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Recent Economic Developments in Iran

A Quarterly Report



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A Note on the Persian Calendar

The Persian calendar is a solar calendar in which years start on the first day of spring and end on the last of winter. The four quarters of the year correspond exactly to the four seasons.

The current Persian year is 1395, which happens to be a leap year. It started on March 20, 2016 and will end on March 20, 2017. The first quarter of 1395 (1395Q1) overlaps with spring and roughly corresponds to the second quarter in the Gregorian calendar (2016Q2). Similarly, 1395Q4 roughly corresponds to 2017Q1, etc.

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

1394Q1	= 03/21/2015 – 06/19/2015, roughly	2015Q2
1394Q2	= 06/20/2015 – 09/22/2015, roughly	2015Q3
1394Q3	= 09/23/2015 – 12/21/2015, roughly	2015Q4
1394Q4	= 12/22/2015 – 03/19/2016, roughly	2016Q1
1395Q1	= 03/20/2016 – 06/20/2016, roughly	2016Q2
1395Q2	= 06/21/2016 – 09/21/2016, roughly	2016Q3
1395Q3	= 09/22/2016 – 12/20/2016, roughly	2016Q4
1395Q4	= 12/21/2016 – 03/20/2017, roughly	2017Q1

Iran's Economy at a Glance

	1394Q1	1394Q2	1394Q3	1394Q4	1394	1395Q1	1395Q2
Participation and Unemployment Rates (percent)							
Participation	38.0	38.9	38.1	37.7	38.2	39.5	40.4
Unemployment (10 years and over)	10.8	10.9	10.7	11.8	11.0	12.2	12.7
Unemployment (Youth ages 15-24)	25.0	25.7	25.4	28.6	26.1	27.8	30.2
Real Growth Rates (percent) *							
Gross Domestic Product (GDP)	0.3	1.4	1.3	2.3	1.3	4.4	9.2
Oil	3.6	3.4	-9.0	16.5	3.6	57.3	-
Agriculture	8.7	5.9	3.6	6.2	5.7	4.0	-
Industries and Mines	-3.8	-2.3	-3.9	-1.4	-2.9	2.9	-
Services	-0.6	-0.1	1.2	1.0	0.4	2.9	-
GDP (Excluding Oil)	0.2	1.4	1.5	1.9	1.3	2.9	-
Gross Fixed Capital Formation	-10.1	-15.1	-19.3	-18.2	-15.7	-10.0	-
Oil (thousand barrels per day)							
Production	3,093	3,161	3,299	3,379	3,231	3,570**	3,653**
Export	1,422	1,534	1,561	1,787	1,574	-	-
Inflation Rates (percent)							
Consumer Price Index	16.3	12.8	10.1	8.9	11.9	7.2	8.9
Producer Price Index	7.4	5.3	4.0	3.2	4.9	2.7	3.0
Balance of Payments (USD millions)							
Oil Exports	10,633	9,432	7,028	6,476	33,569	11,640	-
Non-oil Exports	7,047	6,504	9,740	7,737	31,028	7,264	-
Imports of Goods	12,902	13,171	12,510	13,836	52,419	12,383	-
Goods Account (Net)	4,778	2,764	4,258	377	12,177	6,522	-
Non-oil Goods Account (Net)	-5,218	-6,214	-2,149	-5,577	-19,158	-4,817	-
Current Account	3,947	2,190	3,816	-937	9,016	5,231	-
Capital Account	-4,218	4,166	2,122	-4,583	-2,513	-5,022	-
Change in Foreign Reserves	-647	2,209	2,206	-1,535	2,233	-6,171	-
Foreign Exchange Rates (USD/IRR daily average)							
Free Market	33,279	33,484	35,465	35,731	34,481	34,691	35,326
Official Market	28,499	29,681	29,997	30,179	29,632	30,358	31,014
Monetary and Credit Aggregates (end of period, in IRR trillions)							
Monetary Base	1,317.2	1,375.0	1,427.8	1,533.6	1,533.6	1,585.2	1,655.1
Central Bank Claims on Banks	813.7	806.0	829.9	836.1	836.1	895.1	942.2
Central Bank Claims on Public Sector (Net)	112.7	109.4	-	182.2	182.2	238.9	325.3
Money (M1)	1,123.8	1,180.2	1,158.1	1,367.1	1,367.1	1,364.4	1,480.3
Sight Deposits	826.2	873.8	856.9	995.1	995.1	1,052.8	1,151.1
Non-sight Deposits (Quasi-money)	7,042.9	7,547.3	8,093.6	8,805.8	8,805.8	9,230.6	9,746.8
Liquidity (M2)	8,166.7	8,727.5	9,251.7	10,172.9	10,172.9	10,595.0	11,227.1
Government Budget (IRR trillions)							
Total Revenues	293.2	452.7	416.4	635.0	1,797.3	255.5	580.9
Tax Revenues	142.2	191.9	173.9	283.9	791.9	184.9	248.2
Oil Revenues	100.1	179.3	173.4	217.5	670.3	43.6	201.5
Other	50.9	81.4	69.2	133.6	335.1	27.1	131.1
Total Expenditures	359.6	490.3	439.1	709.7	2,022.5	415.3	685.3
Current Expenditures	359.2	392.8	358.5	596.4	1,706.9	368.8	582.2
Development Expenditures	0.4	85.8	77.5	113.3	277.0	1.4	130.9
Budget Balance	-90.3	-37.6	-22.7	-45.8	-196.3	-159.8	-104.4
Tehran Stock Exchange (end of period)							
Overall Index (TEDPIX)	63,811	61,577	61,519	80,219	80,219	72,615	76,451
Financial Index	138,168	131,121	125,938	158,225	158,225	145,481	155,263
Industrial Index	52,313	50,661	51,010	66,994	66,994	60,464	63,495
Market Capitalization (IRR trillions)	2,793.7	2,640.3	2,661.5	3,448.4	3,448.4	3,080.6	3,168.1

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

*GDP statistics for 1394 and 1395Q1 are based on SCI reports in market prices (1376=100) and the data for 1395Q2 are from CBI in base prices.

**OPEC monthly reports

1. Real Sector

On the basis of statistics released by domestic sources and international organizations, Iran's economy has performed well during the first half of the current Iranian year, year 1395, spanning from March 20 to September 21, 2016. Although the Central Bank of Iran (CBI) has not yet published the GDP statistics for that period, CBI's Governor announced that compared to comparable periods of last year, the economy has grown by 7.4 percent during the first half of the year, consisting of 5.4 percent in Q1 (the first quarter) and 9.2 percent in Q2. The Statistical Center of Iran (SCI) had previously announced the growth rate in Q1 at 4.4 percent. Although the CBI Governor did not give the breakdown of the GDP growth across sectors, his economic deputy has said that except for construction, all economic sectors had registered positive growth rates and that the high growth was mostly due to the expansion of oil production and exports in the aftermath of the JCPOA (Joint Comprehensive Plan of Action).

1.1 Energy

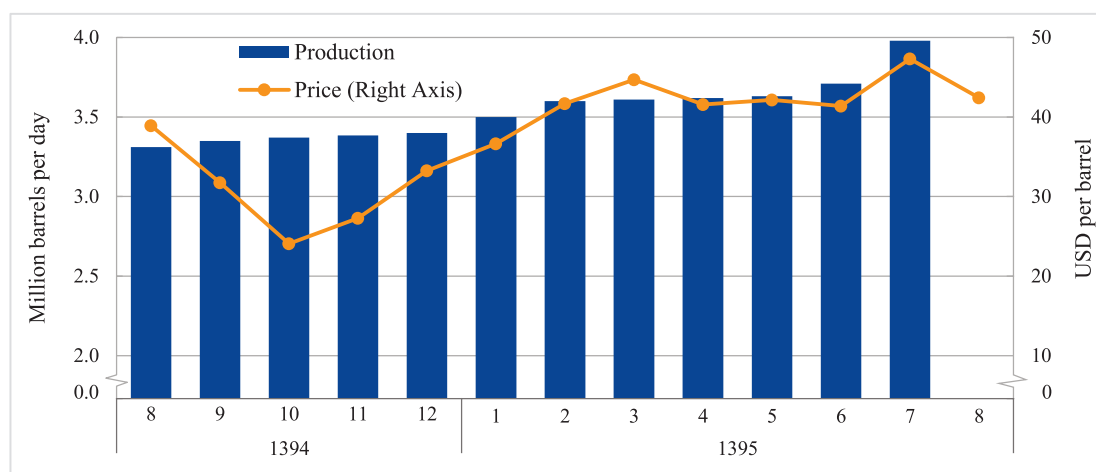
In summer Iran's crude oil production continued its upward trend of the past two years and in 7/1395 (10/2016) rose by 19.5 percent compared to the same month last year to reach 3.9 million barrels per day (bpd). Following five months of increase, the price of

On the expenditures side, both government expenditures and net exports were much higher in the first half of this year than the same period of last year. Private consumption and the overall investment should also have increased given the drop in and the relative stability of inflation and interest rates, and the relative stability of foreign exchange rates during this period.

An IMF statement on December 19, which is quite complimentary to Iran's economic policymakers, has raised its forecast of the 1395 GDP growth rate from 4.5 percent it had projected earlier, to 6.6 percent, followed by 3.5 percent in 1396. In June the World Bank had projected these growth rates at 4.4 percent in 1395 and 4.9 percent in 1396. As increases in oil production cannot go on for long and in time budgetary constraints will also set in to limit growth, long term growth cannot be expected in the absence of macroeconomic stability, which in turn depends on structural changes.

Iran's heavy crude has been generally declining and fluctuating in the USD41-43 range per barrel. It then went up to USD47.3 on the last day of 7/1395 and fell again to USD42.4 in 8/1395. Figure 1 depicts the production and price of Iran's heavy crude oil.

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



Source: OPEC monthly reports

For the first time during the past 8 years, the 14 members of OPEC reached an agreement on November 30 to reduce their aggregate crude production by 1.2 million bpd to bring it to 32.5 million bpd. Saudi Arabia and Iraq will have the highest production cuts while

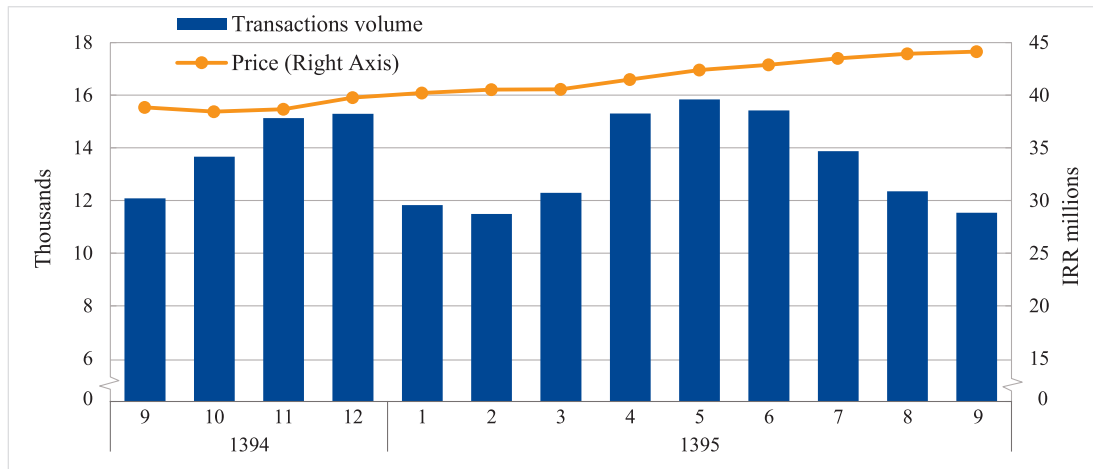
1.2 Housing

In the first 9 months of the year Iran's housing market showed some signs of coming out of the recession of the past few years. No official data is available on the overall housing market but data provided by the Tenement Management Information System provides some insight. As demonstrated in Figure 2, the moving average of the price of traded residential units in Tehran has been rising since the beginning of 1395. It has experienced a 4.7 percent growth in the first 9 month of the year compared to the same period in 1394 but this rate is below the inflation rate, indicating that

Indonesia, Libya and Nigeria will maintain their current levels and only Iran will be allowed to increase its production by 90 thousand bpd to get back to its pre-sanctions level. Following this agreement, crude oil prices jumped up to above USD50 per barrel.

housing prices in real terms are still falling. Data on the number of housing transactions indicates a moderate increase in the number of traded residential units in Tehran. In the first 9 months of the year, the number of residential units traded in Tehran totaled 117.5 thousand, indicating an 8.6 percent rise from the same period in 1394, and this indicates an improvement in the housing market. These modest improvements on the demand side have not yet resulted in a noticeable price increase, no change in private investment in the housing market is expected.

Figure 2 - Moving Average of Price and Number of Traded Housing Units in Tehran



Source: Tehran housing market developments, Central Bank of Iran

1.3 Labor Force

In summer of 1395 the number of employed individuals rose by 628 thousand from last summer, which is a significant achievement. Nevertheless during the same period the unemployment rate has also increased from 10.9 percent in 1394Q2 to 12.7 percent. This phenomenon has been caused by active population growing faster than employment. In other words, the participation rate has grown a lot more than the trend as a result of the movement of some who were previously categorized as inactive to the active category.

They included people who had given up on finding employment or had gone to college as a refuge from unemployment and now were returning to the job market. Besides the rise in unemployment rate, the share of the underemployed also increased in the first two quarters of the year to 8.5 in Q1 and 9.5 in Q2. This indicates that underemployment accounted for a large share of job opportunities in the past year. Table 1 presents quarterly statistics on the main labor market indices in 1394 and 1395.

Table 1 - Labor Market Statistics of the Population Aged 10 and Over (percent)

	1394				1395	
	Q1	Q2	Q3	Q4	Q1	Q2
Participation Rate	38.0	38.9	38.1	37.7	39.5	40.4
Unemployment Rate	10.8	10.9	10.7	11.8	12.2	12.7
Share of Underemployment	4.5	8.5	10.5	11.1	8.5	9.5

Source: Labor Force Survey Result, summer 1395, Statistical Center of Iran

The economic participation rate in summer of this year was 64.9 among men and 15.9 percent among women. Unemployment rate was 10.3 percent among men and as high as 20.3 percent among women. An examination of the unemployment by age groups reveals the very high unemployment rate of 30.2

percent in the population aged 15-24 in Q2, which is the highest rate registered for this quarter in the past 15 years. As for the economic sector of employment, services accounted for 49.1 percent of employment, industry for 31.5 percent and agriculture for the remaining 19.4 percent.

2. Prices and Inflation

The point-to-point consumer price index (CPI) inflation continued its decreasing trend up to 6.8 percent in 3/1395 but then reversed course and increased to 9.5 percent in 6/1395. From then on, this rate started a moderate decreasing trend and eventually registered 9.2 percent in 9/1395 (i.e., 12/2016). The average annual CPI inflation rate also continued its declining trend to reach 8.6 percent in 9/1395.

An examination of the monetary aggregates reveals that the quasi-money share of liquidity during the four quarters to 6/1395 has changed little. In contrast, the growth rate of monetary base has dropped from 11.5 percent in the second half of 1394 to 7.9 percent in the first half of 1395. In the same

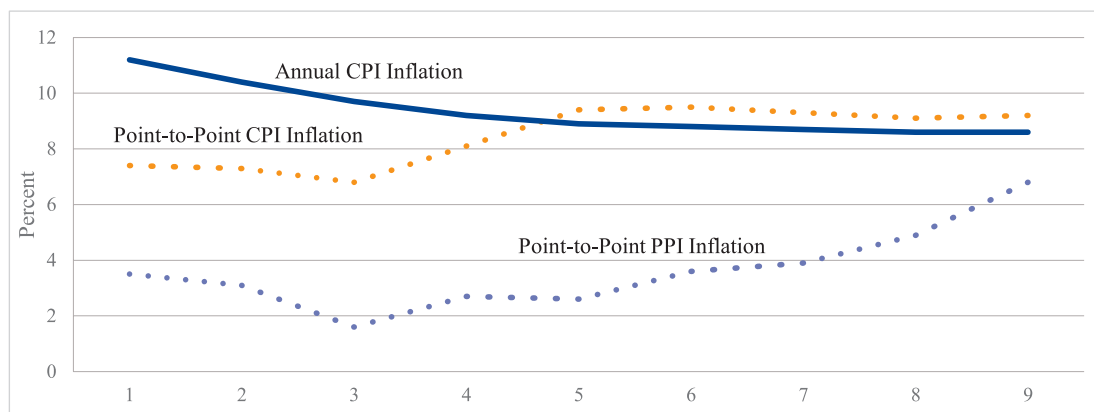
vein, the growth rate of liquidity dropped by 6.6 percent in the same period to reach 10.4 percent. As such, the drop in CPI inflation may be partly attributed to the fall in the growth rates of monetary aggregates.

In contrast to the decreasing trend of the point-to-point CPI inflation, the point-to-point PPI inflation as the precursor to developments in consumer prices started to increase in 6/1395 and rose at a faster pace in 8/1395 and eventually reached 6.8 percent in 9/1395. In light of the lagged effect of PPI on CPI, an increase in the point-to-point CPI inflation is expected for the coming months. The difference between the point-to-point CPI and PPI inflation rates reversed course and decreased from its

lowest of 6.8 percentage points in 5th month of the year to 2.4 in the 9th month. This implies the fact that the growth rate of cost of inputs is approaching the growth rate of PPI, hence the rise

in production costs should reach retail prices at a faster pace. Figure 3 shows monthly CPI and PPI inflation rates in the first 9 months of the year.

Figure 3 - CPI and PPI Inflation Rates in the first 9 Months of the Year



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

The degree to which PPI influences CPI is also dependent on the domestic/import composition of the consumption basket. The more domestically produced goods and services in the consumption basket, the more will be the effect of PPI on CPI inflation. It is thus important to investigate the price changes in the two categories of tradable and non-tradable goods.

The point-to-point inflation rate of tradable goods started to increase from 4/1395 and reached 7.7 percent in 7/1395, mostly as a result of the strengthening of the USD versus the IRR. In contrast, the point-to-point inflation rate of non-tradable goods started a decreasing trend from the mid-Q2 and reached 11.0 percent by the end of the first month of Q3.

Latest data on the consumption basket of goods and services reveals that compared to the preceding month, the price index of all major groups has increased in 9/1395 with the exception

of “tobacco”. In the same period, the point-to-point inflation rate in “housing, water, electricity, gas and other fuels” with highest weight in the basket, increased to 9.3 percent. This rate in “food and beverages,” that has the second highest weight in the basket, reversed course and increased to 9.0 percent in 9/1395. Among major groups of the basket, “health” and “communication” had the highest and lowest point-to-point inflation rates, respectively, registering 17.1 and 0.4 percent. This rate is higher in “Services” than in “Goods”, according to the data on special groups of the basket. Hence, the rise in the overall point-to-point inflation rate has been mainly due to prices rises in items with higher weights in the consumption basket. Table 2 presents the CPI inflation rates in 12 main groups of the consumption basket.

Table 2 - Inflation Rates in Major Groups of Consumption Basket (percent)

	Annual	Point-to-Point				
	1394	5/1395	6/1395	7/1395	8/1395	9/1395
Overall	11.9	9.4	9.5	9.3	9.1	9.2
Food and Beverages	10.3	9.5	11.9	9.5	8.9	9.0
Tobacco	-3.1	12.0	6.9	10.2	10.2	11.0
Clothing and Footwear	10.4	7.0	9.1	6.3	6.1	6.5
Housing, Water, Electricity, Gas and Other Fuels.	12.2	9.5	4.5	9.0	8.8	9.3
Household Equipment and Routine Household Maintenance	5.7	4.5	18.1	4.9	5.2	5.6
Health	23.8	17.3	6.8	17.5	17.2	17.1
Transport	11.0	5.8	0.1	7.4	7.7	7.6
Communication	3.5	0.7	10.7	0.3	0.1	0.4
Recreation and Culture	14.9	8.1	21.7	10.4	11.1	8.5
Education	16.4	21.5	8.6	11.3	11.4	11.5
Restaurants and Hotels	16.1	9.1	10.2	9.0	8.7	8.8
Miscellaneous Goods and Services	11.1	10.9	9.5	9.9	9.3	9.4

Source: Central Bank of Iran, Consumer Price Index Reports

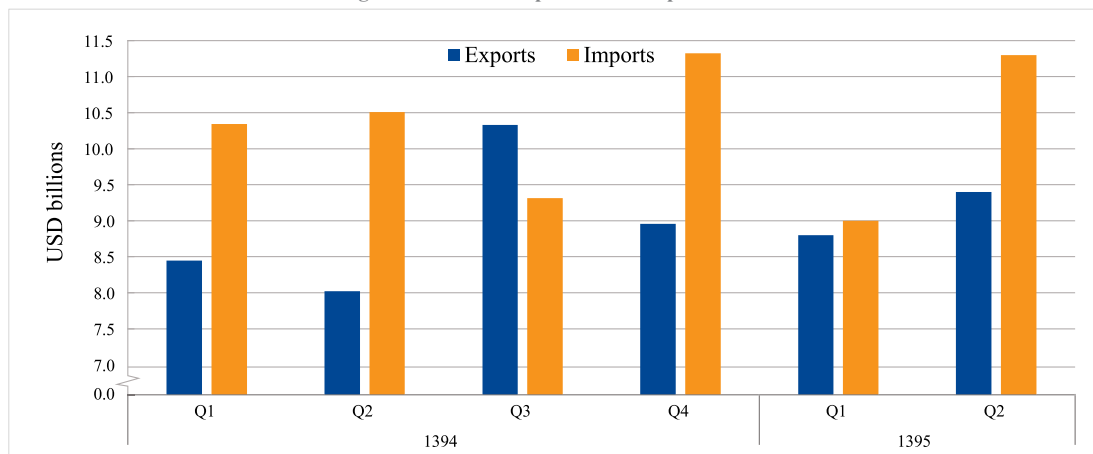
3. Balance of Payments

According to the CBI data, compared to similar period of last year, in 1395Q1 production and exports of oil (including crude oil and net exports of petroleum products) increased by 14.6 percent and 41.2 percent, respectively, to 3.5 and 2.0 million bpd. The value of oil exports (including crude oil, petroleum products, natural gas, and natural gas condensates and liquids) increased by 9.5 percent despite the fall in oil prices in the first quarter of the year. This rise, in conjunction with the fall in imports of gas and petroleum products, led to a 13.4 percent increase in oil trade balance surplus. In the same quarter, the 3.0 percent increase in non-oil exports along with the 1.5 percent decrease in non-oil imports resulted in a 7.7 percent drop in non-oil trade balance. Therefore, the net goods account rose by 36.5 percent in 1395Q1. This rise, in conjunction with the 33.5 percent increase in services account deficit and the small drop

in both net income and current transfers accounts, resulted in a 32.5 percent rise in current account surplus in Q1. In the same period, net capital outflow reached USD5 billion, indicating a 19.0 percent increase from the USD4.2 billion in 1394Q1. Considering USD6.4 billion errors and omissions, foreign reserves fell by USD6.2 billion in that quarter.

According to customs data, in 1395Q2 the value of non-oil exports (excluding natural gas condensates) and imports increased by 6.8 and 25.6 percent, respectively, from 1395Q1, and by 17.2 percent and 7.5 percent from 1394Q2. Comparing the first half of the year to the same period last year, there has been a 10.5 percent increase in the value of non-oil exports and a 2.6 percent decrease in the value of imports. Figure 4 exhibits data on imports and exports from 1394Q1 to 1395Q2.

Figure 4 - Non-oil Exports* and Imports Value



Source: Islamic Republic of Iran Customs Administration, Provisional Foreign Trade Statistics
*Excluding Natural Gas Condensates

The value of non-oil exports (including natural gas condensates but excluding crude oil, mazut, kerosene, and suitcase trade) in the first half of the year reached USD21.7 billion. Hence, non-oil trade balance experienced a surplus of USD1.4 billion in that period, in contrast to a deficit of USD0.4 billion in the first half of 1394. Table 3 presents data on non-oil exports in the first halves of 1394 and 1395. As shown there, the value share of petrochemicals has increased while the value shares

of natural gas condensates and other goods have decreased in the first six month of this year compared to the same period of last year. It seems that in post-JCPOA, the positive effects of the easing of international trade sanctions was stronger than the negative effect of oil price falls in the 3 aforementioned export items, resulting in an increase in the volume and total value of those exports.

Table 3 - Exports in the First Half of 1394 and 1395

	First Half of 1394				First Half of 1395			
	Weight (1000 tons)	Value (USD million)	Share in Total (percent)		Weight (1000 tons)	Value (USD million)	Share in Total (percent)	
			Weight	Value			Weight	Value
Petrochemicals	12,195	7,128	25.9	34.8	18,719	8,698	31.7	40.1
Natural Gas Condensates	9,210	4,011	19.5	19.6	8,901	3,496	15.1	16.1
Other Goods	25,726	9,340	54.6	45.6	31,512	9,512	53.3	43.8
Total Exports	47,131	20,479	100.0	100.0	59,132	21,706	100.0	100.0

Source: Islamic Republic of Iran Customs Administration (IRICA), Provisional Foreign Trade Statistics

During the first half of this year, the main export items were natural gas condensates with value share of 16.1 percent, liquefied natural gas (LNG) with 8.9 percent, and liquefied petroleum gas (LPG) with 3.8 percent. China, UAE, Iraq,

Turkey, and South Korea were the main exports destinations in this period, in that order. In the same period, the value share of exports to South Korea experienced a considerable rise at the expense of the other destinations. Cattle-feed corn with

the value share of 2.7 percent, soybean with 2.5 percent, and rice with 2.3 percent were the main imports items in the same period, and China, UAE, South Korea, Turkey, and Germany were the main sources of imports, in that order.

The latest statistical report by the Customs Administration indicates that in the first 8 months of the year the value of exports (including natural gas condensates) and imports increased by 5.7 percent and 0.9 percent, and reached USD28.1

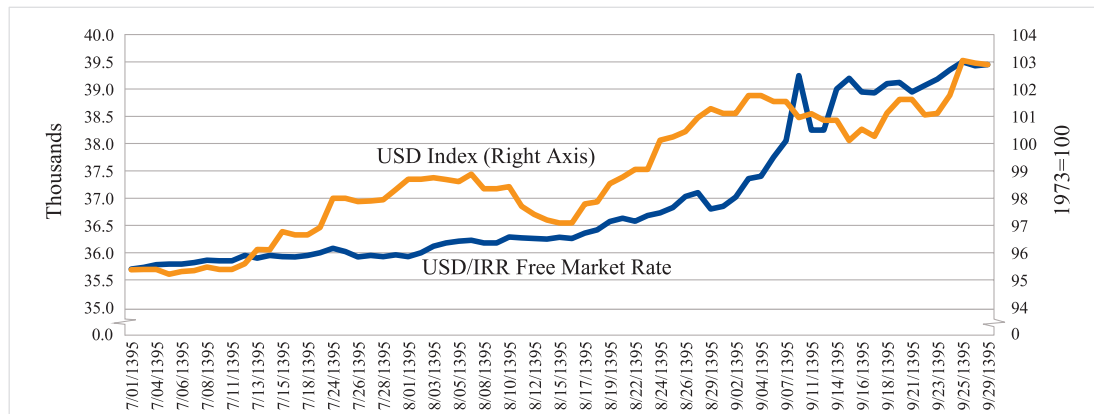
billion and USD27.4 billion, respectively, compared to the same period the year before. The exports value of natural gas condensates in the same period has increased by 46.7 percent. In this 8-month period, the value share of consumer, capital and intermediate goods accounted for 10, 68, and 22 percent of the total value of imports, respectively, indicating that domestic production is still highly dependent on imports of machinery and raw materials.

4. Foreign Exchange Market

The market exchange rate of the USD was more volatile in 1395Q3 than in the two preceding quarters and in 9/1395 touched IRR39,500 and registered the highest price since President Rouhani took office. The exchange rate was hovering around IRR35 thousand during the first seven months of the year but then started to increase and averaged IRR38 thousand in 9/1395. These fluctuations are attributed to economic and political developments, both nationally and internationally.

The overall weakening of the IRR vs. the USD was helped by the drop in petrochemical exports, a major source of foreign exchange supply, in 7/1395 compared to the same period of the year before. Additionally, increased foreign exchange demand by commercial companies for their international settlements as well as increased speculative demand pushed the USD/IRR exchange rate up from the demand side. Figure 5 depicts the daily free market USD/IRR exchange rate in 1395Q3.

Figure 5 - Daily USD Index and USD/IRR Market Exchange Rate in 1395Q3



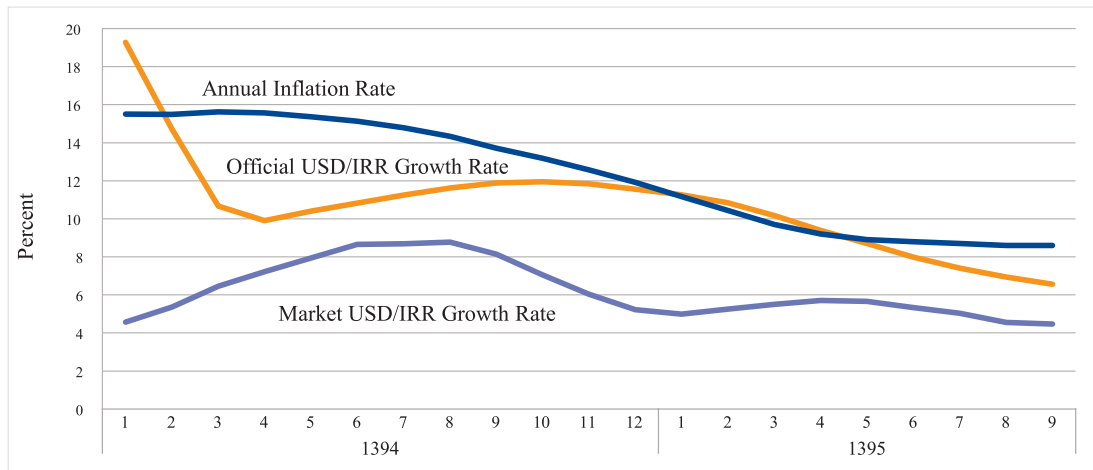
Source: <https://www.investing.com/>, and <https://www.sarafiroyal.com/>, accessed on 12/24/2016

Recent changes in the US dollar index, which measures the value of the USD against six major world currencies, implies the global strengthening of the USD. This index started a moderate upward trend when the US economy exited from its 2008 financial crisis but in November 2016 within 3 weeks after Donald J. Trump's victory in the presidential election surged and for the first time surpassed 100. The fall in the US unemployment rate to 4.6 percent also indicates that the economy has improved and hence will further strengthen the dollar. Such factors eventually led to a 0.25 percentage points increases in US interest rates on December 14. Despite the fact that the Iranian foreign exchange market is not much affected by international developments given that high share of the CBI in foreign exchange market, the speculative demand in

the Iranian foreign exchange market following the surge in the USD index led the free market rate to increase along with the USD index, but at a slower pace.

Unlike its free market rate, the official USD/IRR exchange rate did not fluctuate much and grew by an average of 2.4 percent in the two preceding quarters. As the USD/IRR free market exchange rate grew faster than the official rate, the gap between the two rates widened from 14 percent at the end of 05/1395 to 21 percent at the end of 9/1395. This became an excuse for the CBI to once again postpone the exchange rate unification at least till next year. Figure 6 exhibits the average annual inflation rate and the average growth rates of official and free market USD/IRR exchange rates during the first 9 months of 1395.

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



Source: Central Bank of Iran; Research calculations

Given the tendency to keep the changes in nominal exchange rates to a minimum, the fall in annual inflation rates increases CBI's ability to adjust foreign exchange rates in line with inflation differentials and reduce the real rate at which the IRR

is strengthening vs. foreign currencies. The exemption of Iran from oil production cuts and the 10-year extension of the Iran Sanctions Act by the US Congress in 1395Q3 are among the major opposing influences on the foreign exchange market.

5. Monetary and Credit Aggregates

In the first half of 1395 the monetary base grew by 7.9 percent compared to the end of 1394 and by 20.4 percent compared to the same period of the year before. The main reason for this 20.4 percent expansion is a 203.5 percent increase in CBI's net claims on the public sector, accounting for 15.9 percentage points of that growth. The considerable increase in this component of the monetary base is the result of a 23.8 percent rise in CBI claims on the public sector and 23.6 percent drop of the public sector deposits with the CBI. However, the CBI net claims on public companies and institutions is three times of the CBI's net claims on the government which is attributed to the low amount of deposits of public companies and institutions with the CBI compared to the government's deposits. As the government budget deficit increased from the beginning of the second half of 1394, the increase in CBI claims on the public sector and the decrease in the public sectors deposits with the CBI have accelerated.

The 16.9 percent increase in CBI claims on banks is the second source of the monetary base growth, accounting for 9.9 percentage point of its 20.4 percent growth in the 12-month period ending in 6/1395. The main reason for increase is the rise in CBI claims on public and non-public commercial banks and non-bank financial institutions. This originates in the rise in the facilities extended to public and non-public sectors for financing small and medium sized enterprises (SMEs) at the

time the banks and financial institutions lending ability is reduced severely. Repeated increases of the interbank interest rate and banks' competition to attract deposits by offering interest rates above those approved by the Money and Credit Council especially in 1395Q3 point to the diminishing lending ability of banks - which is the result of delays in restructuring the banking system. It should be noted that 3 sets of plans have been devised and legislated for restructuring the banking system, but the sluggish implementation of them has rendered them ineffective.

The increase in CBI's net foreign assets by 5.1 percent, mainly due to the fall in CBI foreign debts, is the third origin of the monetary base growth, accounting for 6.5 percentage points of the 20.4 percent growth. This indicates that the amendment to the Budget Law of 1395 in the first half of the year was not implemented, hence revaluation of CBI foreign assets, settlement of CBI claims on banks, settlement of banks claims on the government, and the increase in government capital in state-owned banks from the revaluation of assets are not yet reflected in the balance sheet of the banking system. Finally, the 12.5 percent increase in "others" component of the monetary base contributed -11.9 percentage point to the monetary base growth. Table 4 illustrates monetary base components from 1394Q1 to 1395Q2.

Table 4 - Monetary Base Components (end of period, in IRR trillions)

	1394				1395		1395Q2 to 1394Q2	
	Q1	Q2	Q3	Q4	Q1	Q2	Growth Rate (percent)	Share of Growth (percentage point)
Monetary Base	1,317.2	1,375.0	1,427.8	1,533.6	1,585.2	1,655.1	20.4	20.4
CBI Foreign Assets (net)	1,653.4	1,769.8	1,806.6	1,936.4	1,876.6	1,859.4	5.1	6.5
CBI Claims on Public Sector (net)	112.7	107.2	120.0	182.2	238.9	325.3	203.5	15.9
CBI claims on Banks (net)	813.7	806.0	829.9	836.3	895.1	942.2	16.9	9.9
Others (net)	-1,262.6	-1,308.0	-1,328.7	-1,421.3	-1,425.4	-1,471.8	12.5	-11.9

Source: Central Bank of Iran, Selected Economic Indicators, 8/1395

The M2 money multiplier reached 6.8 at the end of summer, showing a 7.1 percent increase from last summer. An examination of the M2 money multiplier components in the period under review reveals that the rise in the ratio of notes and coins with the public to deposits, as well as the rise in the ratio of legal reserves to deposits, were factors leading to falls in M2 money multiplier while the fall in the ratio of excess reserves to total deposits was a factor in increase it. The balance of M2 liquidity at the end of summer increased by 28.6 percent compared to last summer and by 10.4 percent compared to the end of 1394, reaching IRR11,227.1 trillion as a result of the rise in monetary base and the M2 money multiplier. An examination of the M2 components reveals that M1 and quasi-money rose by 25.4 percent and 29.1 percent by the end of the summer compared to the end of last summer, accounting for 3.4 and 25.2 percentage points of the liquidity growth rate, respectively. During this period, cash and coins with the public rose by 7.4 percent and sight deposits rose by 31.7 percent, accounting for 1.9 and 23.5 percentage points of the M1 growth rate, respectively. Sight deposits grew by 9.3 percent in 1395Q2, 3.6 percentage points higher than the rate

in 1394Q2. Quasi-money also rose by 5.6 percent in 1395Q2 which is higher than the 4.8 percent in 1395Q1 but still below the quarterly rates in 1393 and 1394. These led to 13.2 percent and 86.6 percent M1 and quasi-money share of liquidity at the end of 1395Q2, respectively. Table 5 illustrates the components of M2 money multiplier and liquidity (M2) from 1394Q1 to 1395Q2. The discretionary decrease in interest rates on time deposits accelerated the conversion of time deposits to sight deposits. Besides, the narrower profit margin originated from discretionary reduction of lending rates has intensified banks' competition for attracting deposits by offering higher interest rates. This may result in a gradual slowdown in conversion of time deposits to sight deposits. However, higher fluctuations in parallel markets in recent months may exacerbate the instability of the banking system due to increasing conversion of time deposits to sight deposits. Under such circumstances, existing problems in the banking system will continue to frustrate efforts aimed at reducing real deposit rates and thereby stimulating consumption and investment.

Table 5 - M2 Money Multiplier and Liquidity Components (end of period, in IRR trillions)

	1394				1395		1395Q2 to 1394Q2 Growth Rate (percent)
	Q1	Q2	Q3	Q4	Q1	Q2	
M2	8,166.7	8,727.5	9,251.7	10,172.8	10,595.0	11,227.1	28.6
Money (M1)	1,123.8	1,180.2	1,158.1	1,367.0	1,364.4	1,480.3	25.4
Notes and coins with the public	297.6	306.4	301.2	371.9	311.6	329.2	7.4
Sight deposits	826.2	873.8	856.9	995.1	1,052.8	1,151.1	31.7
Quasi-money	7,042.9	7,547.3	8,093.6	8,805.8	9,230.6	9,746.8	29.1
M2 Money Multiplier	6.2	6.3	6.5	6.6	6.7	6.8	7.1

Source: Central Bank of Iran, Selected Economic Indicators, 8/1395

The balance of extended facilities by the banking system at the end of the first half of the year rose by 25.3 percent, registering the highest point-to-point growth rate in the period. Part of this rise is attributed to the considerable increase in the balance of facilities in 6/1395. In the same period the balance of deposits and deposits after deduction of legal reserves rose by 25.2 and 26.6 percent, respectively. Therefore, the ratio of facilities to deposits (after the deduction of legal reserves) reversed its falling trend from the beginning of 1395Q2 and reached 85.9 percent at the end of that quarter. This ratio was 82.1 percent in 1395Q1. According to the CBI, during the first half of the year IRR2,328.8

trillion facilities were extended to various economic sectors, which was 45.4 percent higher than in the same period last year. However, as no breakdown of the new extended facilities and the rolled-over ones are available, an increase or decrease in the lending ability of banks cannot be inferred. Extended facilities aimed at financing working capital and private consumption had the highest value share of the total extended facilities at 65.6 percent and 10.0 percent, respectively. The main recipients of the extended facilities were "services" with 41.3 percent followed by "manufacturing and mining" with 28.0 percent of the total.

6. Government Budget

6.1 Performance in the first half of 1395

Government tax revenues in the first half of 1395 amounted to IRR433.1 trillion, which is below the legislated amount of IRR529.1 trillion but is 29.6 percent higher than that in the same period last year. Compared to the same period last year, the share of direct tax revenues decreased from 57.6 to 56.4 percent and the share of indirect taxes increased.

An examination of direct tax revenues reveals that the tax share of legal entities has been continuously decreasing in recent years. The steep fall in the tax share of non-governmental legal entities from 28.3 percent in the first half of last year to 23.6 percent in the first half of this year was the main reason for this decline. In contrast, the tax share of governmental legal entities increased in terms of both provisional and delayed taxes. It is noteworthy that despite the government's declared policy regarding the

taxation of institutions and foundations affiliated with the Islamic Revolution, tax revenues from them amounted to IRR100 billion in the first half the year, which is half of that in the same period of last year. The share of private sector employees in income tax revenues decreased and that of public sector employees increased. While wealth tax revenues did not experience much change.

In indirect tax revenues, the share of imports tax that had fallen from 10.8 percent in the first half of 1393 to 9.5 percent in the same period of 1394, fell further to 9.3 percent in the first half of the current year. Revenues from tax on imports of vehicles more than doubled from IRR2.1 trillion in the first half of last year to reach IRR4.6 trillion in first half of the current year. The tax on vehicle licensing increased in the same period, while the tax share

of vehicle transactions decreased. In other words, the market for new and imported vehicles experienced a boost. During the first half of the year the share of tax revenues emanating from goods and services in total tax revenues continued to increase, while in a change from the past, value added taxes did not increase by much. In a reversal of recent years' upward trend in value added taxes, in the first half of this year the share of value added taxes in total tax revenues fell by 5.2 percentage points from the first half of last year to reach 22.2 percent.

The 12.3 percent fall in oil revenues in the first half of this year compared to the same period in 1394 resulted in worsening the budget deficit despite the significant increase of the overall tax revenues. The budget deficit during these two periods more than doubled. The government's oil revenues in 1395 is partly due to

the CBI having transferred to the government in late 1394 part of its expected 1395 oil revenues; and the settlement of that advance payment in this year has led to the severe fall in the government's disposable oil revenues.

The 53.5 percent rise in development expenditures in the first half of the year compared to the same period of 1394, although it was still less than half of the legislated amount, exerted additional pressure on the budget deficit. In the same period, disposal of financial assets has increased to even surpass oil revenues. As such, the strengthening of the debt market has had a significant role in financing development expenditures in the face of declining oil revenues. Table 6 shows the fiscal performance of the government in the first two quarters of this year.

Table 6 - Government Revenues and Expenditures (IRR trillions; percent)

	1395Q1 Performance	1395Q2 Performance	1395Q2 to 1394Q2 Growth Rate (percent)	1395 first half to 1394 first half Growth Rate (percent)	1395 first half Performance (percent of approved)
Revenues	255.5	580.9	28.3	12.1	69.4
Tax Revenues	184.9	248.2	29.3	29.6	81.9
Other Current Revenues	26.3	130.2	62.4	19.7	57.3
Oil Revenues	43.6	201.5	12.4	-12.3	64.6
Other Non-financial Revenues	0.7	1.0	-25.1	4.5	7.4
Expenditures	415.3	685.3	39.8	26.0	79.6
Current Expenditures	368.8	582.2	48.2	26.5	87.3
Development Expenditures	1.4	130.9	52.6	53.5	45.2
Budget Balance	-159.8	-104.4	177.7	106.6	148.9

Source: Central Bank of Iran, Selected Economic Indicators Reports, Government Budget and Fiscal Data

6.2 Budget Bill of 1396

In the budget bill for 1396, the 10.9 percent rise in the government general budget and the 10.6 percent rise in the general budget are in line with the expected inflation rate in 1396. Government employees' income is to increase by 10 percent and general

resources rise by only 8.7 percent. The increase in budget items by rates around the expected inflation rate indicates the intention to control further expansion of the government. Table 7 presents the main subdivisions of the 1394 budget bill.

Table 7 - Main Components of the Budget Bill of 1396 (IRR trillions; percent)

	1395 Budget Law	Growth compared to the first ceiling of 1394 Budget Law	Growth compared to the second ceiling of 1394 Budget Law	1396 Budget Bill	Growth compared to the 1395 Budget Law
General Government Budget	9,785.5	17.8	15.6	10,849.4	10.9
General Budget	3,354.9	30.0	22.3	3,711.2	10.6
General resources	2,943.9	33.8	24.6	3,200.0	8.7
Dedicated revenues	411.0	7.8	7.8	511.2	24.4
Budget of state-owned companies, banks and for-profit institutions affiliated to government	6,816.9	13.3	13.3	7,565.4	11.0

Source: General Government Budget Laws; 1396 Budget Bill

Among the components of general resources in the 1396 budget bill, compared to the 1395 budget law current revenues show very small growth compared to the considerable 49.1 percent rise in oil revenues. The rise in forecasted oil revenues emanates from oil prices averaging USD55 per barrel, oil exports rising to 2.4 million bpd, and USD being converted at IRR33,000. The tax revenues are expected to increase by 8.6 percent while other current revenues are to decrease by 12.5 percent and thus current revenues are to rise very little. The 23.8 percent increase

in income tax revenues in 1396 budget bill indicates that the government intends to rely more on this type of tax revenues.

In disposal of financial assets, despite the government's declared intention to rely more on Islamic securities and foreign debts, the net disposal of financial assets are to decline by 32.9 percent as a result of a considerable drop in disposal of state-owned companies. The slowing trend of privatization in this bill is a noticeable departure from the recent past. Keeping the share of the National Development Fund in oil revenues at its previous

level of 20 percent may be a weakness of this bill as it may not enable the Fund to play its role in mobilizing the required private capital necessary for achieving a desirable economic growth. Expecting IRR35 trillion from the disposal of development

projects to the private sector in this bill is questionable given that the government's failure to take such actions in recent past. Table 8 exhibits the resources and expenditures in the 1396 budget bill.

Table 8 - Resources and Expenditures in 1396 Budget Bill (IRR trillions; percent)

Resources	1396 Budget Bill	Growth from 1395 Budget Law	Growth from Forecasted Performance of 1395*	Expenditures	1396 Budget Bill	Growth from 1395 Budget Law	Growth from Forecasted Performance of 1395*
Current Revenues	1,595.9	1.4	37.9	Current Expenditures	2,363.7	10.6	26.7
Tax Revenues	1,127.3	8.6	32.6				
Other Current Revenues	468.5	-12.5	52.6				
Operating Balance	-767.9	36.2	8.3	Acquisitions of Non-financial Assets	627.1	9.1	141.5
Disposal of Non-financial Asset	1,161.4	46.9	139.8				
Of Oil and Oil Products	1,110.9	49.1	131.0				
Of Asset Disposals	15.5	0.0	364.7				
Of Disposal of Development Projects	35.0	16.7	-				
Net Disposal of Non-financial Assets	534.3	147.7	137.8	Acquisition of Financial Assets	209.2	-9.7	955.5
Disposal of Financial Assets	442.7	-23.6	-17.7				
Net Disposal of Financial Assets	233.6	-32.9	-54.9				

*The performance for the whole year is forecasted based on the performance in the first half of the year.

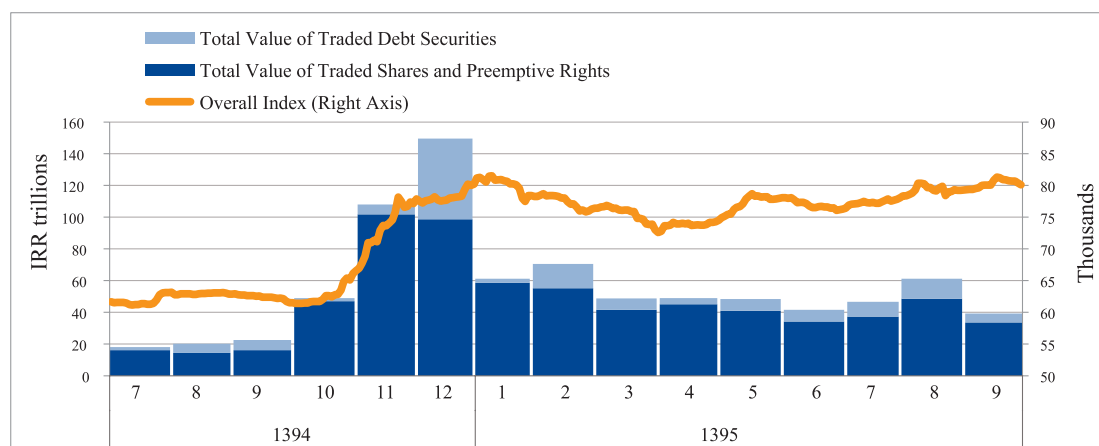
Source: Central Bank of Iran, Selected Economic Statistics; 1396 Budget Bill

7. Capital Market

The overall index of the Tehran Stock Exchange (TSE) started an upward trend in the early days of the second half of the year and after some fluctuations reached 81,342 before closing at 80,122 on the last day of 1395Q3, showing a 3,672 point increase from

the same day in 1394. The value of transaction in “Shares and Preemptive Rights” fell to IRR33.7 trillion in the last month of 1395Q3 to register the lowest monthly value so far in 1395.

Figure 7 - Daily TSE Overall Index and Monthly Value of Shares & Preemptive Rights and Debt Securities Traded



Source: Report of Performance of Securities Market, Tehran Stock Exchange; Rahavard Novin Database and Software

The 3rd, 4th and 5th series of Islamic treasury bills matured in 1395Q3 and the funds were fully paid by the Treasury on time. The 9th and 10th series of these bills totaling IRR30 trillion have also been issued with maturities in 6/1396 and 7/1396 and are

being traded in the OTC market. Additionally, IRR45 trillion of short-term Islamic treasury bills with 4 and 5 month maturities were issued and as of late 1395Q3 are being traded in OTC market.

8. Other Economic Developments

The 10-year extension of the United States' Iran Sanctions Act (ISA) by the US Senate on December 1, 2016, is a noteworthy development in the aftermath of the JCPOA. According to the initial version of ISA, a investment exceeding USD20 million by an American or non-American firm for the development of Iranian oil resources would trigger sanctions by the US against that firm. The Senate voted 99-0 in favor of the resolution and the President did not veto it, although he did not sign it either, letting it become law. In accordance with the JCPOA, since the signing of that agreement the US government has abstained from implementing ISA sanctions. But the outcome of the November presidential election in the US has risen concerns about the future of the JCPOA. Regardless of the upcoming US administration's behavior, since the JCPOA is signed among the P5+1 countries and Iran, the US administration should not be able to unilaterally violate it.

In early Fall the CBI proposed changing the national currency from Rial to the more commonly used unit Tooman that equals 10 Rials. Considering the circulation of 8 billion notes and 5.3 million coins, such a change is estimated to cost IRR52 trillion. However this figure is not included in 1396 budget bill. According to CBI authorities, the substitution of old notes and coins with the new ones would be carried out gradually.

Census of population and housing which is conducted once every 5 years was carried out in 1395Q3, and for the first time online as well. Also, a USD16.6 billion deal between Iran Air and Boeing was signed in in the last days of Fall, according to which 80 aircrafts would be delivered to Iran by 2028. This deal was made possible by the JCPOA and is a first in Iran's international trade in over thirty years.

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Economic Research Department, Middle East Bank

Contributors: Farshid Eslambolchi, Arian Aghabeigi, Mohammad Kousari, and Hossein Soltanabadi

Graphic Design by Hannaneh Niazmand

Middle East Bank Headquarters

No. 2, 5th St., Ahmad Qasir (Bokharest) Ave., Tehran, Iran

Tel: (+98 21) 42178000
www.middleeastbank.ir

Fax: (+98 21) 88701095
info@middleeastbank.ir