

# 14

## Recent Economic Developments in Iran

A Quarterly Report

بانک خاورمیانه  
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## **Recent Economic Developments in Iran, A Quarterly Report** **No. 14, April 2019**

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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, compared to the similar period or point the preceding year. As such, “the growth rate of oil revenues in the first quarter of 1397” indicates the percentage change in oil revenues between the first quarter of 1396 and the first quarter of 1397.

**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 1397 (referred to as 1397Q3), fall of 1397, roughly corresponds to the Fourth quarter of 2018 in the Gregorian Calendar (2018Q4).

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

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

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

**1397Q2** = 06/22/2018 – 09/22/2018, roughly **2018Q3**

**1397Q3** = 09/23/2018 – 12/21/2018, roughly **2018Q4**

**1397Q4** = 12/22/2018 – 03/20/2019, roughly **2019Q1**

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## Iran's Economy at a Glance

|   | 1396Q3   | 1396Q4   | 1396     | 1397Q1   | 1397Q2   | 1397Q3   | 1397Q4  |
|---|----------|----------|----------|----------|----------|----------|---------|
| <b>Labor Force Participation &amp; Unemployment Rates (percent)</b>                   |          |          |          |          |          |          |         |
| Participation (10 Years and Over)   | 39.9     | 39.7     | 40.3     | 41.1     | 40.9     | 40.5     | -       |
| Unemployment (10 Years and Over)  | 11.7     | 12.1     | 12.1     | 12.1     | 12.2     | 11.7     | -       |
| Unemployment (Youth Aged 15-24)   | 28.3     | 29.2     | 28.4     | 28.3     | 27.2     | 27.0     | -       |
| <b>Real Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)*</b> |          |          |          |          |          |          |         |
| Gross Domestic Product (GDP)  | 2.4      | 2.7      | 3.7      | 1.8      | -1.1     | -        | -       |
| Oil   | -3.3     | -4.2     | 0.9      | 5.2      | 0.6      | -        | -       |
| Agriculture   | 4.0      | 2.1      | 3.2      | 0.3      | -3.6     | -        | -       |
| Manufacturing and Mining  | 4.5      | 5.5      | 5.1      | 0.1      | -6.1     | -        | -       |
| Services  | 4.0      | 4.4      | 4.4      | 1.1      | 1.2      | -        | -       |
| Non-Oil GDP   | 4.2      | 4.8      | 4.6      | 0.7      | -1.6     | -        | -       |
| Gross Fixed Capital Formation (at market prices)                                      | 4.1      | 1.2      | 1.4      | -0.8     | -5.6     | -        | -       |
| <b>Oil (daily average - thousand barrels)</b>   |          |          |          |          |          |          |         |
| Production  | 3,836    | 3,812    | 3,849    | 3,805    | 3,603**  | 2,993**  | -       |
| Export  | 2,291    | 2,295    | 2,324    | 2,390    | -        | -        | -       |
| <b>Point-to-Point Inflation Rates (percent)</b>                                       |          |          |          |          |          |          |         |
| Growth Rate of Consumer Price Index (1395=100)  | 9.3      | 9.1      | 9.6      | 10.5     | 24.5     | 35.0***  | 43.1*** |
| Growth Rate of Producer Price Index (1395=100)  | 10.4     | 11.7     | 10.0     | 14.6     | 35.4     | 58.7     | -       |
| <b>Balance of Payments (USD millions)</b>   |          |          |          |          |          |          |         |
| Oil Exports   | 16,468   | 19,448   | 65,818   | 20,980   | -        | -        | -       |
| Non-Oil Exports   | 8,332    | 9,616    | 32,324   | 8,356    | -        | -        | -       |
| Import of Goods   | 19,158   | 22,836   | 75,546   | 16,353   | -        | -        | -       |
| Goods Account (Net)   | 5,643    | 6,227    | 22,596   | 12,983   | -        | -        | -       |
| Non-Oil Goods Account (Net)   | -10,039  | -11,897  | -40,458  | -7,330   | -        | -        | -       |
| Current Account   | 3,473    | 4,902    | 15,816   | 11,061   | -        | -        | -       |
| Capital Account   | -5,499   | -7,528   | -19,321  | -5,263   | -        | -        | -       |
| Change in Foreign Reserves  | -3,078   | 491      | -8,140   | 3,933    | -        | -        | -       |
| <b>Foreign Exchange Rates (USD/IRR daily average)</b>                                 |          |          |          |          |          |          |         |
| In Free Market****  | 40,719   | 45,548   | 40,552   | 60,365   | 103,434  | 132,748  | 118,786 |
| Official Rate   | 34,800   | 36,842   | 34,276   | 41,392   | 42,646   | 42,000   | 42,000  |
| <b>Monetary and Credit Aggregates (end of period - IRR trillions)</b>                 |          |          |          |          |          |          |         |
| Monetary Base (M0)  | 1,995.5  | 2,139.8  | 2,139.8  | 2,186.6  | 2,365.5  | 2,436.0  | -       |
| Central Bank Claims on Banks  | 1,130.7  | 1,320.3  | 1,320.3  | 1,397.1  | 1,506.5  | 1,497.9  | -       |
| Central Bank Claims on Public Sector (Net)  | 279.9    | 55.1     | 55.1     | 82.8     | 82.4     | 132.7    | -       |
| Liquidity (M2)  | 14,453.1 | 15,299.8 | 15,299.8 | 15,827.5 | 16,723.7 | 17,645.8 | -       |
| Money (M1)  | 1,737.4  | 1,946.7  | 1,946.7  | 2,059.5  | 2,436.7  | 2,446.2  | -       |
| Sight Deposits  | 1,385.8  | 1,504.0  | 1,504.0  | 1,635.5  | 1,991.7  | 1,991.2  | -       |
| Non-Sight Deposits (Quasi-Money)  | 12,715.7 | 13,353.1 | 13,353.1 | 13,768.0 | 14,287.0 | 15,199.6 | -       |
| <b>Government Budget and Fiscal Position (IRR trillions)</b>                          |          |          |          |          |          |          |         |
| Total Revenues  | 579.2    | 1,002.7  | 2,598.5  | 590.6    | 676.1    | 639.4    | -       |
| Tax Revenues  | 252.6    | 474.6    | 1,158.4  | 225.9    | 277.5    | 267.8    | -       |
| Oil Revenues  | 193.0    | 279.6    | 919.2    | 326.0    | 304.6    | 263.6    | -       |
| Other Revenues  | 133.6    | 248.5    | 520.9    | 38.7     | 94.0     | 108.0    | -       |
| Total Expenditures*****   | 783.4    | 887.4    | 2,868.6  | 880.7    | 758.3    | 718.2    | -       |
| Current Expenditures  | 560.3    | 794.2    | 2,429.4  | 588.1    | 721.8    | 629.9    | -       |
| Development Expenditures  | 224.0    | 137.0    | 439.2    | 226.7    | 39.7     | 54.6     | -       |
| Budget Balance  | -204.3   | 115.3    | -270.1   | -290.1   | -82.2    | -78.8    | -       |
| <b>Tehran Stock Exchange (end of period)</b>  |          |          |          |          |          |          |         |
| Overall Index (TEDPIX)  | 95,509   | 96,290   | 96,290   | 108,873  | 160,538  | 156,083  | 178,659 |
| Financial Index   | 134,057  | 119,176  | 119,176  | 120,837  | 165,359  | 172,718  | 205,266 |
| Industrial Index  | 74,078   | 86,082   | 86,082   | 98,476   | 146,264  | 141,206  | 161,031 |
| Market Capitalization (IRR trillions)   | 3,946    | 3,847    | 3,847    | 4,213    | 6,124    | 5,924    | 6,830   |

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. The figures for 1397Q2 are based on SCI report and are not comparable with other figures.

\*\* According to OPEC reports from secondary sources

\*\*\* Based on SCI report and incomparable with other figures which are based on CBI reports

\*\*\*\* Since 21/01/1397, the free market USD/IRR exchange rate has been considered based on 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

No new official statistics on national accounts have been released since the publication of the previous Quarterly Report (No. 13). Hence, the same data will not be reassessed here and instead, the outlook of the real sector in 1398 will be discussed.

Most of analyses and studies on the Iranian economy have forecast a severe condition and harsh stagflation in the year 1398. The Islamic Parliament Research Center has projected the economic growth rate to fluctuate between negative 4.5 percent to negative 5.5 percent, varying mainly based on the possible volume of exported oil. Besides, reports of reputable international organizations reveal the expectation of concurrent recession and inflation. The economic growth rate of Iran has been estimated at negative 6.0 percent and negative 3.8 percent, and the inflation rate has been projected at 37.2 percent and 39.2 percent by International Monetary Fund and World Bank, respectively, in 2019 (almost 1398). Likewise, interviews and notes of well-known Iranian economic experts in social media show almost the same prediction.

There are many contributors to this negative prospect for Iran's imminent economic condition, the most imperative of which is oil-related sanctions. Since oil plays a central role in the government's income and gross domestic product of Iran, any restriction on oil exports may adversely overshadow the economy, both directly and indirectly. While this reduction in the government's income will be highly plausible, expenditures are sticky to some degree and cannot fall as well. Therefore, the serious budget deficit is highly probable in this year, which is eventually bound to be compensated by high-powered money that raises liquidity and intensifies inflation.

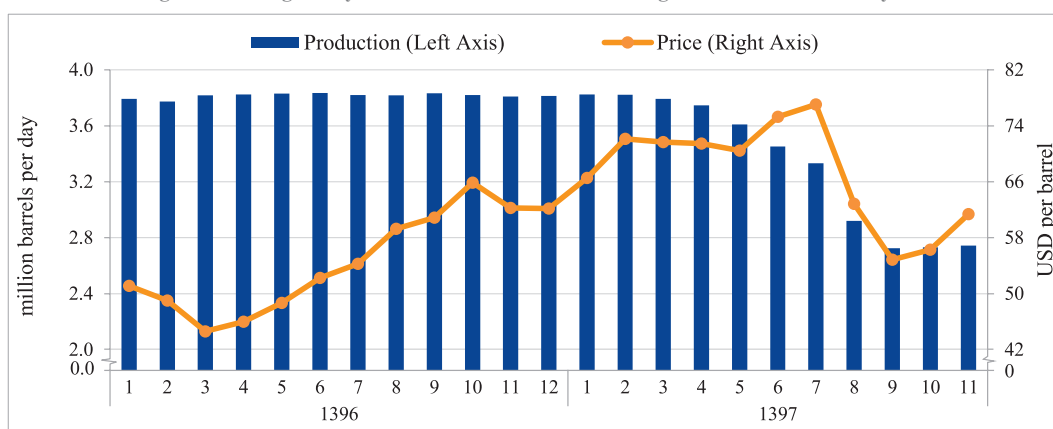
On the other hand, contraction of the gross fixed capital formation in the first half of 1397 (1397H1), which was reported at negative 2.7 percent, indicates that there was no adequate investment,

especially in industries, to lay the basis of economic growth in 1398. Agriculture, also, was considerably damaged in the first month of 1398, because of the heavy rain and flood in many parts of Iran. As a result, at least the first two quarters of this year will face negative growth rates of the agriculture sector. However, services is the only sector to reach most probably its level in the preceding year, albeit with lots of challenges in some subsectors like banking and transportations.

### Oil

The Organization of the Petroleum Exporting Countries, OPEC, has recently reported that Iranian crude oil production had been falling more and more over 1397H2. These statistics are based on secondary sources, as direct ones have refused to release them since October 2018 (almost 07/1397). Iran's average daily crude oil production stood at 2.7 million barrels in 11/1397 (almost the same level as of 09/1397), which shows 30 percent decrease compared to the similar month a year earlier. This downward trend was mainly because of the second phase of US sanctions which overshadowed Iranian oil exports significantly. The waivers that allowed eight countries to import limited amounts of Iranian oil are getting expire in 02/1398. Meanwhile, an Iranian authority in the Oil Ministry declared that those countries are prohibited from buying even a single barrel of Iranian oil, showing their tight fealty to American commands. As a result, production and export of crude oil from Iran would be adversely affected, provided that the president of the US decides not to exempt the eight countries from the sanctions of Iranian oil imports anymore. In 11/1397, the average price of Iranian heavy oil maintained almost at the level in the same month of 1396 and registered USD61.4 per barrel, notwithstanding marked fluctuations in the interval. Figure 1 illustrates the average daily amount of oil production in Iran, as well as its price, in 1396 and 1397.

Figure 1- Average Daily Crude Oil Production and Average Price of Iranian Heavy Oil\*



Source: OPEC Monthly Reports, based on secondary sources

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

The official data on the Iranian oil exports has not been reported since the first quarter of 1397 (1397Q1). Reuters, the international news organization, has estimated that Iran exported

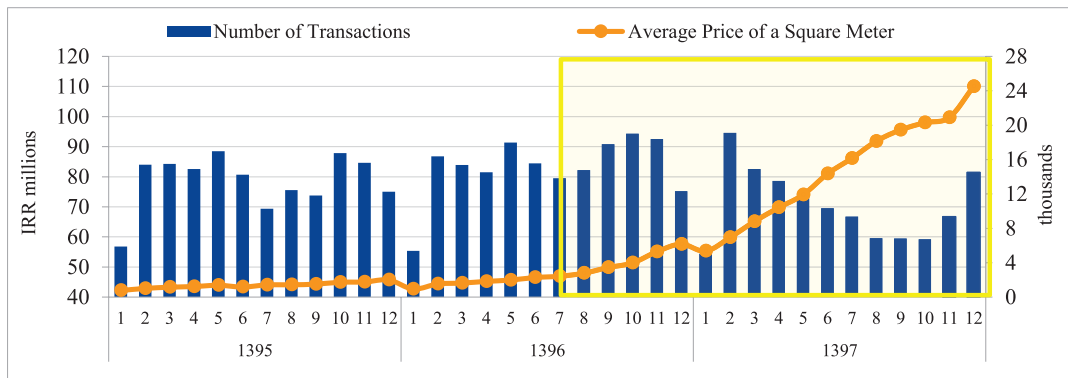
a mere 1.1 million barrels of crude oil in March 2019, while it was around 2.5 million barrels a year earlier.

## Housing

An 88 percent surge in price and a 39 percent plunge in the number of transactions are a brief description of Tehran housing market in 1397Q4. The notable monthly growth rate of residential units' prices, which initiated in the early 1396H2 and has intensified since the beginning of 1397, became gradual in the last quarter of this year and registered a mere 1.7 percent in 11/1397. This rate had averaged 7.5 percent between 02/1397 and 08/1397 and even had touched 9.4 percent in 06/1397. The price level reached IRR99.7 million per square meter in 11/1397, resulting in further reduction

in purchasing power of consumers and hence, lower number of deals. Total number of 6.8 thousand and 9.3 thousand transactions were signed during 10/1397 and 11/1397, respectively, which are much fewer compared to the peak of 19.1 thousand in 02/1397. However, unofficial sources report that housing deals in Tehran in the last month of 1397 bounced back remarkably and 14.5 thousand transactions were recorded in this month, raising the average price of each square meter to IRR110 million. These statistics are demonstrated more precisely in Figure 2.

Figure 2- Average Price of a Square Meter of Residential Units and Number of Monthly Registered Transactions



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

According to the detailed statistics of housing deals in the year 1397, the proportion of residential units aged less than five years has significantly decreased. While this proportion had amounted to 53.8 percent and 48.7 percent in 11/1395 and 11/1396, respectively, it reached 44.3 percent in 11/1397. The noticeable difference of the prices of newly-structured units in comparison to aging ones, as well as high depreciation of units in their first few years, laid the groundwork for lower demand for these units. Besides, in the supply side, a drop in the

construction of housing over the years 1395 and 1396 played a central role in the decline of newly-structured units' deals in 1397. While the number of construction permits issued in Tehran hit a peak of 33.2 thousand in 1390 and averaged 24.5 thousand during the following two years, the corresponding figure was merely 8.6 thousand in 1395 and 10.2 thousand in 1396. In this regard, the latest report shows that in 1397Q1, about 3.0 thousand permits were issued, being estimated to reach around 15 thousand for the whole year.

## Labor Force

According to the report of the Statistical Center of Iran, the unemployment rate and economic participation rate were 11.7 percent and 40.5 percent, respectively, in 1397Q3. While women made up just 32.3 percent of the 3.3 million unemployed, their unemployment rate (18.0 percent) was much more than that of men (10.1 percent). This fact verifies the low amount of women's participation rate in the Iranian economy, although it has been following a gentle upward trend during recent years, reaching from 11.8 percent in 1393Q3 to 16.4 percent in 1397Q3. The corresponding figure for men was also rising over this period, albeit much slightly (from 62.9 percent to 64.4 percent).

More than 4 million people had been added to the active population by 1397Q3 during a four-year period, 70 percent of which entered the labor market and their main destination was services sector. The growth rate of the active population, however, exceeded that of the employed, so that the unemployment rate in almost all of the quarters of these four years was increasing. Table 1 indicates some statistics of the Iranian labor market for both men and women in the fall of 1396 and 1397.

Table 1- Labor Market Indices for the Population Aged 10 and over (percent)

|                            |                   | 1396  |       |       | 1397  |       |       |
|----------------------------|-------------------|-------|-------|-------|-------|-------|-------|
|                            |                   | Total | Men   | Women | Total | Men   | Women |
| Economic Participation     | Rate (percent)    | 39.90 | 64.00 | 15.60 | 40.50 | 64.40 | 16.40 |
|                            | Number (millions) | 26.40 | 21.30 | 5.10  | 27.10 | 21.60 | 5.50  |
| Unemployment               | Rate (percent)    | 11.70 | 10.00 | 19.00 | 11.70 | 10.10 | 18.00 |
|                            | Number (millions) | 31.00 | 21.20 | 9.80  | 31.70 | 21.90 | 9.80  |
| Share of the Underemployed | Rate (percent)    | 11.00 | 12.10 | 5.60  | 11.70 | 12.90 | 6.30  |
|                            | Number (millions) | 2.50  | 2.30  | 0.20  | 2.80  | 2.50  | 0.30  |

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

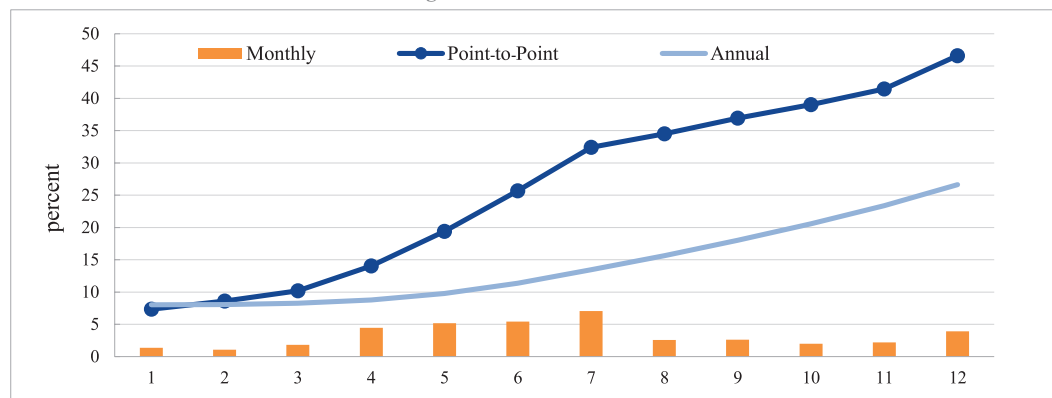
## 2. Prices and Inflation

After the CBI had ceased to publish the statistics of consumer price index (CPI) in 09/1397, the SCI became the only official source of inflation-related data. Although the CBI is at an advantage in calculating the inflation rate, it could have been the lower figures announced by the SCI that convinced the policymaker to stop the CBI from releasing this precious data.

According to the SCI, the CPI (base year: 1395=100) for all Iranian households, including both urban and rural areas, stood at 164.3 in 12/1397, showing 3.9 percent growth from its preceding month and 47.5 percent escalation from the similar month in an earlier year. The latter, in terms of

urban or rural households, was 46.6 percent and 52.7 percent, respectively, both of which are the highest corresponding rates since 1382. The annual CPI inflation rate regained its double-digit figures in 06/1397, followed by a remarkable upward trend and reached 26.8 percent in 12/1397. These continuous rises in the point-to-point CPI inflation rate indicate that the annual rate would be increasing over 1398, even regardless of the considerable inflationary expectations. This rate is projected to become 34.1 percent and 39.2 percent for 2019, by International Monetary Fund and World Bank, respectively. The different types of inflation rates over 1397 are demonstrated in Figure 3.

Figure 3- CPI Inflation Rates



Source: Central Bank of Iran, reports of consumer price index, various issues

The substantial appreciation of the U.S. dollar against Iranian currency over 1397 laid the basis for registering a higher inflation rate for tradable (as opposed to non-tradable) and durable (as opposed to non-durable) goods and services in 12/1397, as had been expected. Among the SCI's 12 major groups in the basket of consumers in this month "tobacco" registered the highest point-to-point inflation rate (125.0 percent), and "appliance" and "food and beverages" ranked next, respectively, with 78.3 percent and 73.2 percent. On the other hand, "education" faced the inflation rate of just 21.1 percent, the lowest amount among these 12 categories. Amongst sub-sectors of "food and beverages", the 115 percent leap in the price level of different kinds of meat was

so perceptible that ordinary people considered it as a so-called inflationary indicator.

It should be noted that the consumer price index of "meat" in urban and rural areas were almost the same and inflated nearly in 12/1397, indicating the tradable nature of this commodity and showing the result of the arbitrage process. Under such circumstances, assigning subsidies to the import of meat from foreign countries is absolutely in question. The majority of these subsidies are bound to benefit the importer and re-exporter of meat and the price level in the market will not change significantly. The real consumer, hence, not only cannot find meat in lower prices but also will suffer from consequences of this exchange rate policy.

### 3. Balance of Payments

At the time of finalizing this report, the latest published data for balance of payments by the CBI pertain to 1397Q1. Those data we analyzed in the previous Report (No. 13) and hence, are not analyzed here.

According to the latest report of the Ministry of Industry, Mine and Trade, the value of goods imported to the country in the first nine months of 1397 amounted to USD32.6 billion which indicates 15.9 percent decline compared to the same period of 1396. Also, goods imports in terms of weight decreased by 13.3 percent in the period under review. The most significant drop of imports in terms of weight and value were related to capital goods and consumption goods, respectively. The value share of imported capital goods, consumption goods, and intermediate goods were 16.9 percent, 16.1 percent, and 67.0 percent, in that order, indicating lower share of consumption goods and higher share of intermediate goods compared to the same period of 1396. While the ratio of value to weight (unit price) for imported capital

goods soared compared to the same period of 1396, it reduced slightly for imported consumption goods and intermediate goods.

On the other hand, the value of exports totaled USD33.4 billion in the first nine months of 1397 which shows 5.4 percent growth. However, the total exports in terms of weight declined by 2.0 percent. The value share of exported capital goods, consumption goods, and intermediate goods amounted to 2.5 percent, 17.8 percent, and 79.7 percent, respectively, indicating a higher share of capital goods and a lower share of intermediate goods compared to the same period of 1396. The export of capital goods in terms of weight and value rose significantly and the ratio of value to weight (unit price) for these goods increased by 88.6 percent in the period under review. Also, export of intermediate goods in terms of value expanded in spite of a reduction in the weight of those items. Table 2 depicts the details of trade in different categories of goods in the first nine months of 1396 and 1397.

Table 2- Details of Trade in Different Categories of Goods in the First Nine Months of 1396 and 1397

|         |                    | First Nine Months of 1396 |                         |                             | First Nine Months of 1397 |                         |                             | Percentage Change |              |
|---------|--------------------|---------------------------|-------------------------|-----------------------------|---------------------------|-------------------------|-----------------------------|-------------------|--------------|
|         |                    | Weight<br>(thousand tons) | Value<br>(USD millions) | Value<br>Share<br>(percent) | Weight<br>(thousand tons) | Value<br>(USD millions) | Value<br>Share<br>(percent) | Weight            | Value        |
| Imports | Capital Goods      | 641.1                     | 6,253.1                 | 16.7                        | 434.7                     | 5,280.4                 | 16.9                        | -32.2             | -15.6        |
|         | Consumption Goods  | 2,645.6                   | 7,322.2                 | 19.6                        | 1,963.5                   | 5,014.9                 | 16.1                        | -25.8             | -31.5        |
|         | Intermediate Goods | 22,157.6                  | 23,838.4                | 63.7                        | 19,612.4                  | 20,938.9                | 67.0                        | -11.5             | -12.2        |
|         | <b>Total</b>       | <b>25,444.3</b>           | <b>37,413.7</b>         | <b>100.0</b>                | <b>22,010.6</b>           | <b>31,234.2</b>         | <b>100.0</b>                | <b>-13.5</b>      | <b>-16.5</b> |
| Exports | Capital Goods      | 61.4                      | 276.6                   | 0.9                         | 98.3                      | 835.1                   | 2.5                         | 60.1              | 201.9        |
|         | Consumption Goods  | 4,427.0                   | 5,674.0                 | 18.0                        | 5,038.3                   | 5,926.6                 | 17.8                        | 13.8              | 4.5          |
|         | Intermediate Goods | 84,228.9                  | 25,605.0                | 81.1                        | 81,801.0                  | 26,588.4                | 79.7                        | -2.9              | 3.8          |
|         | <b>Total</b>       | <b>88,717.3</b>           | <b>31,555.6</b>         | <b>100.0</b>                | <b>86,937.6</b>           | <b>33,350.1</b>         | <b>100.0</b>                | <b>-2.0</b>       | <b>5.7</b>   |

Source: The Ministry of Industry, Mine and Trade; preliminary report of the first nine months of 1397 performance

Based on the latest report of the Islamic Republic of Iran Customs Administration at the time of finalizing this report, imports registered 28.9 million tons, valued at USD38.5 billion and exports reached 105.9 million tons, valued at USD40.1 billion, in the first 11 months of 1397. Imports declined by 17.4 percent and 21.5 percent in terms of weight and value, compared to the same period of 1396, respectively. Meanwhile, exports reduced by 6.4 percent and 0.7 percent in terms of weight and value, in that order. Therefore, USD8.6 billion non-oil trade balance deficit in the first 11 months of 1396 gave place to USD1.6 billion surplus in the same period of 1397.

According to the aforementioned report, the exports of petrochemicals reached 32.2 million tons, valued at USD13.2 billion, showing 12.3 percent and 14.1 percent growth in terms of weight and value, respectively, compared to the first 11 months of 1396. However, the exports of natural gas condensates registered 7.5 million tons, valued at USD3.9 billion, which indicates 51.9 percent and 37.5 percent drop in weight and value, in that order. In the period under review, the main exported items in terms of value were natural gas condensates valued at USD3.9 billion, liquefied natural gas at USD1.9 billion, liquefied propane at USD1.6 billion, light crude oil except gasoline at USD1.3 billion, and methanol at USD1.2 billion. Similar to the first 11 months of 1396, China was the biggest importer of Iranian goods in the first 11 months of 1397, valued at USD8.4 billion. Also, imports of Iraq from Iran rose significantly by 42.0 percent in the

period under review and so, Iraq ousted United Arab Emirates (UAE) from the second place among the biggest importers of Iranian goods by imports valued at USD8.2 billion. Additionally, the UAE, Afghanistan, and Turkey imported USD5.5 billion, USD2.7 billion, and USD2.1 billion from Iran, respectively, to secure next places in the ranking of the largest importers of Iranian goods in the first 11 months of 1397.

On the other hand, cattle feed corn valued at USD1.9 billion, rice at USD1.3 billion, auto parts at USD1.3 billion, soybean at USD1.1 billion, and charcoal electrodes at USD548 million were the main imported items, in that order. China with exports valued at USD9.4 billion, which constituted 24.4 percent of total Iran's imports, was the biggest exporter to the country in the first 11 months of 1397. While imports from China declined by 21.0 percent in terms of value, the value share of these imported items rose slightly. Furthermore, while the value of imports from the UAE reduced by 34.8 percent to reach USD5.9 billion, this country stood in the second place of the largest exporters to Iran with the value share of 15.4 percent. Also, the value of imports from Turkey fell by 23.0 percent and this country ranked third with the value share of 5.9 percent. Meanwhile, India which stood at the fourth place, exported USD2.2 billion to Iran, indicating 9.1 percent growth compared to same period of 1396. Finally, exports of Germany to Iran declined by 19.5 percent to reach USD2.1 billion, denoting it as the fifth main exporter to the country.



## 4. Foreign Exchange Market

The Iranian Rial (IRR) experienced a mild depreciation against other foreign currencies in winter 1397. The free market USD/IRR exchange rate, which had recorded 189,000 at the beginning of fall 1397, descended 99,700 at the end of that season, but reversed course and started to rise slightly in winter. The USD/IRR exchange rate surged at the beginning

of fall 1397 but eventually declined by 10.5 percent on average in 1397Q4 compared to 1397Q3. However, it has grown by 160.8 percent compared to 1396Q4. Figure 4 depicts the daily USD/IRR exchange rates during 1397 in both official and free markets.

Figure 4- Daily USD/IRR Exchange Rates in the Free Market and the Official Market in 1397



Source: Central Bank of Iran and Financial Informing Network

The policy of allocating foreign currencies at decreed rates for imports of essential goods not only did not affect the market price of those goods, but also led to their shortage in the market during 1397. Despite this fact, the government kept on implementing that policy in the remainder of 1397 and even proposed it in the Budget Bill of 1398.

According to Deputy of Internal Trade Development of the Ministry of Industry, Mine and Trade, in the first nine months of 1397, USD11.1 billion at official rate were allocated for imports of essential goods, 4.7 percent up from USD10.6 billion imports of essential goods in the same period of the preceding year. Some of these commodities are included in calculation of CPI, some others in PPI and some in both. Essential goods in CPI, which are eligible for imports at official foreign exchange rates, account for 10.33 percent of the CPI basket of goods based on the Islamic Parliament Research Center report. The price index of these goods has grown 42.0 percent during the first nine months of 1397. The CPI has increased 38.9 percent in the same period. Thus, the decreed exchange rates have not led to stabilize the price of essential goods. The price index of goods imported at other exchange rates has risen almost 73 percent, which is above that of the imported essential goods. However, the gap between these two growth rates is expected to decrease during the time. Moreover, this foreign exchange policy will exacerbate the government budget deficit and, by expanding the monetary base, will lead to a further increase in the general price level. Also, in PPI, price index of the commodities imported at the official rate increased by 32.1 percent during the first nine

months of 1397.

In addition to official foreign exchange rates for importing essential goods, "NIMA" system has provided foreign currencies for importing other goods, although there have been some problems with this process. According to the CBI, EUR11.5 billion were traded in NIMA during 1397 - EUR3.5 billion was provided by the CBI and almost EUR8 billion (equivalent to USD9.2 billion) by non-oil exporters. Out of EUR8 billion supplied by non-oil exporters, EUR7.4 billion were sold and the rest were in the form of import in exchange for export and assignment of privilege to others. Therefore, considering about USD40 billion of non-oil exports during this year, and after deducting the share of National Iranian Gas Company, only about 35 percent of foreign currencies proceeds from non-oil exports returned to the country.

The CBI issued a circular to encourage exporters to return foreign currency proceeds from exports. In this circular, more returns lead to more sales at free market rates and exporters who do not return their foreign currencies will be brought to judicial authorities. Due to CBI intervention in determining the foreign exchange rates in NIMA, there are significant gaps between these rates and the free market rates, and the foreign currencies supplied in NIMA are expected to be exhausted by non-oil exporters. A significant part of the current supply of foreign currencies in this system is made by the CBI and state-owned companies that do not follow profitability motives. A law that seeks to penalize many private exporters will never be enforced or will result in a significant reduction in non-oil exports.

## 5. Monetary and Credit Aggregates

At the time of finalizing this report, the latest published data for monetary aggregates by the CBI pertain to 09/1397. According to this report, monetary base grew by 22.1 percent to reach IRR2,436.0 trillion at the end of 09/1397. The increase of CBI net foreign assets was the main driver of the growth in monetary base in the period under review. This component grew by 24.6 percent with 23.6 percentage points share in the growth of monetary base. CBI net foreign assets measure the difference between CBI foreign assets and CBI foreign debts, which grew by 25.2 percent and 25.9 percent, respectively, in the year ending 09/1397. However, the corresponding numbers for the year ending 09/1396 were 10.4 percent and 22.9 percent, respectively. The main contributors to the increase in CBI foreign assets in the year ending 09/1397 include significant rise in government oil revenues due to expansion of oil exports and relative depreciation of the Iranian rial compared to foreign exchanges in the official market.

Following CBI net foreign assets, CBI claims on banks had the most significant effect on the growth of monetary base in the period under review. This component rose by 32.5 percent with 18.4 percentage points share in the growth of monetary base. The shares of CBI claims on commercial and specialized banks in the total CBI claims on banks have plummeted in recent years, while those of private banks and non-bank credit institutions have soared. For example, the share of CBI claims on commercial banks was about 19.3 percent in 09/1395 and had reached 9.8 percent in 09/1396, before touching 2.4 percent in 09/1397. It is worth mentioning that the reduction in the share of CBI claims on commercial banks is not only due to the increase

in total CBI claims on banks, but also owing to the decline in the aforementioned claims. On the other hand, the share of CBI claims on specialized banks in the three aforementioned months amounted to 55.8 percent, 38.1 percent, and 32.7 percent, respectively. Unlike commercial banks, the downward trend in the share of CBI claims on specialized banks is related to the rise in the total CBI claims on banks. Meanwhile, the share of CBI claims on private banks and non-bank credit institutions showed an upward trend and amounted to 25.0 percent, 52.0 percent, and 65.0 percent in the aforementioned months, respectively. The main causes of this significant rise which led to the growth of overdraft from the CBI include the reduction of quality of these banks' balance sheets due to factors such as deterioration of their assets quality, and the rapid rise of their debts due to high levels of interest rates of deposits in recent years.

In the period under review, the CBI net claims on public sector fell by 52.6 percent with negative share of 7.4 percentage points in the growth of monetary base. In this period, the CBI claims on government increased by 14.3 percent, while deposits of government with the CBI rose by 67.0 percent. Consequently, CBI net claims on government reduced by IRR154.6 trillion. On the other hand, the CBI claims on public corporations and institutions and their deposits with the CBI grew by 7.9 percent and 30.4 percent, respectively. Therefore, the CBI net claims on public corporations and institutions rose by 3.5 percent in the period under review. Finally, net other items increased by 18.8 percent with negative share of 12.5 percentage points in the growth of monetary base. Statistics on monetary base components in different quarters of 1396 and 1397 are presented in Table 3.

Table 3- Monetary Base Components (end of period - IRR trillions)

|                                 | 1396           |                |                |                | 1397           |                |                | 1397Q3 to 1396Q3      |                                     |
|---------------------------------|----------------|----------------|----------------|----------------|----------------|----------------|----------------|-----------------------|-------------------------------------|
|                                 | Q1             | Q2             | Q3             | Q4             | Q1             | Q2             | Q3             | Growth Rate (percent) | Share in Growth (percentage points) |
| <b>Monetary Base</b>            | <b>1,851.9</b> | <b>1,964.9</b> | <b>1,994.5</b> | <b>2,139.8</b> | <b>2,186.6</b> | <b>2,345.1</b> | <b>2,436.0</b> | <b>22.1</b>           | <b>22.1</b>                         |
| CBI Net Foreign Assets          | 1,853.9        | 1,874.4        | 1,913.3        | 2,159.8        | 2,377.0        | 2,364.5        | 2,384.1        | 24.6                  | 23.6                                |
| CBI Net Claims on Public Sector | 282.0          | 292.2          | 279.9          | 55.1           | 82.8           | 82.4           | 132.7          | -52.6                 | -7.4                                |
| CBI Claims on Banks             | 1,013.7        | 1,097.1        | 1,130.7        | 1,320.3        | 1,397.1        | 1,506.5        | 1,497.9        | 32.5                  | 18.4                                |
| Other Items (Net)               | -1,297.7       | -1,298.8       | -1,329.4       | -1,395.4       | -1,670.3       | -1,608.3       | -1,578.7       | 18.8                  | -12.5                               |

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

According to CBI reports, liquidity rose by 22.1 percent in the year ending 09/1397, which is slightly - around 0.1 percentage points - above the corresponding number for the year ending 09/1396. Components of liquidity, i.e. money and quasi-money, grew by 41.0 percent and 19.5 percent, in that order, with the share of 4.9 percentage points and 17.2 percentage points in the growth of liquidity, respectively. Note that expansion of money in the period under review was significantly higher than that in the corresponding period of the last year, mainly due to the growth in money demand because of rising prices in various markets such as housing, forex and gold. Meanwhile, the growth rate of quasi-money in the year ending 09/1396, which was around 23.4 percent, plunged to 19.5 percent in the corresponding period of the succeeding year. As a result, the share of money and quasi-money in liquidity, which were about 12.0 percent and 88.0 percent in 09/1396, respectively, changed to 13.9 percent and 86.1 percent in 09/1397, in that order. Components of money, i.e. notes and coins with the public and sight deposits,

rose by 30.5 percent and 43.7 percent with the share of 6.1 percentage points and 34.9 percentage points in the growth of money, respectively. Therefore, the share of aforementioned components which were about 21.0 percent and 79.9 percent in 09/1396, respectively, changed to 18.6 percent and 81.4 percent in 09/1397, in that order. On the other hand, growth rate of M2 money multiplier which had shown an upward trend in previous years, has slowed down since 1395Q3 and fluctuated between 7.0 and 7.2 afterwards. The aforementioned multiplier reached 7.2 in 09/1397 which was unchanged compared to 09/1396. The relative stability of M2 money multiplier in recent years is mainly due to the reduction of interest rates by the CBI and more strict supervision to ensure that banks comply with the new rates. Also, the gradual change in the share of liquidity components in favor of money facilitated the trend of M2 money multiplier in recent years. Table 4 demonstrates statistics on M2 money multiplier and liquidity components in different quarters of 1396 and 1397.

Table 4- Liquidity Components and M2 Money Multiplier (end of period - IRR trillions)

|                                 | 1396            |                 |                 |                 | 1397            |                 |                 | 1397Q3 to 1396Q3      |                                     |
|---------------------------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------|-----------------------|-------------------------------------|
|                                 | Q1              | Q2              | Q3              | Q4              | Q1              | Q2              | Q3              | Growth Rate (percent) | Share in Growth (percentage points) |
| <b>Liquidity</b>                | <b>13,149.1</b> | <b>13,899.5</b> | <b>14,450.1</b> | <b>15,299.8</b> | <b>15,827.5</b> | <b>16,723.7</b> | <b>17,645.8</b> | <b>22.1</b>           | <b>22.1</b>                         |
| Money                           | 1,647.1         | 1,682.4         | 1,734.4         | 1,946.7         | 2,059.5         | 2,436.7         | 2,446.2         | 41.0                  | 4.9                                 |
| Notes and Coins with the Public | 340.1           | 344.7           | 348.6           | 442.7           | 406.0           | 445.0           | 455.0           | 30.5                  | 0.7                                 |
| Sight Deposits                  | 1,307.0         | 1,337.7         | 1,385.8         | 1,504.0         | 1,653.5         | 1,991.7         | 1,991.2         | 43.7                  | 4.2                                 |
| Quasi-Money                     | 11,502.0        | 12,217.1        | 12,715.7        | 13,353.1        | 13,768.0        | 14,287.0        | 15,199.6        | 19.5                  | 17.2                                |
| M2 Money Multiplier             | 7.1             | 7.1             | 7.2             | 7.2             | 7.2             | 7.1             | 7.2             | 0.0                   | -                                   |

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

The balance of deposits in both IRR and foreign currencies stood at IRR19,482.1 trillion at the end of 09/1397, indicating 31.5 percent rise compared to 09/1396, and 18.3 percent increase from the end of 1396. In 09/1397, the balance of extended facilities amounted to IRR14,155.4 trillion, increasing 27.0 percent from 09/1396 and rising 12.5 percent from the end of 1396. Hence, the ratio of extended facilities to deposits (less required reserves) declined by 2.8 percentage points and 4.5 percentage points compared to 09/1396 and 12/1396, respectively, to reach 80.9 percent in 09/1397.

According to the latest available data, extended facilities by

banking system amounted to IRR5,380.3 trillion in the first 10 months of 1397, indicating 16.4 percent growth compared to the same period of 1396. In the period under review, the share of extended facilities for financing working capital expenditures was about 58.8 percent in total extended facilities which shows 10.0 percent growth compared to the same period of 1396. Extended facilities for financing working capital in the industry sector constituted about 38.4 percent of total extended facilities for this purpose in all sectors. The aforementioned extended facilities made up 78.9 percent of total extended facilities of this sector for all purposes.

## 6. Government Budget and Fiscal Position

### Performance of the First Nine Months of 1397

Tax revenues grew by 24.2 percent in the first quarter of 1397 due to the significant economic growth in 1395 and 1396, while this figure reduced in the next quarters owing to the recession in 1397 and reached 6.0 percent in 1397Q3 – less than annual inflation rate in the same period. Tax revenues during the first nine months of 1397 grew by 12.8 percent and were 28.2 percent below the legislated figure in the Budget Law. Other current revenues decreased by 11.6 percent, only amounted to 42.5 percent of the legislated amount. In contrast to the low realization of current government revenues, current government expenditures during this period grew up by 18.6 percent, equivalent to 87.3 percent of the legislated figure. Thus, the budget deficit in the first nine months of 1397 experienced significant growth of 41.5 percent and was even 74.5 percent higher than the legislated figure in the Budget Law.

The net disposal of non-financial assets in the period under review was 69.2 percent higher than the amount in the same period of the preceding year and 67.1 percent above the legislated figure in the Budget Law. Despite the start of the new round of US sanctions, oil revenues that account for much of the disposal of non-financial assets, rose by 39.8 percent in the first nine months of the year and covered 117.1 percent of the legislated figure in the Budget Law. A part of the increase in oil revenues was due to the depreciation of USD/IRR exchange rate to 42,000 and the other part was corresponding to the increase in oil sales in 1397Q1, before the start of oil sanctions and the rise in world oil prices. Reducing oil revenues to levels below the legislated figure is expected in the whole year due to the sharp decline in Iranian oil sales in 1397Q4. Development expenditures

sharply increased in the first quarter of the year, but decreased afterwards. The acquisition of non-financial assets (development expenditures) grew by only 6.2 percent in the first nine months of 1397, equivalent to 68.5 percent of the legislated figure.

Total government revenues in the period under review rose by 19.4 percent compared to the same period a year earlier and equaled 77.9 percent of the legislated figure in the Budget Law. Total government expenditures in the same period increased by 19.0 percent, covering 87.6 percent of the legislated figure. Accordingly, budget deficit reached IRR451.1 trillion, 17.0 percent up from that in a year earlier and 84.9 percent up from the legislated figure in the Budget Law.

During the first nine months of 1397, the disposal of financial assets rose by 8.7 percent, approximately 37.1 percent above the legislated figure in the Budget Law. The sale of state-owned companies share in the disposal of financial assets has been continually decreasing in recent years and the issuance of government debt securities has been the main contributor to the rise in the disposal of financial assets whose repurchase will impose high burden on the government in coming years. In addition, repayment of National Development Fund (NDF) facilities will also lead to an increase in the acquisition of financial assets in forthcoming years, while there are no certain resources for that in this years. The ratio of public debt to gross domestic product, which has always been low in the Iranian economy and has not been a matter of concern, is rising fast and going to exacerbate Iran's severe economic challenges. During the first nine months of 1397, the acquisition of financial assets – settlement of government's previous debts - reached IRR202.6 trillion and is expected to sharply increase in coming years. Table 5 exhibits the government fiscal performance in 1397.

Table 5- Government Fiscal Performance in 1397 (IRR trillions - percent)

|  | Q1            |               | Q2           |                | Q3           |              | First Nine Months |             | Performance of the First Seven Months of 1397 Compared to the Legislated Figures |
|--|---------------|---------------|--------------|----------------|--------------|--------------|-------------------|-------------|--|
|  | Amount        | Growth        | Amount       | Growth         | Amount       | Growth       | Amount            | Growth      |  |
| <b>Revenues</b>                        | <b>590.6</b>  | <b>38.6</b>   | <b>676.1</b> | <b>14.5</b>    | <b>639.4</b> | <b>10.4</b>  | <b>1,906.1</b>    | <b>19.4</b> | <b>77.9</b>  |
| Tax Revenues                           | 225.9         | 24.2          | 277.5        | 11.3           | 267.8        | 6.0          | 771.2             | 12.8        | 71.8   |
| Other Current Revenues                 | 38.3          | -29.8         | 92.9         | 13.2           | 106.9        | -19.5        | 238.1             | -11.6       | 42.5   |
| Oil Revenues                           | 326.0         | 72.6          | 304.6        | 18.2           | 263.6        | 36.6         | 894.2             | 39.8        | 117.1  |
| Other Disposal of Non-Financial Assets | 0.4           | -50.5         | 1.1          | -21.0          | 1.1          | 45.5         | 2.6               | -12.6       | 5.2  |
| <b>Expenditures</b>                    | <b>880.7</b>  | <b>46.6</b>   | <b>758.3</b> | <b>27.0</b>    | <b>718.2</b> | <b>-8.3</b>  | <b>2,357.2</b>    | <b>19.0</b> | <b>87.6</b>  |
| Current Expenditures                   | 588.1         | 7.2           | 721.8        | 37.2           | 629.9        | 12.4         | 1,939.8           | 18.6        | 87.3   |
| Development Expenditures               | 226.7         | 2,649.2       | 39.7         | -43.2          | 54.6         | -75.6        | 321.0             | 6.2         | 68.5   |
| <b>Budget Balance</b>                  | <b>-290.1</b> | <b>66.0</b>   | <b>-82.2</b> | <b>1,183.4</b> | <b>-78.8</b> | <b>-61.4</b> | <b>-451.1</b>     | <b>17.0</b> | <b>184.9</b>   |
| Operating Balance                      | -389.8        | 9.4           | -339.0       | 73.3           | -298.0       | 71.3         | -1,026.9          | 41.5        | 174.5  |
| Net Disposal of Non-Financial Assets   | 99.7          | -45.0         | 256.8        | 35.8           | 219.2        | -            | 575.8             | 69.2        | 167.1  |
| <b>Disposal of Financial Assets</b>    | <b>290.1</b>  | <b>57.3</b>   | <b>129.2</b> | <b>87.5</b>    | <b>234.4</b> | <b>-32.7</b> | <b>653.7</b>      | <b>8.7</b>  | <b>137.1</b>   |
| <b>Acquisition of Financial Assets</b> | <b>0.0</b>    | <b>-100.0</b> | <b>47.0</b>  | <b>-24.7</b>   | <b>155.6</b> | <b>8.1</b>   | <b>202.6</b>      | <b>-6.2</b> | <b>87.0</b>  |

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

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

In the subgroup of tax revenues, “tax on legal entities” and “tax on goods and services” accounted for the highest share in “direct tax” and “indirect tax” categories. Tax on legal entities rose by only 1.7 percent in the first nine months of the year, translating to deep depression in economic firms, given the high inflation rate. Thus, despite 17.8 percent increase in income tax and 35.0 percent increase in wealth tax revenues, total direct tax revenues

recorded growth rate of 9.0 percent. In contrast, revenues from indirect taxes rose by 16.5 percent. The 17.6 percent increase in value added tax revenues during this period due to the high inflation rate has been one of the major contributors to the significant growth of indirect tax revenues. Table 6 shows the components of government tax revenues in the first nine months of 1396 and 1397.

Table 6- Components of Tax Revenues (IRR trillions - percent)

|                       | First Nine Months of 1396 |              |             | First Nine Months of 1397 |              |             |
|-----------------------|---------------------------|--------------|-------------|---------------------------|--------------|-------------|
|                       | Amount                    | Share        | Growth      | Amount                    | Share        | Growth      |
| <b>Tax Revenues</b>   | <b>683.8</b>              | <b>100.0</b> | <b>4.4</b>  | <b>771.2</b>              | <b>100.0</b> | <b>12.8</b> |
| <b>Direct</b>         | <b>336.3</b>              | <b>49.2</b>  | <b>-3.4</b> | <b>366.5</b>              | <b>47.5</b>  | <b>9.0</b>  |
| Legal Entities        | 205.4                     | 30.0         | -7.6        | 208.9                     | 27.1         | 1.7         |
| On Income             | 111.4                     | 16.3         | 4.3         | 131.2                     | 17.0         | 17.8        |
| On Wealth             | 19.5                      | 2.9          | 3.4         | 26.4                      | 3.4          | 35.0        |
| <b>Indirect</b>       | <b>347.5</b>              | <b>50.8</b>  | <b>13.2</b> | <b>404.7</b>              | <b>52.5</b>  | <b>16.5</b> |
| On Imports            | 87.2                      | 12.7         | 15.5        | 99.4                      | 12.9         | 14.1        |
| On Goods and Services | 260.3                     | 38.1         | 12.5        | 305.3                     | 39.6         | 17.3        |
| On Value Added        | 163.0                     | 23.8         | 12.2        | 191.8                     | 24.9         | 17.6        |

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

## The Budget Law of 1398

The Budget Bill of 1398 had two ceiling: If the realization of oil revenues exceeds the first ceiling, government expenditures will increase to the second ceiling. However, even the realization of oil revenues of the first ceiling is infeasible due to oil sanctions and the budget deficit is likely to intensify. The parliament removed the second ceiling and increased the first one. Beyond the estimated oil revenues of IRR1,425.4 trillion in the Budget Law, the parliament also gave the government a permission to settle its debts by selling crude oil to its creditors up to IRR400 trillion. The oil price in this process will be based on the price of Iran Energy Exchange or the regional price of oil. In other words, the government disposes of oil to his creditors, because it is unable to sell it. This is not the only settlement of the government’s debts from the unrealizable government revenues in the 1398 Budget

Law. For example, the disposal of development plans for the settlement of government’s debt to Social Security Organization and some pension funds was added to 1398 Budget Bill by the parliament, while the government could not sell any development plans in preceding years.

In the 1398 Budget Bill, the government set the NDF’s share in the oil revenues 20 percent, which was 14 percentage points lower than the legal mandate of the Sixth Development Plan. The parliament maintained the same share in the Budget Law, but set this 14 percentage point as a government debt to the NDF. The parliament has allowed foreign exchange facilities to be provided from the sources of the NDF with state guarantees, up to EUR2,375 billion. The repayment of these facilities is set to be considered in 1399-1404 Budget Laws, while the repayment of previous facilities that should have been included in the

1398 Budget Law, is not included and has been postponed to subsequent years. It is possible that the government's debts to NDF turns into doubtful debts in the same mechanism.

The requirement for state-owned companies to submit financial reports for parliamentary scrutiny is among considerable points added to the Budget Law. The arrangements for changing the financial relationship between the government and the main subsidiaries of the Ministry of Oil has been considered in this Budget Law. At present, a fix share of 14.5 percent of oil and gas revenues is attributed to National Iranian Oil Company and National Iranian Gas Company, respectively. So, investment of these companies is pinned to oil and gas prices or exports. Changing the financial relationship between the government and these companies helps to overcome this problem.

The government is obliged by the 1398 Budget Law to allocate USD14 billion of foreign exchange earnings from its oil exports at official exchange rates for import, purchase and distribution of essential goods, or allocate the earnings from the differential

between official rates and NIMA rates to maintain Iranians living standards or support the production of basic goods. Obviously, the second way is preferred, although the elimination of NIMA rates and referring to free market rates is the first-best.

The parliament also changed the 1398 Budget Bill in relation to uses of Targeted Subsidies Plan. Cash subsidies of households have reduced by IRR14 trillion, meaning more households will be excluded from cash subsidies and instead, the absolute poverty reduction budget has risen from IRR70 trillion to IRR84 trillion.

The marriage facilities for each of the couples in the Budget Bill of 1398 were considered IRR150 million, which raised by the parliament to IRR300 million. The banking system is also required to provide the information about taxpayer's bank accounts and transactions to Iranian National Tax Administration upon its request. Apart from banking secrecy, this decision may lead to unsustainable banking resources and even more demand for banknotes that means less demand for bank deposits. Table 7 exhibits an overview of 1398 Budget Law.

Table 7- Overview of 1398 Budget Law (IRR trillions - percent)

|  | Sources         |  |   | Uses                                  |  |   |
|--|-----------------|--|---|---------------------------------------|--|---|
|  | 1398 Budget Law | Growth Rate Compared to 1398 Budget Bill | Growth Rate Compared to 1397 Budget Law | 1398 Budget Law                       | Growth Rate Compared to 1398 Budget Bill | Growth Rate Compared to 1397 Budget Law |
| Revenues                                 | 2,390           | 14.5                                     | 10.9                                    | Expenditures                          | 3,524                                    | 9.9                                     |
| Disposal of Non-Financial Assets         | 1,585           | 7.1                                      | 47.4                                    | Acquisition of Non-Financial Assets   | 669                                      | 7.8                                     |
| Disposal of Financial Assets             | 511             | 0.1                                      | -19.0                                   | Acquisition of Financial Assets       | 293                                      | 17.4                                    |
| <b>Total General Sources</b>             | <b>4,486</b>    | <b>10.0</b>                              | <b>16.2</b>                             | <b>Total General Uses</b>             | <b>4,486</b>                             | <b>10.0</b>                             |
| Dedicated Revenues                       | 714             | 0.7                                      | 25.1                                    | From Dedicated Revenues               | 714                                      | 0.7                                     |
| <b>Government General Budget Sources</b> | <b>5,200</b>    | <b>8.6</b>                               | <b>17.3</b>                             | <b>Government General Budget Uses</b> | <b>5,200</b>                             | <b>8.6</b>                              |
| State-Owned Companies' Sources           | 12,771          | 0.2                                      | 52.2                                    | State-Owned Companies' Uses           | 12,771                                   | 0.2                                     |
| <b>Sources of Budget</b>                 | <b>17,443</b>   | <b>2.4</b>                               | <b>42.7</b>                             | <b>Uses of Budget</b>                 | <b>17,443</b>                            | <b>2.4</b>                              |

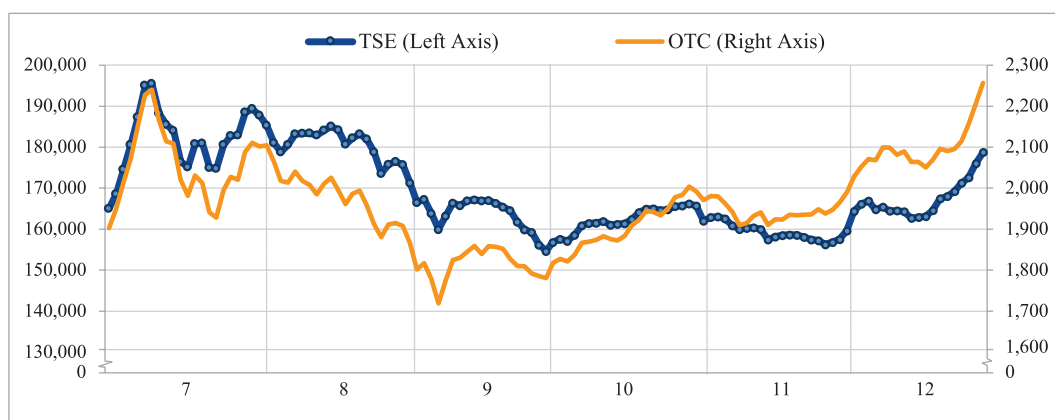
Source: 1398 and 1397 Budget Laws; 1398 Budget Bill

## 7. Capital Market

The overall index of Tehran Stock Exchange (TSE) recorded a surge of 85.3 percent during the year 1397, the highest annual growth rate in recent years. However, this expansion in the equity market was not due to any development in the production or productivity of firms. It was mainly because of the upsurge in USD/IRR exchange rate and hyperinflation. Thus, the assets like U.S. dollar, gold and housing enjoyed from a higher rate of return in this period. The mentioned upward trend in the overall index was neither constant nor continuous over the year. It was owing to a huge escalation in less than two months since

early 05/1397, touching a peak of 195,480 at the beginning of 07/1397. Conversely, a downward erratic movement followed this, dipping to just below 180,000 in the last working day of this year. Meanwhile, Over the Counter (OTC) market faced almost the same pattern, albeit with a significantly higher growth rate since the beginning of 10/1397. The overall index of OTC started the year 1397 at 1,102, hovered wildly around 2,000 during the second half of this year and hit a peak of 2,258 at the end of the year. Figure 5 draws a comparison between the overall indices of TSE and OTC in 1397H2.

Figure 5- TSE and OTC Overall Indices Over 1397H2



Source: Official websites of the TSE (<http://new.tse.ir>) and the OTC (<http://ifb.ir>)

The market capitalization of the TSE and the OTC reached IRR6,830 trillion and IRR2,727 trillion, respectively, at the end of 1397. The total value of transactions in the TSE amounted to almost IRR450 trillion in 1397Q4, 86 percent of which was associated with equity. In the first month of this quarter, the equity of banks and the automobile-related group were the most popular shares. However, the automobile group could not remain in boom and slipped back dramatically in the last week of 10/1397, mostly because of negative prospects of two huge Iranian car manufacturers. Besides, the whole equity market experienced a downward movement in 11/1397, considering lots of crucial

uncertainties in terms of economic and political issues. Fulfilling the legal requirements of the FATE, restrictions of exports in the presence of harsh sanctions, performance and feasibility of the Instrument in Support of Trade Exchanges (INSTEX), and other similar concerns were among the uncertainties. Nonetheless, a rise in oil prices, as well as the world price of some commodities like metals, laid the groundwork for raising the overall index in the last month of the year. Moreover, under the high-inflationary circumstances of 1397, most firms tended to raise their capital by revaluating their assets in the last weeks of this year.

## 8. Other Economic Developments

The INSTEX eventually established in January 2019 by France, Germany, and the United Kingdom to facilitate non-dollar trades with Iran. In the first step, it is supposed to finance Iran's food and drug imports backed by Iranian oil sales. In the next steps, when other countries join this system, hopefully imports of other goods would also be financed. Is it able to provide credits for Iranian oil and trade of other goods without any fear of US sanctions? Given direct US sanctions on Iranian oil trade, it seems that the INSTEX can hardly be successful in attracting traditional Iranian oil buyers. So, Iran should seek active foreign diplomacy and domestic structural reforms to overcome the economic challenges.

Among these reforms is easing of doing business. It is recommended to pay attention to supply-side economy, because of Iran's stagflation. The business environment in Iran is not appropriate and recent government policies have not only failed to improve that, but also in some cases damaged it. According to World Bank's Doing Business 2019 report, Iran ranked 128<sup>th</sup> among 190 countries in the world (falling from 124<sup>th</sup> in previous year's report) and ranked 19<sup>th</sup> in comparison with regional countries considered in Iran's 20-Year Vision Plan (25 countries). Measures such as setting up Trade Unit Window, introducing an online system for social security, value-added tax and corporate income tax payments, and also reducing the bankruptcy period from 4.5 years to 1.5 years, have helped improve Iran's standing in three indicators: "paying taxes", "trading" and "closing a business". However, in other indicators,

including "starting a business", "dealing with licenses", "hiring and firing", "registering property", "getting credit", "protecting investors", and "enforcing contracts", Iran's rating got worse. In starting a business and protecting investors indicators, Iran has ranked 173<sup>rd</sup>.

The Eliminating Obstacles to Competitive Production Law was legislated in 1394, and proper implementation of that could have resulted in significant improvement in Iran's position in Doing Business reports. However, three years have passed from the time of approving this law and it has not been implemented correctly yet. For example, aimed at help to resolve the credit crunch of banks and reduce the banking system risks, the law requires banks to dispose of at least 33 percent of their excess assets and subsidiaries with a share of over 50 percent per year to be completed within three years. Banks are also required to give up their equities in non-bank companies. As reported by Islamic Parliament Research Center, the estimated banks' excess immovable properties were IRR258 trillion. According to banks' self-declaration, their asset disposal in 1395 and 1396 was IRR112 trillion, which was 43 percent of total. The equities of non-bank companies held by banks in 1395 were estimated at IRR305 trillion, and their disposal in 1395 and 1396 was about IRR97 trillion, equivalent to 32 percent of the total amount. The law's mandate about raising capital of state-owned banks by increasing the price of water and energy carriers, reducing government expenditures, or disposing of development plans have not yet been implemented.



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