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# Recent Economic Developments in Iran

## A Quarterly Report

بانک خاورمیانه
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**Recent Economic Developments in Iran, A Quarterly Report**

**No. 15, July 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 1398" indicates the percentage change in oil revenues between the first quarter of 1397 and the first quarter of 1398.

**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 1398 that started on March 21, 2019, and ends on March 20, 2020. The First quarter of 1398 (referred to as 1398Q1), Spring of 1398, roughly corresponds to the Second quarter of 2019 in the Gregorian Calendar (2019Q2).

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

**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**

**1398Q1** = 03/21/2019 – 06/21/2019, roughly **2019Q2**

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

## Iran’s Economy at a Glance

| | 1396 | 1397Q1 | 1397Q2 | 1397Q3 | 1397Q4 | 1397 | 1398Q1 |
|---|---|---|---|---|---|---|---|
| **Labor Force Participation & Unemployment Rates (percent)** | | | | | | | |
| Participation (10 Years and Over) | 40.3 | 41.1 | 40.9 | 40.5 | 39.5 | 40.5 | - |
| Unemployment (10 Years and Over) | 12.1 | 12.1 | 12.2 | 11.7 | 12.1 | 12.0 | - |
| Unemployment (Youth Aged 15-24) | 28.4 | 28.3 | 27.2 | 27.0 | 28.1 | 27.7 | - |
| **Real Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)** | | | | | | | |
| Gross Domestic Product (GDP) | 3.9 | 1.6 | -1.0 | -11.4 | -8.4 | -4.9 | - |
| Manufacturing and Mining | 2.0 | 0.5 | -2.7 | -21.1 | -15.0 | -9.6 | - |
| Agriculture | 1.0 | -0.4 | -3.4 | -1.8 | 1.4 | -1.5 | - |
| Services | 6.8 | 2.8 | 1.3 | -1.8 | -2.1 | 0.0 | - |
| Non-Oil GDP | 4.6 | 1.8 | -1.5 | -5.4 | -4.1 | -2.4 | - |
| *Gross Fixed Capital Formation (at market prices)* | 3.4 | 0.3 | -5.6 | -6.3 | -10.7 | -5.6 | - |
| **Oil (daily average - thousand barrels)** | | | | | | | |
| Production* | 3,815 | 3,813 | 3,603 | 2,993 | 2,725 | 3,283 | - |
| Export | 2,324 | 2,390 | - | - | - | - | - |
| **Point-to-Point Inflation Rates (percent)** | | | | | | | |
| Growth Rate of Consumer Price Index (1395=100) | 9.6 | 10.5 | 24.5 | 35.0** | 43.1** | 26.8** | 51.1** |
| Growth Rate of Producer Price Index (1395=100) | 10.0 | 14.6 | 35.4 | 58.7 | 66.3** | - | - |
| **Balance of Payments (USD millions)** | | | | | | | |
| Oil Exports | 65,818 | 20,980 | - | - | - | - | - |
| Non-Oil Exports | 32,324 | 8,356 | - | - | - | - | - |
| Import of Goods | 75,546 | 16,353 | - | - | - | - | - |
| Goods Account (Net) | 22,596 | 12,983 | - | - | - | - | - |
| Non-Oil Goods Account (Net) | -40,458 | -7,330 | - | - | - | - | - |
| Current Account | 15,816 | 11,061 | - | - | - | - | - |
| Capital Account | -19,321 | -5,263 | - | - | - | - | - |
| Change in Foreign Reserves | -8,140 | 3,933 | - | - | - | - | - |
| **Foreign Exchange Rates (USD/IRR daily average)** | | | | | | | |
| In Free Market*** | 40,552 | 60,365 | 103,434 | 132,748 | 118,786 | 106,229 | 136,762 |
| Official Rate | 34,276 | 41,392 | 42,646 | 42,000 | 42,000 | 42,056 | 42,000 |
| **Monetary and Credit Aggregates (end of period - IRR trillions)** | | | | | | | |
| Monetary Base (M0) | 2,139.8 | 2,186.6 | 2,365.5 | 2,436.0 | - | - | - |
| Central Bank Claims on Banks | 1,320.3 | 1,397.1 | 1,506.5 | 1,497.9 | - | - | - |
| Central Bank Claims on Public Sector (Net) | 55.1 | 82.8 | 82.4 | 132.7 | - | - | - |
| Liquidity (M2) | 15,299.8 | 15,827.5 | 16,723.7 | 17,645.8 | - | - | - |
| Money (M1) | 1,946.7 | 2,059.5 | 2,436.7 | 2,446.2 | - | - | - |
| Sight Deposits | 1,504.0 | 1,635.5 | 1,991.7 | 1,991.2 | - | - | - |
| Non-Sight Deposits (Quasi-Money) | 13,353.1 | 13,768.0 | 14,287.0 | 15,199.6 | - | - | - |
| **Government Budget and Fiscal Position (IRR trillions)** | | | | | | | |
| Total Revenues | 2,598.5 | 590.6 | 676.1 | 639.4 | - | - | - |
| Tax Revenues | 1,158.4 | 225.9 | 277.5 | 267.8 | - | - | - |
| Oil Revenues | 919.2 | 326.0 | 304.6 | 263.6 | - | - | - |
| Other Revenues | 520.9 | 38.7 | 94.0 | 108.0 | - | - | - |
| Total Expenditures**** | 2,868.6 | 880.7 | 758.3 | 718.2 | - | - | - |
| Current Expenditures | 2,429.4 | 588.1 | 721.8 | 629.9 | - | - | - |
| Development Expenditures | 439.2 | 226.7 | 39.7 | 54.6 | - | - | - |
| Budget Balance | -270.1 | -290.1 | -82.2 | -78.8 | - | - | - |
| **Tehran Stock Exchange (end of period)** | | | | | | | |
| Overall Index (TEDPIX) | 96,290 | 108,873 | 160,538 | 156,083 | 178,659 | 178,659 | 234,879 |
| Financial Index | 119,176 | 120,837 | 165,359 | 172,718 | 205,266 | 205,266 | 295,179 |
| Industrial Index | 86,082 | 98,476 | 146,264 | 141,206 | 161,031 | 161,031 | 209,497 |
| Market Capitalization (IRR trillions) | 3,847 | 4,213 | 6,124 | 5,924 | 6,830 | 6,830 | 8,933 |

Source: Central Bank of the Islamic Republic of Iran (CBI) and Statistical Centre of Iran (SCI), various reports
* According to OPEC reports from secondary sources
** Based on SCI report and incomparable with other figures which are based on CBI reports. For producer price index inflation rate, the SCI considers 1390 as the base year.
*** Since 21/01/1397, the free market USD/IRR exchange rate has been reported based on Tehran’s unofficial 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

The Iranian economy underwent harsh condition in 1397. After simultaneously experiencing inflation and recession over 1391 and 1392, a more severe stagflation took place in less than five years. The majority of internal and external challenges in this year were attributed to the supply side of the economy. The US unilateral withdrawal from Iran Nuclear Deal (JCPOA) was the chief external shock, distrupting the export and production of oil seriously and weakening the economy both directly and indirectly. Not only did international constraints weaken the oil industry, but also they restricted many aspects of non-oil sectors including banking system and foreign investment.

These negative exogenous factors, however, were only one part of obstacles and the role of internal economic structure and incorrect policies in forming this problematic economic situation was by no means negligible. Unpleasant business environment, for example, is one of the most chronic issues of the economy, casting a big shadow on private sector economic activities. Government intervention in pricing, unstable rules and legislations, as well as other uncertainties make an undesirable environment for investors, through which speculation would be more attractive than production. The government, on the other hand, spent considerably on hidden subsidies (especially on fuel and foreign exchanges) instead of investment, which adversely affected productivity in the supply side. In addition, some particular policies in 1397, such as assigning under-valued dollar for importing some commodities and prohibiting export for some others, played a central role in the fall of production.

According to the preliminary estimates of the Statistical Center of Iran (SCI), the economic growth rate in 1397 dropped to negative 4.9 percent and non-oil growth rate amounted to negative 2.4 percent. During this year, the total value added of economic activities recorded IRR24,294 trillion, out of which 17.6 percent pertained to the extraction of oil and natural gas. This sector, which is one of the subsectors of manufacturing in SCI reports, contracted by 13.1 percent, mostly because of the significant decline of oil production in the second half of 1397 (1397H2). Value added of "Other mines", likewise, experienced almost the same contraction (13.9 percent) and that of "construction", also, fell by 5.6 percent. The 4.5 percent decline in the value added of agriculture sector was another infrequent case that the economy underwent in this year. "Services" was the only sector whose growth rate was not negative. Table 1 presents the growth rates of different sectors of the Iranian economy.

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

| | 1396 | 1397 | | | | |
|---|---|---|---|---|---|---|
| | Year | Q1 | Q2 | Q3 | Q4 | Year |
| **Industry** | **2.0** | **0.5** | **-2.7** | **-21.1** | **-15.0** | **-9.6** |
| Manufacturing | 3.6 | -1.1 | -3.0 | -8.9 | -12.2 | -6.5 |
| Mining | 1.6 | 1.0 | 0.8 | -31.7 | -23.8 | -13.1 |
| Extraction of Oil and Natural Gas | 1.5 | 1.0 | 0.6 | -33.5 | -25.2 | -13.9 |
| Other Mines | 2.8 | 2.5 | 3.3 | -1.3 | -1.3 | 0.8 |
| Water, Gas, and Electricity Supply | 0.2 | 1.9 | -11.4 | -13.5 | 0.5 | -5.6 |
| Construction | 3.2 | -1.0 | -8.0 | -3.4 | -4.7 | -4.5 |
| **Agriculture** | **1.0** | **-0.4** | **-3.4** | **-1.8** | **1.4** | **-1.5** |
| **Services** | **6.8** | **2.8** | **1.3** | **-1.8** | **-2.1** | **0.0** |
| **Non-Oil Gross Domestic Product** | **4.6** | **1.8** | **-1.5** | **-5.4** | **-4.1** | **-2.4** |
| **Gross Domestic Product (at market prices)** | **3.9** | **1.6** | **-1.0** | **-11.4** | **-8.4** | **-4.9** |

Source: Statistical Center of Iran, Report of National Accounts

On the demand side, constant fall in private consumption and the continuation of decrease in gross fixed capital formation at constant prices were the two most important matters in the Iranian economy. In 1397, private consumption totaled IRR10,156 trillion (41.8 percent of the whole GDP), falling by 2.2 percent at constant prices. The gross fixed capital formation in this year dropped to about 70 percent of its value in 1390 (at constant prices), which was much worse in machinery (as opposed to construction). The 16 percent and 38 percent drops in exports and imports, respectively, resulted in a 4.1 percent fall of the net exports. Public consumption was the only group that registered a positive growth rate (4.9 percent) in this year. The growth rates of gross domestic expenditure and its components are demonstrated in Table 2.

Table 2- Growth Rates of GDP’s Components on the Expenditures Side at Constant 1390 Prices (percent)

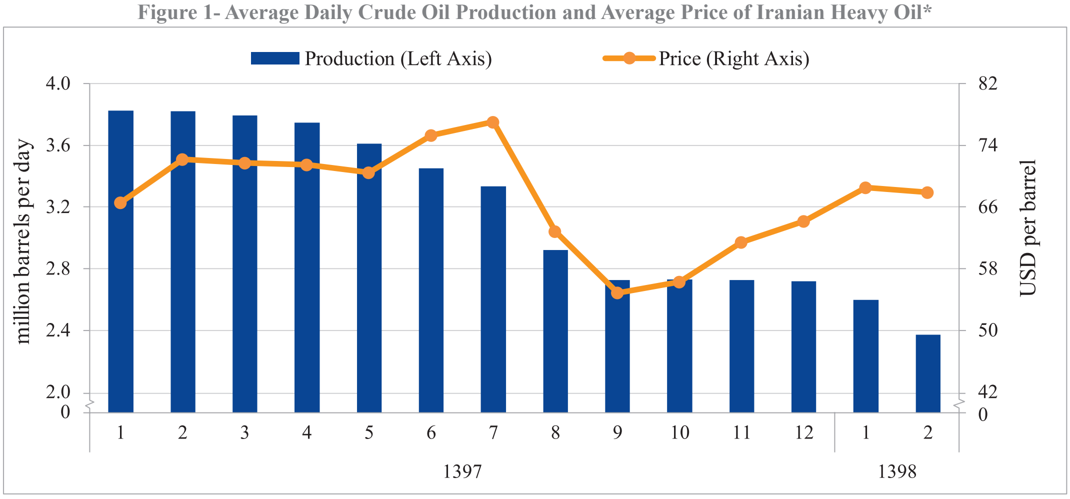
| | 1396 | 1397 | | | | |
|---|---|---|---|---|---|---|
| | Year | Q1 | Q2 | Q3 | Q4 | Year |
| **Private Consumption** | **7.2** | **4.1** | **-0.7** | **-6.5** | **-5.3** | **-2.2** |
| **Public Consumption** | **7.5** | **4.6** | **4.6** | **4.6** | **4.6** | **4.6** |
| **Gross Fixed Capital Formation** | **3.4** | **0.3** | **-5.6** | **-6.3** | **-10.7** | **-5.6** |
| Machinery | 3.6 | 1.6 | -2.7 | -8.9 | -17.3 | -6.9 |
| Construction | 3.2 | -1.1 | -8.0 | -3.3 | -4.7 | -4.5 |
| **Net Exports of Goods and Services** | **-8.0** | **8.9** | **7.7** | **-23.0** | **-12.8** | **-4.1** |
| Exports | -3.0 | 7.9 | -0.7 | -30.2 | -30.4 | -13.5 |
| Imports | 13.4 | 5.2 | -31.7 | -46.2 | -70.4 | -38.3 |
| **Gross Domestic Product (at market prices)** | **3.9** | **1.6** | **-1.0** | **-11.4** | **-8.4** | **-4.9** |

Source: Statistical Center of Iran, Report of National Accounts

## Oil

According to the most recent OPEC report which cites secondary sources, Iran’s average daily crude oil production stood at approximately 2.4 million barrels in May 2019 (almost 02/1398), roughly equal to the volume of exports in the year before. This downward trend in production was mainly due to the second phase of US sanctions implementation and the expiration of waivers, distrupting Iranian oil exports significantly. The average price of Iranian heavy oil, which commenced an upward trend in 09/1397, registered USD67.9 per barrel in 02/1398, a bit less than its level in the previous month. However, during periods of heavy sanctions, keeping some noticeable discounts in place is a strategy for Iran to retain some of its buyers. Besides, the more intensive sanctions the US imposes, the more transaction costs Iran would shoulder in order to remain in the market. Figure 1 illustrates the average daily amount of oil production in Iran, as well as its price irrespective of any discount.

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

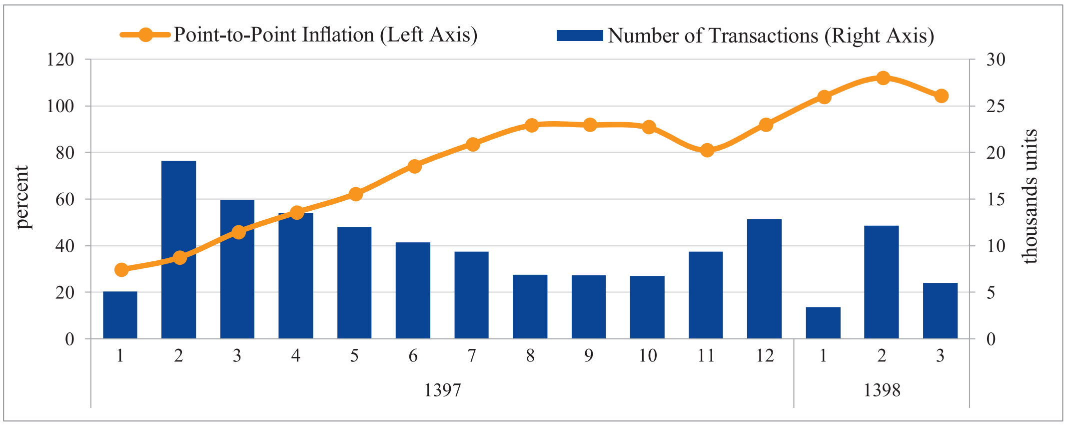



Source: OPEC Monthly Reports, based on secondary sources
* OPEC statistics are based on Gregorian calendar years and their conversion into Persian calendar years are only approximate.

## Housing

Tehran housing market recorded 21.5 thousand transactions with the average price of IRR124.1 million for each square meter in the first quarter of 1398 (1398Q1), registering a 44.8 percent decline in the number of deals and 106.7 percent escalation in the price. The climbing trend of residential units’ prices that had started at the beginning of 1397, intensified in 1398Q1 and touched the unexampled point-to-point growth rate of 112 percent. The number of transactions, meanwhile, experienced a different trend and went into a deep recession, mainly due to the worsening of consumers’ purchasing power in this market. Less than 6 thousand deals wear officially registered in the third month of this quarter, the lowest amount since the beginning of the 1390s. Figure 2 demonstrates the point-to-point inflation rate in average housing prices and the number of transactions recorded in each month.

**Figure 2- The Growth Rate of Average Housing Prices and the Number of Registered Transactions in Each Month**




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

One of the inevitable consequences of such deterioration in the purchasing power of housing consumers is their tendency to buy lower quality residential units that suffer from higher age, smaller build-up area, and being located in inferior regions. Study of the pattern of home deals in terms of age reveals that in 03/1398, only 39.7 percent of transactions belonged to homes aged less than five years, while this figure was 46.8 percent in 03/1396. Beside the demand-related explanation, the fall in the real value of private sector investment in the housing market and therefore, the decrease in the number of newly-constructed buildings are other drivers of restricting the supply of low-aged units. Considering the size, 51.1 percent of sold units measured between 40 and 80 square meters, implying that homebuyers were forced to buy smaller units. Moreover, an enlarging portion of demanders could not afford even lower quality units and entered the rental market, which affected the rent prices. In 03/1398, according to the Central Bank of Iran (CBI) report, the rent price index rose by 23.0 percent in comparison with the same month in the previous year. It is a fact that in the housing market, housing price indices fluctuate more wildly and increase more considerably than the rent prices. The gap between the average growth rates of these two indices in recent months, however, has remarkably widened and it is highly likely to contract henceforward.

## Labor Force

Iran's unemployment rate, the proportion of the jobless population among those above 10 years, stood at 12 percent in 1397, indicating a 0.1 percent rise compared with the year before. Considering genders, there has always been a significant gap between the unemployment rate of men and women in Iran. While 10.4 percent of men were considered unemployed, women's joblessness hovered around 18.9 percent in 1397. The economic participation rate is another index that represents the undermined position of women in the Iranian job market. About 64.8 percent of men were considered active in 1397, while, this figure for women was merely 16.1 percent; as was almost the case in previous years. Some cultural issues may deter female population from engaging in some activities. Nevertheless, the role of weak infrastructure in both educational and professional systems is by no means negligible in this context. In other words, being disappointed by similar experiences, many women even refused to look for a job.

Meanwhile, unemployment in Iran is especially high among young and highly-educated individuals. According to official figures, the rate of youth (aged 15-29) unemployment is more than twice as large as the general unemployment rate, registering 25.1 percent. This rate reached 38.6 percent for women. The other group whose unemployment rate is considerable is highly-educated individuals, 18.1 percent of which failed to find a job position although they wanted and were able to do so. The greater unemployment rate among people who are highly-educated compared to the average rate shows that going to university was not a facilitator of entering the labor market. To put it more simply, the education system does not properly match the requirements of the domestic labor market so that the more time one spends on education, the more challenges he/she would face to find a suitable career. Moreover, many of those who are considered employed in Iran are actually underemployed. A total of 2.6 million people, 10.8 percent of the employed population, had been working less than 44 working hours per week in spite of their ability and willingness to work more. Table 3 indicates the main indicators of the Iranian labor market in 1397.

Table 3 – Labor Market Indicators in 1397

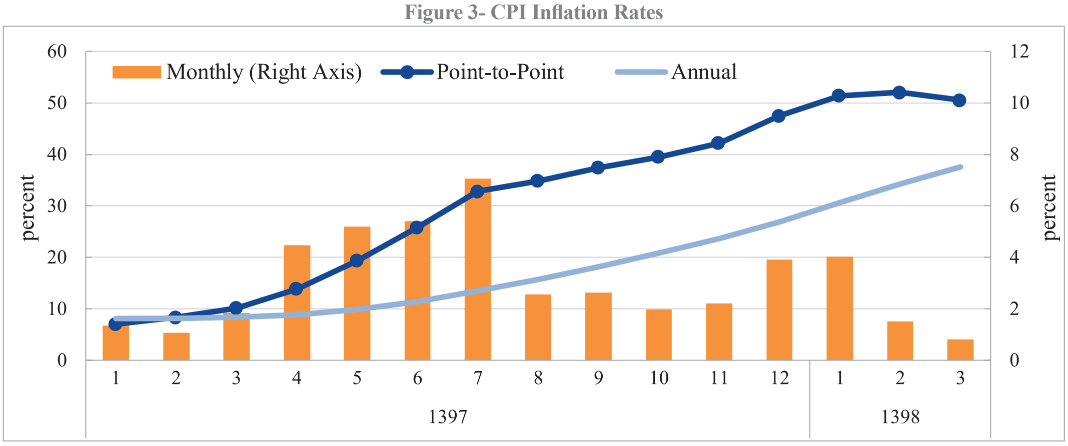
| | | Q4 | Year | | |
|---|---|---|---|---|---|
| | | Total | Total | Men | Women |
| Economic Participation Rate, Population Aged 10 and Over | Rate (percent) | 39.5 | 40.5 | 64.8 | 16.1 |
| | Number (million) | 26.5 | 27.1 | 21.7 | 5.4 |
| Employment Ratio, Population Aged 10 and Over | Rate (percent) | 34.7 | 35.6 | 58.1 | 13.0 |
| | Number (million) | 23.3 | 23.8 | 19.5 | 4.3 |
| Unemployment Rate, Population Aged 10 and Over | Rate (percent) | 12.1 | 12.0 | 10.4 | 18.9 |
| | Number (million) | 3.2 | 3.3 | 2.3 | 1.0 |
| Unemployment Rate, Population Aged 15-29 | Rate (percent) | 25.5 | 25.1 | 21.2 | 38.6 |
| | Number (million) | 1.7 | 1.7 | 1.1 | 0.6 |
| Unemployment Rate, Highly-Educated Population | Rate (percent) | 17.4 | 18.1 | 12.9 | 28.1 |
| | Number (million) | 1.2 | 1.3 | 0.6 | 0.7 |
| Share of the Underemployed | (percent) | 11.5 | 10.8 | 12.0 | 5.8 |

Source: Statistical Center of Iran, Summary Results of the Labor Force Survey, 1397

## 2. Prices and Inflation

As the SCI reported, the average goods and services consumer price index (CPI) with the base year of 1395 stood at 174.9 in 03/1398, registering 0.8 percent growth from its preceding month and 50.4 percent climb from the similar month in an earlier year. Since the beginning of 1397, the former has been the lowest monthly inflation rate and the latter has been the only point-to-point rate that has not exceeded its value in a month earlier. The annual CPI inflation rate at the end of this month, however, maintained its increasing path and reached 37.6 percent, 3.4 percentage points higher than that in a preceding month. Considering regions, rural areas witnessed a higher point-to-point inflation rate than urban areas in 03/1398, registering 56.5 percent and 49.3 percent, respectively. Figure 3 represents different types of CPI inflation rates for all Iranian households.

Figure 3- CPI Inflation Rates




Source: Statistical Center of Iran, Reports of consumer price index, various issues

One of the most perceptible points in recent statistics of inflation belongs to the negative monthly inflation rate of "foods and beverages" in 03/1398. The price index of this category recorded 0.2 percent lower than that in 02/1398, albeit 74.1 percent greater than the figure in 03/1397. It should be noted that the price index of meat dropped by 0.6 percent in this period, in spite of the elimination of foreign exchange currencies with official rate that had been set for its imports. It vividly shows the deficiency and inefficacy of assigning the foreign exchange currencies with official rate to particular commodities in order to control their prices, through which a huge amount of economic rent was distributed in the past.

Table 4 illustrates another classification of CPI inflation rate for goods and services. As shown, about 51 percent of expenditures in the basket of a typical Iranian consumer are attributed to goods that can be divided in three discrete groups in terms of durability. In 03/1398, durable goods (like automobile) saw a 0.2 percent decline in their price index compared to a month earlier. Meanwhile, the monthly inflation rate for semi-durable goods, neither perishable nor lasting such as clothing or furniture, was 3.0 percent and for non-durable goods averaged a mere 0.3 percent.

Table 4- CPI Inflation Rates for Particular Groups in 03/1398 (percent)

| | Importance Coefficient | Monthly | Point-to-Point | Annual |
|---|---|---|---|---|
| **Overall Index** | **100.0** | **0.8** | **50.4** | **37.6** |
| **Foods and Beverage, and Tobacco** | **27.2** | **-0.2** | **75.0** | **56.4** |
| **Services and Other Goods** | **72.8** | **1.3** | **40.4** | **30.1** |
| **Services** | **49.1** | **1.2** | **27.1** | **22.2** |
| **Goods** | **50.9** | **0.5** | **72.0** | **52.1** |
| Durable | 5.5 | -0.2 | 1.2 | 83.8 |
| Semi-durable | 5.1 | 3.0 | 73.0 | 51.6 |
| Non-durable | 40.3 | 0.3 | 66.5 | 48.0 |

Source: Statistical Center of Iran, Report of consumer price index, 03/1398

## 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 were analyzed in Report No. 13 and, hence, will not be examined here.

According to the latest report of the Ministry of Industry, Mine, and Trade, the value of goods imported to the country in 1397 amounted to USD42.6 billion which indicates 21.8 percent decline compared to 1396. Also, goods imports in terms of weight decreased by 17.5 percent in the period under review. The most significant drop of imports in terms of weight and value were associated with capital goods and consumption goods, respectively. The value share of imported capital goods, consumption goods, and intermediate goods were 16.9 percent, 16.3 percent, and 66.8 percent, in that order, indicating lower share of consumption and capital goods and higher share of intermediate goods compared to 1396.

On the other hand, the value of exports totaled USD44.3 billion in 1397 which shows negative 5.7 percent growth. However, the total exports in terms of weight declined by 11.8 percent. The value share of exported capital goods, consumption goods, and intermediate goods amounted to 2.5 percent, 17.9 percent, and 79.5 percent, respectively, indicating a higher share of capital and consumption goods and a lower share of intermediate goods compared to 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 58.5 percent in the period under review. Table 5 depicts the details of trade in different categories of goods in 1396 and 1397.

Table 5- Details of Trade in Different Categories of Goods in 1396 and 1397*

| | | 1396 | | | 1397 | | | Percentage Change | |
|---|---|---|---|---|---|---|---|---|---|
| | | Weight (thousand tons) | Value (USD millions) | Value Share (percent) | Weight (thousand tons) | Value (USD millions) | Value Share (percent) | Weight | Value |
| Imports | Capital Goods | 914.2 | 8,900.4 | 17.2 | 546.4 | 6,963.4 | 16.9 | -40.2 | -21.8 |
| | Consumption Goods | 3,374.8 | 9,744.0 | 18.8 | 2,831.4 | 6,708.6 | 16.3 | -16.1 | -31.2 |
| | Intermediate Goods | 30,241.7 | 33,131.2 | 64.0 | 26,802.9 | 27,564.1 | 66.8 | -11.4 | -16.8 |
| | **Total** | **34,530.7** | **51,775.6** | **100.0** | **30,180.7** | **41,236.1** | **100.0** | **-12.6** | **-20.4** |
| Exports | Capital Goods | 87.2 | 449.1 | 1.0 | 136.8 | 1,116.7 | 2.5 | 56.9 | 148.7 |
| | Consumption Goods | 6,307.5 | 8,033.1 | 17.2 | 7,034.5 | 7,948.0 | 17.9 | 11.5 | -1.1 |
| | Intermediate Goods | 126,485.3 | 38,344.4 | 81.9 | 110,054.9 | 35,235.9 | 79.5 | -13.0 | -8.1 |
| | **Total** | **132,880.0** | **46,826.6** | **100.0** | **117,226.2** | **44,300.6** | **100.0** | **-11.8** | **-5.4** |

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

* The total imports reported by the Ministry of Industry, Mine, and Trade are higher than the sum of consumption goods, capital goods and intermediate goods imports, and the Ministry's report does not provide any explanation for this discrepancy.

Based on the latest report of the Islamic Republic of Iran Customs Administration at the time of finalizing this Report, imports in the first month of 1398 registered 2.1 million tons, valued at USD2.3 billion and exports reached 8.5 million tons, valued at USD2.5 billion in this month. Imports rose by 7.8 percent and declined by 7.7 percent in terms of weight and value, compared to the same period of 1397, respectively. Meanwhile, exports rose by 7.7 percent and declined by 18.3 percent in terms of weight and value, in that order. Therefore, USD587 million non-oil trade balance surplus in the first month of 1397 gave place to USD213 million surplus in the same period of 1398.

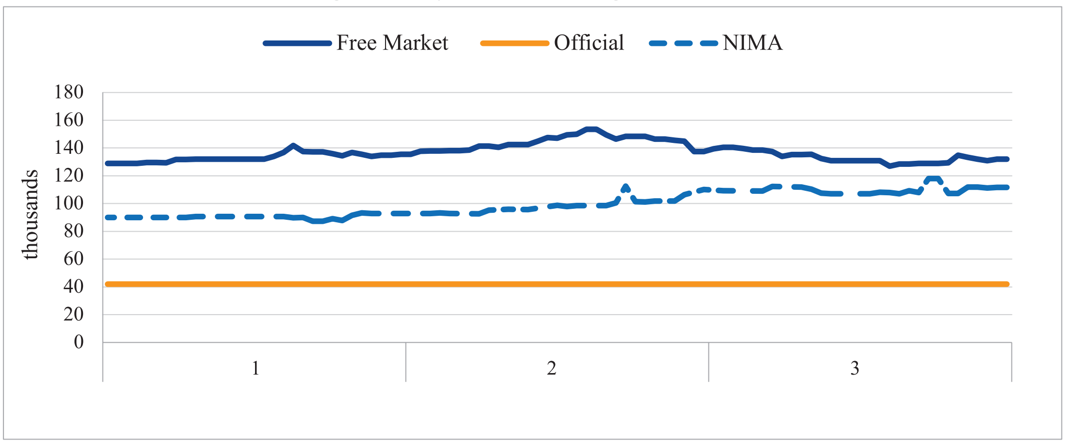
According to the aforementioned report, the exports of petrochemicals in the first month of 1398 reached 2.3 million tons, valued at USD881 million, showing positive 18.4 percent and negative 15.2 percent growth in terms of weight and value, respectively, compared to the first month of 1397. The exports of natural gas condensates registered 674 thousand tons, valued at USD348 million, which indicates 21.7 percent and 22.2 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 USD348 million, light crude oil except gasoline at USD147 million, liquefied propane at USD144 million, and methanol at USD100 million. Similar to the first month of 1397, China was the biggest importer of Iranian goods in the first month of 1398, valued at USD711 million. However, due to a significant drop in Iran's exports to the UAE in the first month of 1398, Iraq by imports valued at USD389 million and South Korea by imports valued at USD250 million from Iran took the second place of the UAE by imports valued at USD231 million and stood at the second and third places of the largest importers from Iran, respectively.

On the other hand, rice valued at USD196 million, cattle feed corn valued at USD123 million, soybean meal at USD98 million, packaged butter at USD91 million, and soybean at USD75 million were the main imported items to Iran, in that order. China with exports valued at USD434 million to Iran, which constituted 18.6 percent of total Iran's imports (6.1 percentage points less than that in the first month of 1397), was the biggest exporter to the country in the first month of 1398. Turkey's exports to Iran rose by 159.8 percent and reached USD346 million to become the second-largest exporter to Iran. Furthermore, while the value of Iran exports to the UAE reduced, Iran imports from this country rose by 7.4 percent and the UAE stood in the third place of the largest exporters to Iran. The share of the UAE in total Iran imports was 14.5 percent in the first month of 1398, 2.1 percentage points more than that in the first month of 1397. India and the Netherlands stood in fourth and fifth places of the largest exporters to Iran, by 212.7 percent and 217.9 percent growth rates in value of exports to Iran, respectively

# 4. Foreign Exchange Market

The Iranian Rial (IRR) demonstrated approximately a stable trend against other foreign currencies in 1398Q1. The free market USD/IRR exchange rate, which had recorded 128,900 at the beginning of this quarter, ascended to 132,000 at the end. Along with the relative stability of the USD/IRR exchange rate in the free market and the absolute stability of the USD/IRR official exchange rate, the rate in the second market (NIMA) gradually increased and reached 111,800 from 90,100 during the quarter. It seems that the CBI plans to gradually converge the foreign exchange rates in the second market and the free market. The lowest gap of USD/IRR exchange rate in the free market and the second market in this period was 9.3 percent, while it was 58.0 percent at the beginning of spring. The USD/IRR free market exchange rate grew by 15.1 percent on average in 1398Q1 compared to 1397Q4 and by 125.9 percent compared to 1397Q1. Figure 4 depicts the daily USD/IRR exchange rates during 1398Q1 in official, second and free markets.

Figure 4- Daily USD/IRR Exchange Rates in 1398




Source: Central Bank of Iran, Financial Informing Network and https://sanarate.ir

One of the most important foreign exchange rate related policies of the CBI was announced to be the establishment of a organized forex market in 1398. The details of this market have not been published at the time of publication of this Report. However, the banks and legal currency exchanges are supposed to play the role of the market broker. The purpose of launching this market is unclear. Since this market does not significantly affect the supply and demand of foreign currencies, it cannot alter foreign exchange rates. Currently, the CBI intervention in the foreign exchange market is carried out through an over the counter (OTC) market, and the discovered rates are roughly unique. Therefore, transparency in the price discovery cannot be considered as a favorable aspect of the new market. The only positive consequence of this market may be to exclude economic rents from the allocation of foreign currencies - from the CBI resources - through the auction process. In this way, the foreign currencies that the CBI wants to inject into the market can be allocated to all agents and brokers, instead of a specific state-owned currency exchange that is responsible for distributing the CBI's foreign reserves. In this situation, the organized forex market can also provide market participants and research institutions with valuable information on the supply and demand volume of the CBI in the foreign exchange market.

The CBI has issued a new circular about returning foreign currency proceeds from non-oil exports to the country in 1398. Accordingly, the petrochemical companies are obliged to supply at least 60 percent and other exporters at least 50 percent of their foreign currency proceeds from exports in

NIMA system. Meanwhile, the US has recently imposed new sanctions against Iran's petrochemical industry. The major part of imports is financed by NIMA system relying on mostly petrochemical exports resources. The CBI's foreign reserves are allocated to imports of some essential goods and pharmaceuticals by official rates. Imports by official foreign exchange rates recorded nearly USD5 billion and those by NIMA foreign exchange rates amounted to more than USD6 billion in 1398Q1.

## 5. Monetary and Credit Aggregates

At the time of finalizing this Report, the latest published data for monetary variables by the CBI pertain to 09/1397, which was elaborated in the preceding issue of this Report (No. 14). Here, the focus is on general aggregates. At the end of 1397Q3, liquidity stood at IRR17,645.8 trillion and monetary base at IRR2,448.3 trillion, accounting for their 22.1 percent and 22.7 percent growth rates, respectively. As a result, about 7.2 units of liquidity were created by each unit of the monetary base.

Balance of "banks and non-bank credit institutions" assets and liabilities grew by 22.6 percent to IRR29,030.6 trillion at the end of 1397Q3, 64.7 percent of which was made up by "non-state banks and non-bank credit institutions". On the assets side, the main contributing factor was attributed to claims on non-public sector, with the share of 41.6 percent. Foreign assets, with the share of 14.4 percent, ranked second, registering the highest growth rate (43.7 percent) among the items in the assets side. Notes and coins, on the other hand, constituted just 0.3 percent of assets and experienced 11.3 percent fall at this time, compared to the end of 09/1396. On the liabilities side, deposits of non-public sector accounted for the highest share (59.2 percent) and grew by 21.9 percent. Meanwhile, "loans and deposits of the public sector" and "capital account" experienced 2.7 percent and 54.6 percent declines in this period, in that order. Table 6 indicates the assets and liabilities of banks and non-bank credit institutions at the end of 1397Q3.

Table 6- Assets and Liabilities of Banks and Non-Bank Credit Institutions at the End of 09/1397 (in IRR trillions)

| Description | Balance at the End of 1397/09 | Share of Banks and Non-Bank Credit Institutions (percent) | | | Percentage Change Compared to | |
|---|---|---|---|---|---|---|
| | | Public Commercial | Public Specialized | Non-Public and Non-Bank | 1396/09 | 1396/12 |
| **Assets (excluding below the line items)** | **29,030.6** | **17.4** | **17.9** | **64.7** | **22.6** | **16.2** |
| Foreign Assets | 4,177.6 | 13.6 | 28.5 | 57.9 | 43.7 | 28.5 |
| Notes and Coins | 99.5 | 37.0 | 10.7 | 52.4 | -11.3 | 8.4 |
| Deposits with the CBI | 1,893.8 | 21.3 | 7.0 | 71.7 | 23.5 | 18.0 |
| Claims on Public Sector | 2,320.2 | 28.0 | 24.6 | 47.4 | 21.0 | 12.7 |
| Claims on Non-Public Sector | 12,081.1 | 16.5 | 21.6 | 61.9 | 18.9 | 10.6 |
| Others | 8,458.4 | 16.5 | 8.0 | 75.4 | 20.2 | 19.9 |
| **Liabilities (excluding below the line items)** | 29,030.6 | 17.4 | 17.9 | 64.7 | 22.6 | 16.2 |
| Deposits of Non-Public Sector | 17,190.8 | 20.1 | 10.4 | 69.5 | 21.9 | 15.7 |
| Claims of the CBI | 1,497.9 | 2.4 | 32.7 | 65.0 | 32.5 | 13.5 |
| Loans and Deposits of Public Sector | 259.7 | 38.4 | 44.1 | 17.4 | -2.7 | -4.6 |
| Capital Account | 353.3 | -5.9 | 66.6 | 39.2 | -54.6 | -34.9 |
| Foreign Exchange Loans and Deposits | 3,438.1 | 12.7 | 28.5 | 58.8 | 51.1 | 34.5 |
| Others | 6,290.8 | 16.6 | 25.3 | 58.1 | 22.9 | 15.8 |

Source: Central Bank of Iran, Selected Economic Indicators

The whole deposits of banks and non-bank credit institutions in both IRR and foreign currencies amounted to IRR20,673.4 trillion at the end of 1397, indicating a 25.6 percent rise compared to the beginning of this year. Around 10.2 percent of these deposits were taken out as legal reserve requirement of the CBI and the banks and non-bank credit institutions were able to make loans and create money on the remainder. At the end of 1397, the balance of extended facilities totaled IRR15,090.2 trillion, increasing 19.9 percent from the beginning of this year. The ratio of extended facilities to deposits (less required reserves), therefore, declined by 4.1 percentage points, compared to the end of 1396, to reach 81.3 percent in 12/1397. This ratio was about 110 percent at the beginning of the 1390s and has been decreasing almost constantly thereafter. The details of this data are available in Table 7.

Table 7- Balance of Banks' and Non-Bank Credit Institutions' Extended Facilities and Deposits in IRR and Foreign Currencies During 1393-1397

| | 1393 | 1394 | 1395 | 1396 | 1397 | |
|---|---|---|---|---|---|---|
| | | | | | Amount | Change (percent) |
| Extended Facilities (EF - in IRR trillion) | 6,739.7 | 7,916.1 | 9,866.6 | 12,587.1 | 15,090.2 | 19.9 |
| Deposits (in IRR trillion) | 8,192.8 | 10,619.0 | 12,728.4 | 16,464.1 | 20,673.4 | 25.6 |
| Deposits Less Required Reserves (DLRR - in IRR trillion) | 7,257.0 | 9,573.9 | 11,374.1 | 14,741.9 | 18,568.3 | 26.0 |
| Legal Reserve Ratio (percent) | 11.4 | 9.8 | 10.6 | 10.5 | 10.2 | - |
| EF to DLRR Ratio (percent) | 92.9 | 82.7 | 86.7 | 85.4 | 81.3 | - |

Source: Central Bank of Iran, Banking Statistics

# 6. Government Budget

At the time of finalizing this Report, the latest official data released on government fiscal performance is for the first nine months of 1397, which was discussed in detail in the previous issue and will not be duplicated here. At the end of 1398Q1, Planning and Budget Organization unveiled a preliminary version of the structural budget reform framework which was based on cutting budget's direct dependence on oil income. This program consists of four main pillars: 1) Budget institutional reinforcement, 2) Efficient spending, 3) Making sources sustainable, and 4) Stabilizing macroeconomy and sustainable development. Complying with the fiscal rule and increasing transparency and responsibility is the basis for the implementation of this program. This is while the issuance of public data on government fiscal performance has ceased for several months.

With the aim of increasing the predictability of budget sources, this program calls for the CBI to commit to open market operation (OMO) and interest rate management. This is in contrast to the independence of the CBI. In other words, the CBI should pursue its target (inflation) independently of the fiscal behavior of the government. Increasing the cost of interest on government debt securities is useful for government debt control, and forcing the CBI to include government debts into its balance sheet can make the monetary policymaker fail to achieve its target of inflation control.

One of the positive aspects of this program is its attempt to increase the budgeting interval. At present, the government budget is set on an annual basis and it is impossible to pursue mid-term government plans and budget adjustments with five-year development plans. Moreover, many government decisions have long-term consequences. The president and his team ought to be responsible for controlling the long-term negative consequences of these decisions, regardless of the remaining period of their responsibility. Long-term budgeting may consider these consequences.

Another positive point of this program is its endeavor to prevent rising uses and overestimating sources in the process of approving the Budget Law in the Parliament. Providing a detailed report of all public sector receipts and payments in line with the actual cost and financial and operational information of government performance in the two previous years will be helpful to achieve this purpose.

The program emphasizes the government's avoidance of price intervention, which is a very productive step. The disposal of government ownership and management in firms related to Edalat (equity) shares is another positive aspect of this program. Moreover, taxation of capital gains by focusing on the housing sector is another positive feature, which not only increases government revenues and reduces the budget deficit, but also controls price volatilities in relevant markets.

The program considers the elimination of cash subsidies to rich households by relying on personal income tax database to provide vulnerable people with a minimum livelihood guarantee. In this process, the government requires households to submit tax returns. The government is authorized to inspect all information received to identify high-income people. Although moving toward personal income tax instead of corporate tax is appropriate, examining the details of all tax returns is a very costly process and also leads to a reduction in social capital by reinforcing the sense of privacy breach. A more rational approach is that vulnerable people voluntarily allow the government to review their income details and receive a cash subsidy upon proof of their need.

The program also proposes that the National Development Fund (NDF), in addition to its developmental role, plays the role of stabilizer for the government budget. Before the establishment of the NDF, Foreign Exchange Reserve Fund correctly played the role of an absorber against the exogenous shocks. After that, the sources of this fund became limited and were allocated by the NDF only for developmental purposes. The program has rightly emphasized that, in addition to the NDF's developmental role, the role of stabilizer is required.

Regarding the reform of subsidies, this program has focused on allocating quotas to Iranian households for the use of energy carriers' subsidies and on their price liberalization simultaneously. This is superior to the current situation, which is both unfair and energy consumption booster. However, this method makes it difficult to gradually reduce energy subsidies in the future. With respect to the subsidies on essential goods, provision of coupons and working capital facilities to consumers and producers is proposed instead of allocating foreign exchanges at preferential rates to importers. Allotment of this subsidy to all final consumers will result in the removal of existing economic rents. However, allocating it to some producers through extending working capital facilities does not eliminate the current economic rents and will only transfer them from the importer to the producer.

One of the most critical elements of this program is its emphasis on double-ceiling budgeting for stabilization. But, in practice, this method leads to budget instability. The macroeconomic implications of different budget ceilings will vary and the fiscal policy in this situation will be ambiguous.

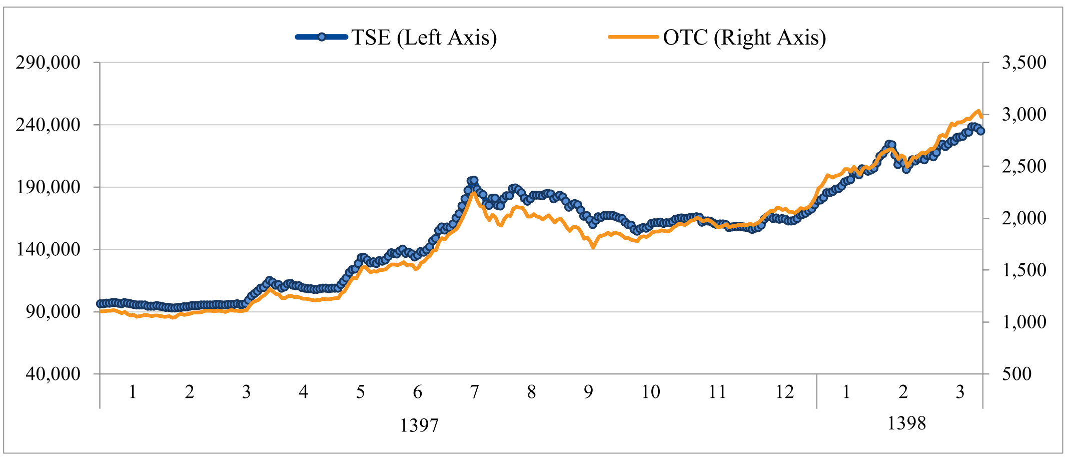
Another main drawback of the program is the use of government debt repayment to banks as an incentive for them to extend facilities to the government's proposed economic sectors. Actually, the government's debt to banks is currently the source of some puzzles in the banking system. Failure to securitize these debts has resulted in overdrafts from the CBI. According to the program, the government's debt to banks is not set to be securitized quickly, and it is even supposed to be a tool to intensify mandatory facilities. The government wants to leverage limited budget sources with the aid of banks and private sector in selected projects. The result of this process will be the inefficient allocation of economy's sources and deteriorating the banking crisis, and ultimately the liquidity crisis and higher inflation.

In general, the program's focus on fiscal rule and controlling the budget deficit should be highlighted, although the mentioned similar current rules in the upstream rules - such as the Sixth Development Plan - have not been so much implemented by the government.

# 7. Capital Market

The overall index of Tehran Stock Exchange (TSE) closed 1398Q1 at 234,879, recording more than 31.5 percent rise over only a quarter. It was the highest return compared to that of foreign exchange, gold, automobile, and housing markets. During this period, the growth rate of the financial index was more than the industrial index, implying that the return of banks' and other financial firms' shares in the TSE exceeded that of corporations' and manufacturing plants' shares. Evaluating the index of 30 largest companies and the equally-weighted overall index indicates that small and medium-sized enterprises benefited a higher return in comparison with large firms. Over 1398Q1, the transaction value of equity securities totaled IRR675 trillion, accounting for a surprisingly giant 453 percent escalation compared to the same period in the preceding year. Derivative securities and exchange-traded funds, notwithstanding their insignificant shares in this market, registered 2,720 percent and 258 percent soar in transactions value, respectively. On the other hand, the value of transactions for debt securities in the TSE declined by 47 percent and summed around IRR13 trillion. At the end of 03/1398, TSE market capitalization reached IRR8,933 trillion, 22.9 percent of which was constituted by chemical industries and 15.3 percent by basic metals. The same almost held true for the other part of Iranian capital market, OTC, in this quarter and its overall index reached 2,978, showing a 30 percent hike. As well, OTC market capitalization surged by 22.6 percent in the three months under review and amounted to IRR3,345 trillion at the end of 1398Q1. TSE and OTC overall indices are depicted in Figure 5.

Figure 5- TSE and OTC Overall Indices




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

# 8. Other Economic Developments

The economic authorities in Iran have recently discussed the possibility of reviving a rationing scheme or couponing essential goods aimed at providing sustainable livelihood for vulnerable people. In the current situation, this target is pursued in a way by paying subsidies in the form of setting preferential foreign exchange rates for suppliers. The government also intervenes in the pricing of essential goods. These policies are merely the source of economic rent distribution and have not reached their desired goals. As a result, many policymakers consider the strategy of introducing quotas on essential goods with a public or targeted distribution of electronic coupons as a solution. Although this plan may be slightly preferable to the current situation, its disadvantages are so considerable that it may not even justify the spending required to provide its infrastructure.

Rationing will be subject to economic rents and corruption, as the current state. In rationing, suppliers seek to satisfy government – in order for their products to be eligible for a coupon - instead of gaining consumer satisfaction. The black market will be the inevitable result of the coupon system, like the current condition. Even the allocation of subsidized prices or coupons to low-quality goods does not lead to the more receipt of subsidies by vulnerable people. Allocating subsidies to tradeable goods - if be more than the cost of smuggling or exporting – will result in arbitrage and finally, the law of one price will hold. In this case, subsidies will be transferred to exporters, smugglers, and people from neighboring countries. The creation of a secondary market for coupons, even though it reduces the cost of liquidating coupons, will cost the vulnerable people more than a cash subsidy.

It seems that allocation of cash subsidies to vulnerable people is simpler and more efficient. Even if the government cannot identify the people in question, the allocation of a universal cash subsidy - in other words, increasing the current cash subsidies - can make the government closer to its goal. Obviously, the plan should not lead to an exacerbation of the budget deficit and an increase in inflation. In this way, the amount of the cash subsidy should be commensurate with the removal of current subsidy policies. The removal of hidden subsidies will provide significant sources for the government and, at the same time, it will prevent a serious imbalance in the market of goods and services subject to hidden subsidies. At present, due to the low price of electricity - in some cases even free electricity - allocated to some centers and sectors of the economy, significant investment has been made to mine cryptocurrencies at these centers. In this way, excessive power consumption is increasing. This process is the same as the one that has intensified consumption and smuggling of gasoline. Eliminating these subsidies, in addition to optimizing consumption in these markets, will provide significant sources for the government to support vulnerable people. Obviously, the implementation of such a plan requires significant social capital which is achievable through increasing transparency. However, the government has been moving away from transparency on the pretext of being exposed to “current difficult situation”.

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