer to or from Iran of graphite, raw, or semi-finished metal, coal, and software for integrating industrial processes;

sanctions on significant transactions related to the purchase or sale of Iranian rial, or the maintenance of significant funds or accounts outside the territory of Iran denominated in the Iranian rial; sanctions on the purchase, subscription to, or facilitation of the issuance of Iranian sovereign debt; and sanctions on Iran's automotive sector.

At the end of each wind-down period, the United States Department of the Treasury would update the List of Specially Designated Nationals and Blocked Persons and the category of activities that would be sanctionable, which may largely expose the economy of Iran to US sanctions. Instability and political risks in the aftermath of US withdrawal from the JCPOA have inclined some international companies to cease their activities in Iran. Total S.A. and Groupe PSA terminated their partnerships with Iran, while Boeing canceled its licenses to sell aircrafts to Iran before the end of the relevant wind-down period.

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