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Recent Economic Developments in Iran

A Quarterly Report

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Notes

Note 1: In this Report the growth rate of a variable means the percentage change of that variable during the period under review, or at the point under discussion, 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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Iran's Economy at a Glance

	1397Q1	1397Q2	1397Q3	1397Q4	1397	1398Q1	1398Q2
Labor Force Participation & Unemployment Rates (percent)							
Participation (10 Years and Over)	41.1	40.9	40.5	39.5	40.5	40.6	-
Unemployment (10 Years and Over)	12.1	12.2	11.7	12.1	12.0	10.8	-
Unemployment (Youth Aged 15-24)	28.3	27.2	27.0	28.1	27.7	26.5	-
Real Growth Rates of GDP and Its Subsectors at Constant 1390 Prices (percent)							
Gross Domestic Product (GDP)	1.6	-1.0	-11.4	-8.4	-4.9	-	-
Manufacturing and Mining	0.5	-2.7	-21.1	-15.0	-9.6	-	-
Agriculture	-0.4	-3.4	-1.8	1.4	-1.5	-	-
Services	2.8	1.3	-1.8	-2.1	0.0	-	-
Non-Oil GDP	1.8	-1.5	-5.4	-4.1	-2.4	-	-
Gross Fixed Capital Formation (at market prices)	0.3	-5.6	-6.3	-10.7	-5.6	-	-
Oil (daily average - thousand barrels)							
Production*	3,813	3,603	2,993	2,725	3,283	2,409	-
Export	2,390	-	-	-	-	-	-
Point-to-Point Inflation Rates (percent)							
Growth Rate of Consumer Price Index (1395=100)	8.5	19.7	35.0	43.1	26.8	51.3	41.3
Growth Rate of Producer Price Index (1395=100)	25.0	39.7	56.1	66.3	47.5	69.5	-
Balance of Payments (USD millions)							
Oil Exports	20,980	-	-	-	-	-	-
Non-Oil Exports	8,356	-	-	-	-	-	-
Import of Goods	16,353	-	-	-	-	-	-
Goods Account (Net)	12,983	-	-	-	-	-	-
Non-Oil Goods Account (Net)	-7,330	-	-	-	-	-	-
Current Account	11,061	-	-	-	-	-	-
Capital Account	-5,263	-	-	-	-	-	-
Change in Foreign Reserves	3,933	-	-	-	-	-	-
Foreign Exchange Rates (USD/IRR daily average)							
In Free Market**	60,365	103,434	132,748	118,786	106,229	136,762	119,395
Official Rate	41,392	42,646	42,000	42,000	42,056	42,000	42,000
Monetary and Credit Aggregates (end of period - IRR trillions)							
Monetary Base (M0)	2,186.6	2,365.5	2,436.0	2,656.9	2,656.9	2,744.3	-
Central Bank Claims on Banks	1,397.1	1,506.5	1,497.9	1,381.7	1,381.7	1,345.5	-
Central Bank Claims on Public Sector (Net)	82.8	82.4	132.7	292.0	292.0	414.8	-
Liquidity (M2)	15,827.5	16,723.7	17,645.8	18,828.9	18,828.9	19,799.1	-
Money (M1)	2,059.5	2,436.7	2,446.2	2,852.3	2,852.3	3,108.7	-
Sight Deposits	1,635.5	1,991.7	1,991.2	2,304.8	2,304.8	2,606.5	-
Non-Sight Deposits (Quasi-Money)	13,768.0	14,287.0	15,199.6	15,976.6	15,976.6	16,690.4	-
Government Budget and Fiscal Position (IRR trillions)							
Total Revenues	590.6	676.1	639.4	-	-	-	-
Tax Revenues	225.9	277.5	267.8	-	-	-	-
Oil Revenues	326.0	304.6	263.6	-	-	-	-
Other Revenues	38.7	94.0	108.0	-	-	-	-
Total Expenditures***	880.7	758.3	718.2	-	-	-	-
Current Expenditures	588.1	721.8	629.9	-	-	-	-
Development Expenditures	226.7	39.7	54.6	-	-	-	-
Budget Balance	-290.1	-82.2	-78.8	-	-	-	-
Tehran Stock Exchange (end of period)							
Overall Index (TEDPIX)	108,873	160,538	156,083	178,659	178,659	234,879	302,104
Financial Index	120,837	165,359	172,718	205,266	205,266	295,179	364,579
Industrial Index	98,476	146,264	141,206	161,031	161,031	209,497	270,769
Market Capitalization (IRR trillions)	4,213	6,124	5,924	6,830	6,830	8,933	11,045

Source: Various reports of Central Bank of the Islamic Republic of Iran (CBI), Statistical Centre of Iran (SCI), and Tehran stock exchange (TSE)

* According to OPEC reports from secondary sources

** Since 21/01/1397, the free market USD/IRR exchange rate has been reported 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

The Iran's non-oil economic growth rate was 0.4 percent in 1398Q1. Value added of agriculture sector rose by 6.5 percent at constant prices and that of manufacturing and mining sector remained unchanged compared to 1397Q1. These data have been quoted from CBI governor and government spokesperson and were the only available information of economic growth for the first quarter of 1398 at the time of finalizing this report. The Iran's GDP growth rate in 2019 is forecasted to be negative 8.7 percent by the Word Bank and negative 6.0 percent by the International Monetary Fund, although the role of oil sector in these high negative rates is by no means negligible.

According to the latest report of the Statistical Center of Iran, the Iran's economy underwent a harsh condition in 1397, facing serious stagflation. During the year, the value added of economic activities totaled IRR24,294 trillion, which shows 4.9 percent contraction in constant prices compared to 1396. About 17.6 percent of the GDP pertained to the extraction of oil and natural gas whose growth rate in constant prices amounted to negative 13.9 percent, indicating much more severe decline in activities compared to non-oil sector.. Oil sector as well as non-oil sector have been hindered by reintroduction of US sanctions in 2018. As a result of severe sanctions, Iran's banking system has been heavily constrained and foreign investment shrank vastly. Also, internal challenges put more pressure on the supply side of the economy. Factors like government intervention in pricing, chronic unpleasant business environment, unstable rules and legislations, as well as other uncertainties has hurt the investors seriously , making speculation more attractive than production. Moreover, hidden subsidies granted by the government and lack of public investment in infrastructures adversely affected productivity in the supply side. In addition, some particular policies in 1397, such as assigning under-valued foreign currencies for importing predetermined commodities and prohibiting export for some others, played a central role in the fall of production.

Due to significant restrictions and delays that recently appeared on releasing economic data, the exact estimation of the real sector performance in 1398 is impossible. However, the intensity of uncertainty in this year has subsided moderately and the condition of the supply side is not as worse as the preceding year. Thanks to the recent stability of the exchange market, the other markets are experiencing pretty stable condition too, causing slight economic improvements compared to 1397. However, it seems that some problems are surfacing on the demand side of the economy, causing a decline in aggregate demand and leading to unused capacities. The reduction in aggregate demand is attributable to some factors. First of all, sanctions have seriously limited the export of oil and even non-oil products. Moreover, the high inflationary expectation in the previous year convinced people to purchase durable and non-durable commodities even more than their immediate requirements, due to which a portion of their demand has already been fulfilled. The recession in the housing market and consequently the possible fall in private housing investment is another fact that through different channels reduces the demand for a wide range of goods and services. In addition, the government as a significant part of the economy has lost the considerable portion of its oil revenue and thereby would be forced to reduce its demand.

Investment is an indispensable part of economic growth in the long run. However, the ratio of investment on GDP in Iran has been declining during the last two decades, reaching merely 14 percent in 1397. The other crucial factor in economic growth is the productivity. Productivity is the degree of efficiency of firms, organizations, industries, and the economy as a whole in converting inputs (labor, capital, and raw materials) into output (products). It depends chiefly on the level of technology, legal and institutional infrastructure such as transparency and predictability of policies, relevant laws such as labor and business law, resource allocation mechanisms, and also various types of governmental support. Importing technology in the form of capital and intermediary goods as well as enhancing the ability of businesses through learning from external partners, particularly in large industries such as oil and gas, can lay the foundation for increasing the productivity. Nevertheless, Iran's economy has not been successful in improving its productivity level by these means. In conclusion, neither current low level of investment nor meager level of productivity show a promising economic growth in the future.

Investment

According to the Ministry of Industry, Mine and Trade, during the first four months of 1398, the number of establishment permits of manufacturing units totaled 8,355 and about IRR970 trillion investment is forecasted to be needed for them, showing a 24 percent and a 26 percent rise compared to the same period in the preceding year, respectively. Besides, the number of operation permits of manufacturing units grew by 16.5 percent to reach 1,910, out of which 1,029 permits are issued for newly-established units and 881 permits for the development of existing units. This information shows that the majority of newly-issued permits in this period belonged to the small and medium sized enterprises which need a relatively lower amount of capital. Table 1 makes a comparison between the first four months of 1397 and 1398, in terms of capital needed for manufacturing units' permits.

Table 1 – The capital needed for issued permits (IRR trillion)

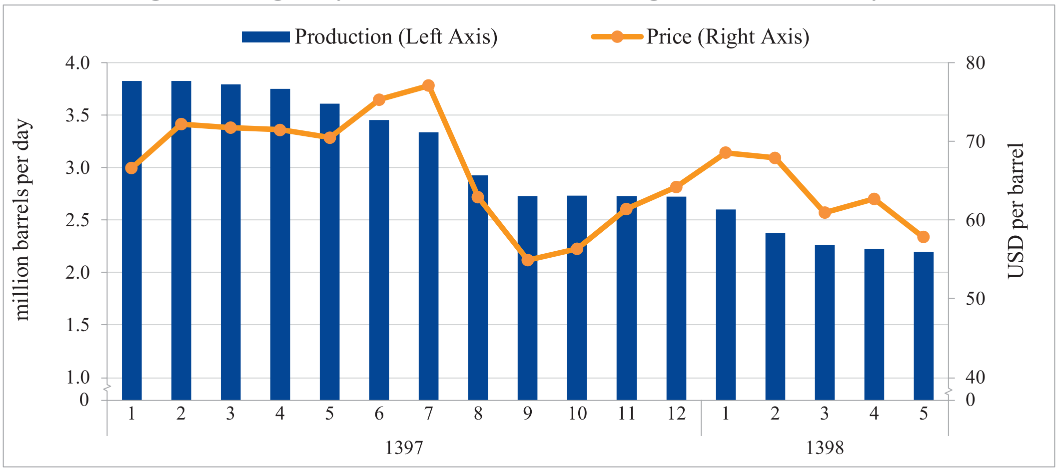
	First Four Months of 1397	First Four Months of 1398	Percentage Change
Establishment Permits	768,267	970,248	26.3
Operation Permits	275,879	125,487	-54.5

Source: Ministry of Industry, Mine and Trade, the preliminary report of the performance of first four months of 1398

Oil

The last official report of Iranian oil production has been released a year ago and even OPEC reports since then have quoted these statistics only from the secondary sources. According to the latest OPEC monthly report, Iran's average daily oil production dropped to 2.2 million barrels in August 2019, which was unexampled in the last few years. Since the beginning of 1397, a downward trend in the production of Iranian oil has appeared which was mainly attributable to the reintroduction of US sanctions and the expiration of oil importing waivers for a few countries, disrupting Iranian oil exports significantly. The statistics of volume and value of Iran's oil exports, particularly in the last year, have been regarded as a confidential data by officials. However, some news agencies have tried to obtain rough estimations for these statistics by using unofficial sources like Kpler[1], one of which has estimated Iran's oil production a mere 200 thousand barrels per day in recent months, lower than Iran's production level during Iran-Iraq war. The daily-average price of Iranian heavy oil reached USD57.8 per barrel in 05/1398, which is roughly equal to the corresponding price at the beginning of last winter. Anyway, intensive oil and banking sanctions imposed by United States have forced Iran to export its oil at a large discount and accept unusually high transaction costs in order to remain in the market. Figure 1 depicts the average daily amount of crude oil production of Iran and the average price of Iran's heavy oil.

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

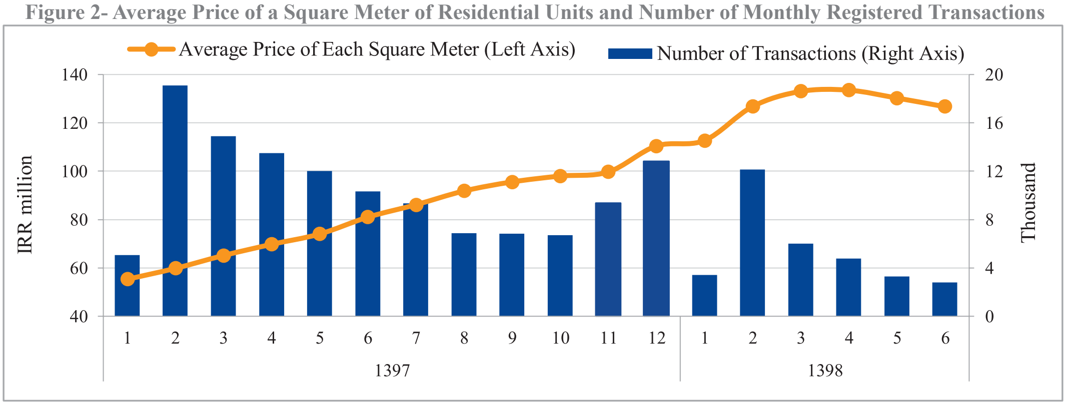


Source: OPEC Monthly Reports, based on secondary sources
* OPEC statistics are based on Gregorian calendar years and their conversion into Persian calendar years are only approximate.

Housing

Tehran housing market experienced another monthly decline in nominal prices for the second consecutive month in 06/1398. The average price of one square meter of transacted residential units, which had touched a pick of IRR133 million in 04/1398, slipped back to IRR127 million in 06/1398, showing a 4.5 percent fall over only two months. The point-to-point growth rate of this price decreased to 56.5 percent in 06/1398, being the lowest figure among the corresponding figures in its preceding 12 months. Considering the number of transactions, in this month a new exceptional record was registered and merely 2,800 units were transacted, the lowest figure since the beginning of 1391. It could be justified by the fact that in the presence of high uncertainty in economy, maintaining liquid assets deter speculators and investment-oriented demanders from participating in the housing market. In addition, the dramatic plunge in the purchasing power of housing consumers forced a notable portion of them to exit the market and consider other alternatives like rental houses. Consequently, the demand of various groups has plunged considerably, thereby reducing the number of transactions. Figure 2 shows the movement of housing price and the number of transactions recorded in each month in Tehran since 01/1397.

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

1. a data intelligence company that provides transparency solutions to commodity markets

The index of housing rental prices in Tehran rose by 31.4 percent in 06/1398 compared to the same period of the previous year. This index normally has a moderately upward trend even over housing market recession periods and its growth intensifies in the booming periods, although it rises much slower than that of housing prices and with a noteworthy delay. In the first half of 1398, in spite of the decline in the point-to-point growth rate of housing prices, the average growth rate of rental prices rose from 21.9 percent in 01/1398 to 31.4 percent in 06/1398. Considering the trend of housing prices, it is highly probable that the growth rate of rental prices will decrease in the next months.

Labor Force

According to the most recent report of the SCI, the unemployment rate shrank by 1.3 percentage points, registering the rate of 10.8 percent in 1398Q1. The economic participation rate, however, not only experienced no improvement in this period but also dipped by 0.5 percentage points and reached 40.6 percent. In other words, although the number of unemployed reduced by about 365 thousand, only 321 thousand added to the employed, due to the fact that a net of 43 thousand people left the labor market. Surprisingly, the aforementioned drop in the active population is completely attributable to a considerable reduction in the number of active women (170 thousand), as the number of active men even increased (by 127 thousand) in the period under review. Therefore, the Iranian women's labor market conditions, which was improving gradually over the preceding years, worsened again and the women's economic participation rate went down.

Among about 3 million unemployed in this spring, 40.3 percent had graduated from university, showing the insufficiency of obtaining higher education degrees to secure a job, particularly for females. Moreover, about 2.2 million men and 0.2 million women were classified as underemployed in 1398Q1, working less than 44 hours per week despite their ability and eagerness to work more. The share of underemployment in this quarter (10.0 percent) was slightly lower in comparison with that in the preceding spring. Table 2 illustrates the main labor market indices in 1398Q1 and in the same quarter a year earlier.

Table 2 - Labor Market Indicators

		1397Q1			1398Q1		
		Total	Male	Female	Total	Male	Female
Economic Participation Rate	Rate (percent)	41.1	65.3	16.8	40.6	65.0	16.1
	Number (million)	27.4	21.8	5.6	27.3	21.9	5.4
Unemployment Rate	Rate (percent)	12.1	10.3	19.2	10.8	9.2	17.3
	Number (million)	3.3	2.2	10.7	3.0	2.0	0.9
Underemployed	Share (percent)	10.2	11.2	5.7	10.0	10.9	6.1
	Number (million)	2.5	2.2	0.3	2.4	2.2	0.2
Share of the Highly-Educated Unemployed in the Total Unemployed (percent)		36.4	23.8	63.1	40.3	28.9	64.9

Source: Statistical Center of Iran, Summary Results of the Labor Force Survey, 1398Q1

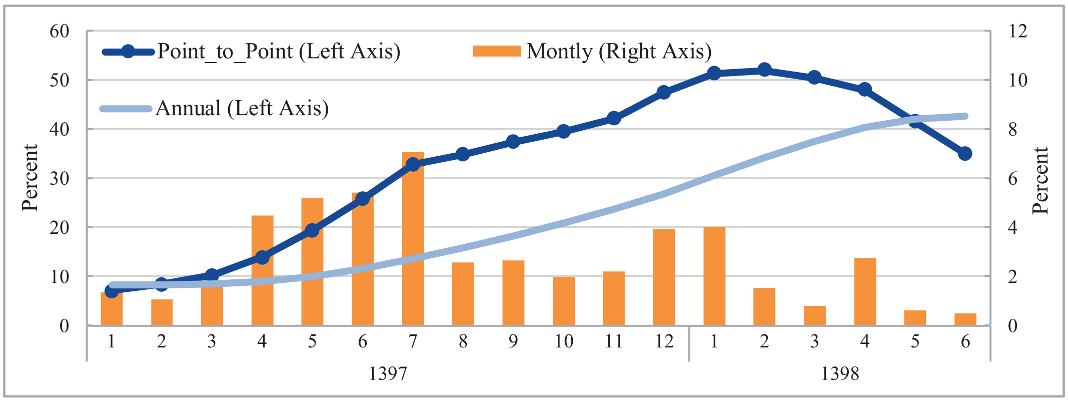
2. Prices and Inflation

High rates of inflation, which are considerably higher than world's average inflation rate, have always been a chronic problem in Iran, although government and policy makers always claim that reduction of inflation is among their high-priority targets. Widening the wealth gap, diminishing the level of welfare, intensifying uncertainty for both firms and households, depreciating the national currency, having detrimental effects on investment and production motivation, disrupting the optimal distribution of resources, and many other side effects are directly and indirectly caused by high inflation rates.

In 1397 and early 1398, inflation rate was mainly surged by considerable growth of liquidity in past years in tandem with low or even negative economic growth. In this situation, there is more money chasing almost the same number of goods and services, which means higher prices. The other factor that played a central role in appearing the high inflation rates was the notable jump in the exchange rate, which increased the price of imported tradable goods and even that of non-tradable ones afterwards. Under these circumstances government made various efforts to re-examine some policies that had failed in several similar cases in the past and unsurprisingly none of them became fruitful.

The average annual consumer price index (CPI) inflation rate in the first 6 months of 1398 was about 38 percent, not much different from the long term inflation rate in the last decades. In addition, the World Bank and the International Monetary Fund (IMF) estimate the annual inflation rate of Iran in 2019 to be 38.3 percent and 37.2 percent, respectively. These figures imply that the one-digit inflation rates experienced in 1395 and 1396 did not base on a radical change in monetary or fiscal policies and mainly followed by high real interest rate as well as a downward adjustment in inflation expectations. According to the most recent SCI's report, in 1398/06, the CPI (base year: 1395=100) for all Iranian households, rose by 0.5 percent compared to the preceding month and 35.0 percent compared to the same month a year before. The former is the lowest monthly inflation rate since the beginning of 1397 and the latter is the lowest point-to-point inflation rate since 08/1398. Thanks to steady reduction in the point-to-point inflation rate during recent months, the annual inflation rate almost ceased to increase, standing at 42.7 percent in 06/1398. Figure 3 represents the different types of CPI inflation rates for each month of 1397 and 1398H1.

Figure 3- CPI Inflation Rates



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

The aforementioned 42.7 percent annual inflation rate of 06/1398 could be divided into 59.7 percent inflation rate of goods and 24.5 percent inflation rate of services. Out of 12 major groups in the consumption basket of goods and services, tobacco had the greatest annual inflation rate (99.2 percent) and education had the lowest one (22.0 percent). This figure for foods and beverages amounted to 82.5 percent. However, it is noteworthy that negative monthly inflation rates were seen in a couple of major groups, the most significant one belonged to transport by 1.0 percent. Table 3 exhibits CPI inflation rates in major groups of the consumption basket in 06/1398.

Table 3 - Inflation Rates of Major Groups in the Consumption Basket in 06/1398 (percent)

	Weight in the Basket	Monthly	Point-to-point	Annual
Food and Beverages	26.6	0.5	46.0	62.6
Tobacco	0.6	-0.4	1.8	99.2
Clothing and Footwear	4.8	2.1	47.2	51.5
Housing, Water, Electricity, Gas and Other Fuels	35.5	2.4	24.1	23.5
Household Equipment	3.9	1.5	57.1	71.6
Health	7.1	0.8	27.0	25.4
Transport	9.4	-1.0	29.8	45.6
Communication	2.9	-0.9	21.0	34.2
Recreation and Culture	1.7	1.7	50.3	67.0
Education	1.9	2.3	24.7	22.0
Restaurants and Hotels	1.4	1.4	44.7	40.9
Others	4.2	0.9	39.3	51.4
Overall	**100.0**	**0.5**	**35.0**	**42.7**

Source: Statistical Center of Iran, Reports of consumer price index, 06/1398

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.

Based on the latest report of the Islamic Republic of Iran Customs Administration (IRICA) at the time of finalizing this report, imports in the first five months of 1398 registered 14.1 million tons, valued at USD17.7 billion and exports reached 60.7 million tons, valued at USD17.8 billion in this period. Imports declined by 0.1 percent and by 6.8 percent in terms of weight and value, compared to the same period of 1397, respectively. Meanwhile, exports rose by 29.9 percent and declined by 9.1 percent in terms of weight and value, in that order. However, the recent depreciation of the rial was expected to have an increasing effect on exports value. In fact, due to government inappropriate policies - including price controls and the export ban on some commodities aimed at reducing inflation - exports proceeds have declined and thus, the supply of foreign currency has narrowed, the rial has depreciated further and inflation has increased.

As a result of the country's trade developments, USD549 million non-oil trade balance surplus in the first five months of 1397 gave place to USD61 million surplus in the same period of 1398, indicating a significant decline of 88.9 percent. Table 4 depicts the details of trade in the first five months of 1397 and 1398.

Table 4 - Details of Trade in the First Five Months of 1397 and 1398

	first five months of 1398		first five months of 1397		Percentage Change	
	Weight (thousand tons)	Value (USD millions)	Weight (thousand tons)	Value (USD millions)	Weight	Value
Imports	14,126	17,739	14,141	19,041	-0.1	-6.8
Exports	60,737	17,800	46,770	19,590	29.9	-9.1
Non-oil Trade Balance	**46,611**	**61**	**32,629**	**549**	**42.9**	**-88.9**

Source: Islamic Republic of Iran Customs Administration, trade preliminary statistics for the first five months of 1398 report

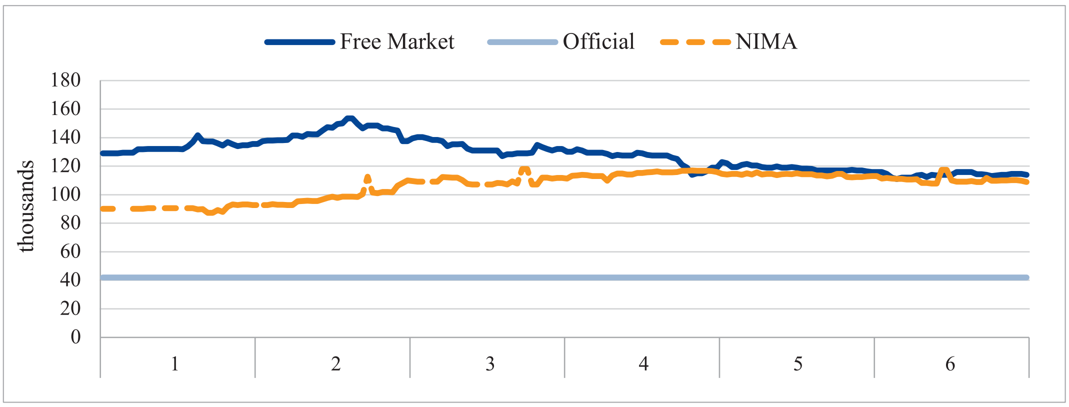
Unfortunately, the IRICA has refused to publish details of the country's trade since 01/1398 and has also omitted top 10 imported and exported commodities from its preliminary reports. Regarding main trading partners of Iran, similar to 1397, China was the biggest importer of Iranian goods in the first five months of 1398 by 24.9 percent share of Iran's total exports, valued at USD4.4 billion. China's share of Iran's exports in 1397 was 20.8 percent. Also, similar to 1397, Iraq was the second largest importer of Iranian goods in the first five months of 1398, valued at USD3.9 billion. Iraq's share of Iran's total exports in the first five months of 1398 was 22.0 percent, while for the whole of 1397 was 20.1 percent. Turkey, with USD2.5 billion imports from Iran, accounted for 13.9 percent of Iran's total exports, ranking third in Iran's export targets. Meanwhile, the UAE's share of 13.4 percent of Iran's exports in 1397 fell to 9.4 percent in the first five months of 1398. Therefore, the UAE is fourth largest importer of Iranian goods with imports of USD1.7 billion from Iran during this period. Afghanistan is in fifth place with USD0.9 billion of imports from Iran and 5.0 percent share. It had a 6.6 percent share of Iran's total exports in 1397. It can be acknowledged that Iran's exports have almost focused on the two countries China and Iraq in 1398. Although this is normal in the face of sanctions, it will pose more risks to the country.

On the other hand, China with exports valued at USD4.3 billion to Iran, which constituted 24.2 percent of Iran's total imports (0.1 percentage points more than that in 1397), was the biggest exporter to the country in the first five months of 1398, same as 1397. UAE with exports valued at USD3.0 billion to Iran, was second-largest exporter to Iran in the same period, same as preceding year. Its share increased from 15.3 percent in 1397 to 17.1 percent in the first five months of 1398. Turkey, which was Iran's fourth-largest exporter to Iran with a 6.1 percent share of Iran's total imports in 1397, exported USD2.2 billion to Iran (12.5 percent of Iran's total imports) in the first five months of 1398 and sat in the third place. Furthermore, India fell from third place in 1397 to the fourth position of largest exporters to Iran in the first five months of 1398, though its share increased from 6.4 percent of Iran's total imports to 10.6 percent. Its exports to Iran was USD1.9 billion during the same period. Germany was fifth-largest exporter to Iran in the first five months of 1398, just like the last year. Germany's exports of USD0.9 billion to Iran accounted for 4.9 percent of Iran's total imports during that period, while its share was 5.8 percent in 1397. As such, Iran's imports were concentrated on its four largest partners in the first five months of 1398, and Germany's share as the most important European exporter to Iran declined.

4. Foreign Exchange Market

The Iranian Rial (IRR) experienced a mild appreciation against the other foreign currencies in summer 1398. The free market USD/IRR exchange rate, which had recorded 128,900 at the beginning of the year and rose to 132,000 at the end of spring, descended to 113,900 at the end of summer. Along with the absolute stability of the USD/IRR official exchange rate, the rate in the second market (NIMA) experienced approximate stability in 1398Q2, although it had gradually increased in 1398Q1. The USD/IRR exchange rate in NIMA, which had previously been below free market rates and higher than the official exchange rate, exceeded even free market rates in some summer days. For example, USD/IRR exchange rate in NIMA was 3.0 percent more than free market rate at 06/14/1398, while USD/IRR exchange rate in free market was 58.0 percent more than NIMA rate at 01/20/1398. The USD/IRR free market exchange rate has decreased by 12.7 percent on average in 1398Q2 compared to 1398Q1, while it has risen by 15.4 percent compared to 1397Q2. Figure 4 depicts the daily USD/IRR exchange rates during 1398H1 in official, second and free markets.

Figure 4- Daily USD/IRR Exchange Rates in 1398H1



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

The return of foreign exchange denominated proceeds from non-oil exports to the country has increased due to the rising USD/IRR exchange rate in NIMA, helping the USD/IRR exchange rate reduction in the free market. Non-oil exporters supplied more than USD5 billion of foreign currencies to NIMA in the first four months of this year, compared to USD18.7 billion for the entire preceding year. According to the governor of the CBI, in the first half of this year, USD11 billion foreign currencies has supplied to NIMA by non-oil exporters and about USD8 billion in the same period was earmarked by the CBI for imports of medicines and essential goods. Currently, the foreign exchange rates in the NIMA and the free market are very close. Moreover, increasing the official foreign exchange rates can help further reduce the NIMA exchange rates and free market rates, and eventually lead to a unified foreign exchange rate.

The governor of the CBI has announced that financing imports of essential goods alongside financing production are the major concerns for the CBI. In fact, the CBI not only has no intention of removing the official foreign exchange rates, but also its main purpose is to finance essential goods imports by the same foreign exchange rate, not control the monetary aggregates to control inflation. While in most countries in the world, the central bank's main goal is inflation targeting, and the central bank is in charge of monetary policies - not foreign exchange policies - to achieve that.

However, it seems that the gradual elimination of part of the foreign currency allocation with official exchange rates is on the CBI's agenda, and some items that were previously eligible for this allocation have been referred to the NIMA.

The CBI has also announced the launch of the Organized Foreign Exchange Market as one of its most important foreign exchange policies in 1398. However, the launch of the market has been postponed several times and the CBI's promise has not been fulfilled yet.

5. Monetary and Credit Aggregates

According to the latest available balance sheet of the CBI, the monetary base (M0) reached IRR2,744 trillion at the end of 1398Q1, with 3.3 percent growth compared to the beginning of this year. CBI net foreign assets, the main part of the monetary base, declined by 4.4 percent and 2.8 percent in the 3-month and 12-month periods ended 03/1398, respectively. Likewise, CBI claims on banks as the second biggest part of the monetary base dipped by 2.6 percent and 3.7 percent in aforementioned periods, in that order. CBI net claims on the public sector, on the other hand, experienced noticeable jumps and registered a quarterly hike of 42.1 percent and an annual leap of 401.0 percent in the period under review, although due to its relatively small share, it had no considerable impact on monetary base. Besides these three items, there is another part named "net other items", which its growth has a reducing effect on monetary base. The CBI released no detailed information about this noteworthy element, despite its significant effect on the developments of M0. At the end of 03/1398, the aggregation of the first three aforementioned items of M0 totaled IRR4,070.7 trillion and the "net other items" reduced IRR1,326.4 trillion of this aggregate. Considering the change of monetary base elements, during the year ended 1398Q1, the decline of the first two largest items totaled IRR118.2 trillion, however, the rise in "net other items" amounted to IRR343.9 trillion, showing the significant role of this item in M0 changes. Statistics on the monetary base and its components are presented in Table 5.

Table 5 - Monetary Base Components (end of period - IRR trillions)

	1397				1398	Percentage Change of 1398Q1 Compared to	
	Q1	Q2	Q3	Q4	Q1	1397Q4	1397Q1
Monetary Base	**2,186.6**	**2,345.1**	**2,436.0**	**2,656.9**	**1,851.9**	**3.3**	**25.5**
CBI Net Foreign Assets	2,377.0	2,364.5	2,384.1	2,416.5	1,853.9	-4.4	-2.8
CBI Net Claims on Public Sector	82.8	82.4	132.7	292.0	282.0	42.1	401.0
CBI Claims on Banks	1,397.1	1,506.5	1,497.9	1,381.7	1,013.7	-2.6	-3.7
Net Other Items	-1,670.3	-1,608.3	-1,578.7	-1,433.3	-1,297.7	7.5	100.6

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

The amount of liquidity (M2) reached about IRR2,000 trillion at the end of 1398Q1, 84 percent of which was comprised of quasi-money and the remaining 16 percent was considered as money (M1). The share of money in the liquidity was moderately lower in the years of 1396 and 1397 and averaged out at 12 percent and 14 percent, respectively. The majority proportion of money (more than 80 percent) has been made up by sight deposits and notes and coins with the public have constituted just a minor part of it. For the year ended 03/1398, money rocketed by around 51 percent and quasi-money increased by about 21 percent, resulting in a 25.1 percent escalation in the whole liquidity. This annual growth rate of liquidity was almost the same in 02/1398 but 4.7 percentage points more than the corresponding rate in 03/1397. The increase in monetary base played the central role in the liquidity growth in this 12-month period, as the M2 money multiplier was almost stable in the period and remained around 7.2. Table 6 demonstrates statistics on M2 money multiplier and liquidity components from 1397Q1 onwards.

Table 6 - Liquidity Components and M2 Money Multiplier (end of period - IRR trillions)

	1397				1398	Percentage Change of 1398Q1 compared to	
	Q1	Q2	Q3	Q4	Q1	1397Q4	1397Q1
Liquidity	**15,827.5**	**16,723.7**	**17,645.8**	**18,828.9**	**19,799.1**	**5.2**	**25.1**
Money	2,059.5	2,436.7	2,446.2	2,852.3	3,108.7	9.0	50.9
Notes and Coins with the Public	406.0	445.0	455.0	547.5	502.2	-8.3	23.7
Sight Deposits	1,653.5	1,991.7	1,991.2	2,304.8	2,606.5	13.1	57.6
Quasi-Money	13,768.0	14,287.0	15,199.6	15,976.6	16,690.4	4.5	21.2
M2 Money Multiplier	7.2	7.1	7.2	7.1	7.2	1.8	-0.3

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

At the end of 1398Q1, the balance of extended facilities amounted to IRR15,657.2 trillion, registering a 3.8 percent and a 20.7 percent rise in comparison with the end of 1397 and the same time in the year before, respectively. Meanwhile, The whole deposits of banks and non-bank credit institutions in both IRR and foreign currencies totaled IRR21,765.7 trillion, increasing 26.6 percent compared to the end of 1397Q1. The legal reserve ratio, averaging 10.5 percent over 1395 and 1396, commenced decreasing slightly since the first months of 1397 and reached about 10.2 percent at the end of 1398Q1. So, CBI took IRR2,228 trillion from deposits as legal reserve requirement. Consequently, the ratio of extended facilities to deposits (less required reserves), dipped to 80.1 percent, being 4.0 percentage points lower than that of a year earlier. This ratio was about 110 percent at the beginning of the 1390s and has been decreasing almost constantly thereafter. Table 7 summarizes these statistics.

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

	1395	1396	1397	1398Q1	Percentage Change of 1398Q1 Compared to	
					1397Q4	1397Q1
Extended Facilities (EF - in IRR trillion)	9,866.6	12,587.1	15,090.2	15,657.2	3.8	20.7
Deposits (in IRR trillion)	12,728.4	16,464.1	20,673.4	21,765.7	5.3	26.6
Deposits Less Required Reserves (DLRR - in IRR trillion)	11,374.1	14,741.9	18,568.3	19,537.5	5.2	26.7
Legal Reserve Ratio (percent)	10.6	10.5	10.2	10.2	0.5	-0.9
EF to DLRR Ratio (percent)	86.7	85.4	81.3	80.1	-	-

Source: Central Bank of Iran, Banking Statistics

6. Government Fiscal Performance

At the time of publication of 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 No.14 issue and will not be duplicated here.

About four months after the beginning of 1398, the government reformed this year's budget law through the Supreme Council of Economic Coordination - a joint meeting attended by the heads of the three branches of power in Iran. The main reason for this budget reform is the review of oil revenues, not the structural reform of the budget. The government previously used to submit a supplement to the parliament to amend the budget figures, though this somewhat transparent process of its approval in the parliament didn't take place in 1398 and the Supreme Council of Economic Coordination approved the budget law amendment unilaterally. For this reason, the available information on this decree is not very clear and accurate and has only been informed through informal sources.

The government had estimated the export of oil and gas condensate more than 1.5 million barrels per day in the budget bill of 1398. However, reputable research institutions such as the Islamic Parliament Research Center warned that this figure was overestimated. The parliament not only did not reduce the estimated oil revenues in the budget bill, but also added about IRR100 trillion in the budget law, relying on selling crude oil to government creditors. The price of crude oil in this process is determined by the energy exchange or the average of regional prices. This did not occur because energy market participants were reluctant to buy crude oil due to US sanctions, let alone government creditors. Therefore, the oil revenues in the budget law of 1398 were highly unrealistic.

The amendment reduces the estimate of oil exports to about 300,000 barrels per day and, accordingly, has made further changes to both sources and uses sections of the budget law. Table 8 provides an overview of these changes.

Table 8- Main Subdivisions of the Budget Law of 1398, Before and After the Amendment (IRR trillion)

Description	Sources			Description	Uses		
	Before Amendment	After Amendment	Percentage Change		Before Amendment	After Amendment	Percentage Change
Revenues	2,390	1,960	-18	Expenses (Current)	3,524	3,100	-12
Disposal of Non-financial Assets	1,585	625	-61	Acquisition of Non-financial Assets	669	430	-36
Disposal of Financial Assets	511	1,275	150	Acquisition of Financial Assets	293	330	13
Total Government General Resources	**4,486**	**3,860**	**-14**	**Total Government General expenditures**	**4,486**	**3,860**	**-14**

Source: The Budget Law of 1398; Donya-e-Eqtesad Newspaper, No.4666

According to unofficial news, oil revenues in the amendment is estimated at IRR570 trillion, which adds up to IRR625 trillion considering other disposal of non-financial assets, indicating 61 percent decrease compared to the budget law. Assuming the oil price to be similar to the budget bill and the budget law (USD54 per barrel), after deducting the share of the National Development Fund and the share of national oil and gas companies - considering gas condensate sales to domestic petrochemical industries and net gas exports - the government's share of oil revenues will be about USD8.4 billion, assuming export of 300 thousand barrels of oil per day. However, the budget bill allocated USD14 billion of government oil revenues to imports of essential goods at the official foreign exchange rates. Therefore, the government want to reduce the imports of essential goods at the official foreign exchange rates, though its complete elimination will provide the government with much more revenues than anticipated in the amendment. In the current situation, imports of essential goods at the official foreign exchange rates must be reduced to USD5 billion in 1398 in order to earn the IRR570 trillion projected oil revenues in the amendment.

The government's revenues has also fallen by about 18 percent compared to the budget law, though details are unclear. Thus, the total decrease in revenues and disposal of non-financial assets amounted to about IRR1,390 trillion.

The government also reduced its current and development expenditures by about IRR663 trillion, of which about IRR424 trillion is related to current expenditures (about 12 percent reduction) and about IRR239 trillion to development expenditures (about 36 percent reduction). It should be noted that this amendment also increased the acquisition of financial assets (debt repayments) by approximately IRR37 trillion.

Inevitably, the government has increased disposal of financial assets by about 150 percent compared to the budget law (about IRR764 trillion) to about IRR1,275 trillion. Only IRR100 trillion of this amount comes from the disposal of government assets. The rest is related to using the National Development Fund resources (up to IRR450 trillion), issuing government debt securities (up to IRR380 trillion) and using the Foreign Exchange Reserve Account resources (IRR45 trillion). Meanwhile, the government's total use of the National Development Fund resources and the proceeds of issuance of government debt securities should not exceed IRR620 trillion.

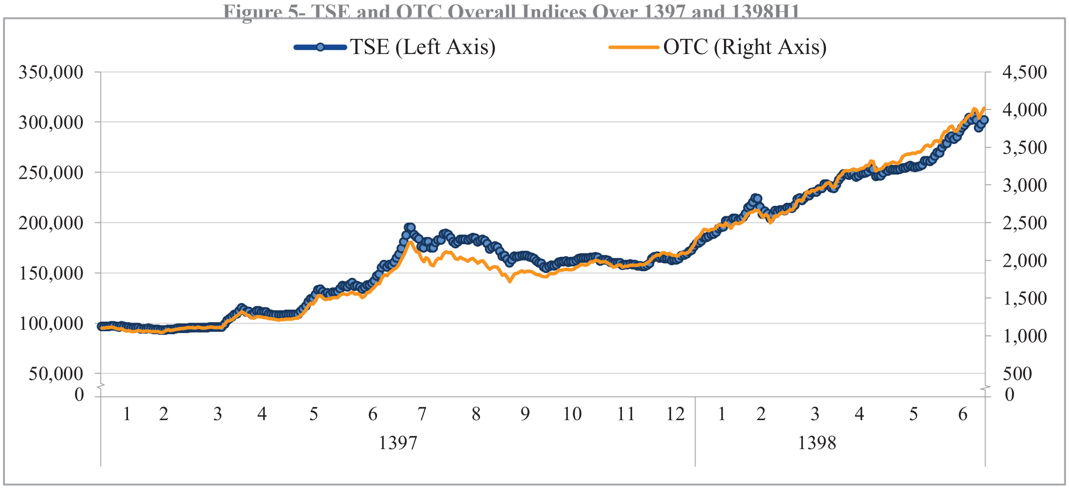
In accordance with the amendment, the Cabinet approved the procedures of the issuance of IRR380 trillion government debt securities in 06/1398. This is beyond the predicted government debt securities issuance of IRR430 trillion in the budget law. As a result, the financial burden of debt securities due to the budget deficit of 1398 has almost doubled. Increasing government debt will raise interest rates and have a crowding out effect on the private sector. As a result, private capital formation, as primary source of economic growth, will be hindered more than before. The 36 percent reduction in government development expenditures (according to the amendment) compared to the budget law will reduce public capital formation as well. Thus, the CBI will have no choice but to buy a large amount of government debt securities through open market operation, which was included in 1398 budget law and its related instructions approved by Money and Credit Council in 01/1398.

7. Capital Market

The Iran's capital market enjoyed a profound expansion in the first half of 1398. The overall index of Tehran Stock Exchange (TSE) rocketed up by 69.1 percent in only 6 months and reached more than 302 thousand at the end of this period, registering an annual growth of 88.2 percent. This return was exceptionally higher than the returns in other markets like the foreign exchange, gold, automobile, and housing market. The growth rate of the financial index and industrial index of the TSE were 77.6 percent and 68.1 percent in this 6-month period and 127.1 percent and 85.1 percent in the year ended 06/1398, respectively, implying much more return for banks and other financial firms' shareholders than their counterparts in manufacturing companies.

Meanwhile, Over the Counter (OTC) market index faced almost the same pattern, although its return overtook that of the TSE. During the first half of this year, the overall index of OTC market saw an unprecedented surge, hitting a peak of 4 thousand at the end of 06/1398, which was 75.6 percent and 113.8 percent higher than that at the beginning of the year and at the same time a year before, in that order. During the 1398H1, unlike the past, the overall index of OTC market fluctuated much less than TSE market index, registering a steady positive growth in the majority of working days. These two overall indices are depicted in Figure 5.

Figure 5- TSE and OTC Overall Indices Over 1397 and 1398H1



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

The market capitalization of the TSE surged by more than 80 percent, reaching IRR11,045 trillion and the OTC one escalated by 56 percent, reaching IRR3,867 trillion at the end of 1398H1. The total market capitalization of these markets, therefore, approximately exceeded half of the Iran's nominal GDP. More interestingly, in the period under review, these markets experienced more than twofold increase in the volume and value of transactions, touching new records. In the TSE, the equity market transaction volume totaled 486 billion shares and its value amounted to IRR1,446 trillion over 1398H1. Considering the transactions of debt securities (IRR51 trillion), derivatives (IRR0.7 trillion), and exchange-traded funds (IRR85 trillion), the total value of transactions in the TSE market reached the outstanding amount of IRR1,582 trillion in 1398H1. Table 9 demonstrates some important performance statistics of Tehran Stock Exchange

Table 9 - Tehran Stock Exchange Performance

	During the Period			At the End of the Period			
	The Volume of Equity Transactions (Billion Shares)	The Value of Equity Transactions (IRR trillion)	The Value of Total Transactions (IRR trillion)	Market Capitalization (IRR trillions)	Overall Index (Thousand)	Financial Index (Thousand)	Industry Index (Thousand)
1398H1	486.6	1,445.6	1,582.1	11,045.4	302.1	364.6	270.8
1397H1	207.2	506.8	576.5	6,124.1	160.5	160.5	146.3
Percentage Change	134.9	185.3	174.4	80.4	88.2	127.1	85.1

Source: Tehran Stock Exchange, Market Analysis Report, variouse issues

8. Other Developments

The pressure of US sanctions against Iran have been on the rise. The CBI and the National Development Fund (NDF) were sanctioned by the US Treasury in 1398/06. The CBI has previously been subject to sanctions by Iran tag, but this time it has been subject to sanctions by financing terrorism tag. This situation will increase the risk of cooperation with the CBI for other countries, though Iranian officials emphasize its ineffectiveness and redundancy. On the other hand, the imposed sanctions on the NDF, in addition to limiting the fund's foreign investment capability, will further limit the usage of foreign exchange facilities provided by the NDF's resources. Thus, the US sanctions have made it difficult to use previously earned oil revenues - in addition to generating new oil revenues - for Iran.

In contrast, Iran's members of parliament have put forward some plans to counter US sanctions. One of these measures is the "countering US sanctions by replacing goods and services imports" plan. According to this plan, the government is required to identify, remove and replace all direct and indirect imports of goods and services from the United States. Iran's imports from the United States increased significantly in 2018, though much of that was related to agricultural products and foodstuffs. In addition to the risk of US-Iran trade interruption and the seizure of current opportunity in the near future, another reason for this increase is the US-China trade war, which results in lower demand for American products and lower prices for them. So banning imports from the United States would be a self-imposed ban on accessing cheaper essential goods. On the other hand, the boycott of imports from Iran does not impose a huge cost on the US economy, but as the US has monopolized the markets of many products and technologies, removing them would impose a heavy burden on the Iran's economy due to the impossibility of replacing them. Furthermore, the production of many goods and services are indirectly related to United States, and eliminating them from imports would be detrimental to the Iran's economy. In other words, approving the aforementioned plan could even help US sanctions to achieve their goals more easily.

The other plan of the parliament is the government's obligation to support Iranian individuals and corporations that have suffered from US sanctions. The funding for such supports is not specified in the plan. Regardless of the potential corruption in the implementation of the plan, it will result in increased budget deficit, exacerbating the effects of oil sanctions.

Another plan has also been put forward in parliament called "government commitment to take legal action against companies joining US sanctions against Iran." The plan aims to penalize foreign perfidious corporations. Since penalizing companies that have terminated their contract with Iran unilaterally is possible only if they wish to re-cooperate with Iran under the new contract after lifting the sanctions, this plan would make it difficult for Iranian companies to re-establish international relations if sanctions are lifted in the future, preventing Iran to enjoy the benefits of returning to the global economy.

Another recent economic development was the approval of a plan to separate the trade sector from the Ministry of Industry, Mine and Trade and the establishment of an independent ministry of commerce. The government claimed that the current duties of the Ministry of Industry, Mine and Commerce are heavy and the formation of the Ministry of Commerce will facilitate price controls. Regardless of all the direct and indirect consequences of this decision, it is not reasonable to pay the cost of this plan, given the current high level of budget deficit. The implementation costs are planned to be covered by reducing current expenditures, while this is not feasible, otherwise the government did not have to issue additional IRR380 trillion of government debt securities to cover a part of its budget deficit.

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