8

Recent Economic Developments in Iran

A Quarterly Report

بانک خاورمیانه
Middle East Bank

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Notes

Note 1: In this Report the growth rate of a variable means the percentage change of that variable during the period under review, or at the point under discussion, from the similar period or point in the preceding year. As such, "the growth rate of oil revenues in the first quarter of 1396" indicates the percentage change in oil revenues between the first quarter of 1395 and the first quarter of 1396.

Note 2: The Persian Calendar is 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 1396 that started on March 21, 2017, and ends on March 20, 2018. The first quarter of 1396 (referred to as 1396Q1), spring 1396, roughly corresponds to the second quarter in the current Gregorian calendar (2017Q2).

The following provides an easy reference while reading this Report:

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**

1396Q1 = 03/21/2017 – 06/21/2017, roughly **2017Q2**

1396Q2 = 06/22/2017 – 09/22/2017, roughly **2017Q3**

Iran's Economy at a Glance

	1395Q1	1395Q2	1395Q3	1395Q4	1395	1396Q1	1396Q2
Participation & Unemployment Rates (percent)							
Participation (10 years and over)	39.5	40.4	38.9	38.9	39.4	40.6	41.0
Unemployment (10 years and over)	12.2	12.7	12.3	12.5	12.4	12.6	11.5
Unemployment (Youth aged 15-24)	27.8	30.2	30.4	28.1	29.2	28.8	-
Real Growth Rates of GDP and its Subsectors at Constant 1390 Prices (percent) *							
Gross Domestic Product (GDP)	7.5	12.9	16.8	12.9	12.5	6.5	-
Oil	57.6	66.2	77.7	47.1	61.6	4.7**	-
Agriculture	3.5	4.1	5.0	4.4	4.2	3.1	-
Industries and Mining	-5.1	3.0	4.1	6.4	2.2	5.1**	-
Services	-0.7	4.2	6.0	4.9	3.6	8.3	-
GDP (Excluding Oil)	-1.8	3.9	5.4	5.6	3.3	7.0	-
Gross Fixed Capital Formation	*-16.3*	*3.1*	*-9.5*	*3.1*	*-3.7*	*7.1*	-
Oil (thousand barrels per day)							
Production	3,544	3,639	3,963	3,909	3,761	3,878***	-
Export	2,008	2,157	2,426	2,316	2,224	-	-
Inflation Rates (percent)							
Growth Rate of Consumer Price Index (1395=100)	7.5	9.2	8.9	10.5	9.1	11.4	8.8
Growth Rate of Producer Price Index (1390=100)	2.7	3.0	5.2	8.8	5.0	8.9	9.9
Balance of Payments (USD millions)							
Oil Exports	11,640	13,167	15,070	15,875	55,752	-	-
Non-Oil Exports	7,264	6,073	7,078	7,811	28,226	-	-
Imports of Goods	12,382	15,114	16,761	18,879	63,135	-	-
Goods Account (Net)	6,522	4,126	5,387	4,807	20,843	-	-
Non-Oil Goods Account (Net)	-4,817	-8,718	-9,135	-10,851	-33,521	-	-
Current Account	5,231	3,459	3,225	4,473	16,388	-	-
Capital Account	-5,022	-5,814	-3,298	-4,154	-18,288	-	-
Change in Foreign Reserves	-6,171	-1,473	-231	209	-7,666	-	-
Foreign Exchange Rates (USD/IRR daily average)							
In Free Market	34,691	35,326	36,987	38,581	36,487	37,494	38,236
In Interbank Market	30,358	31,014	31,845	32,380	31,458	32,445	32,900
Monetary and Credit Aggregates (end of period, in IRR trillions)							
Monetary Base (M0)	1,585.2	1,655.1	1,704.7	1,798.3	1,798.3	1,851.9	-
Central Bank Claims on Banks	895.1	942.2	1,047.9	996.9	996.9	1,013.7	-
Central Bank Claims on Public Sector (Net)	238.9	325.3	233.1	202.6	202.6	282.0	-
Liquidity (M2)	10,595.0	11,227.1	11,848.6	12,533.9	12,533.9	13,149.1	-
Money (M1)	1,364.4	1,480.3	1,540.7	1,630.3	1,630.3	1,674.1	-
Sight Deposits	1,052.8	1,151.1	1,213.0	1,237.0	1,237.0	1,307.0	-
Non-sight Deposits (Quasi-money)	9,230.6	9,746.8	10,307.9	10,903.6	10,903.6	11,502.0	-
Government Budget (IRR trillions)							
Total Revenues	255.5	580.9	473.5	892.7	2,202.7	426.1	-
Tax Revenues	184.9	248.2	221.9	359.7	1,014.7	181.9	-
Oil Revenues	43.6	201.5	176.8	316.9	738.8	188.9	-
Other	27.1	131.1	74.8	216.1	449.1	55.3	-
Total Expenditures****	416.0	674.7	488.2	912.4	2,491.2	600.8	-
Current Expenditures	368.8	582.2	449.2	670.0	2,070.2	548.8	-
Development Expenditures	1.4	120.9	36.0	262.7	421.0	8.2	-
Budget Balance	-160.4	-93.8	-14.7	-19.7	-288.6	-174.7	-
Tehran Stock Exchange (end of period)							
Overall Index (TEDPIX)	72,615	76,451	80,123	77,230	77,230	78,736	85,832
Financial Index	145,481	155,263	151,049	131,865	131,865	130,664	129,604
Industrial Index	60,464	63,495	67,466	66,100	66,100	67,681	74,823
Market Capitalization (IRR trillions)	3,081	3,168	3,374	3,220	3,220	3,201	3,396

Sources: Central Bank of Iran (CBI), and Statistical Centre of Iran (SCI), various reports
* Statistics for 1395 are based on CBI reports at basic prices and statistics for spring of 1396 are based on SCI reports at market prices.
** Due to differences in the definitions of "Oil" and "Industries and Mining" sectors by CBI and SCI, growth rates of these two sectors in spring of 1396 are not fully comparable to their growth rates in preceding quarters.
*** According to OPEC reports from direct sources
**** 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

While the Central Bank of Iran (CBI) is yet to publish its national accounts statistics for the first quarter of 1396 (hereafter referred to as 1396Q1, almost overlapping with 2017Q2 in the Gregorian calendar), the Statistical Center of Iran (SCI) has recently published its version of these data in constant 1390 prices. SCI statistics indicate the persistence of high GDP growth observed in 1395 and positive growth in the value-added of all major economic sectors, including construction, in spring of 1396. On the expenditures side, they indicate a significant rise in private consumption and some growth in gross fixed capital formation in both machinery and construction.

In line with the exceptionally high 11.0 percent GDP growth in 1395 that was mainly due to the implementation of the Joint Comprehensive Plan of Action (JCPOA) that permitted the utilization of high unused capacity in various sectors, especially in the oil sector, the GDP grew by 6.5 percent in spring of this year. In 1395 the 35.0 percent growth in value-added of the extraction of oil and natural gas subsector had caused the oil-GDP growth to be far above the non-oil one. But of course such a high growth rate in the oil sector could not persist for long and its value-added grew by only 4.7 percent in 1396Q1, leading to a non-oil GDP growth of 7.0 percent that is slightly *above* the overall GDP growth rate of 6.5 percent.

As shown in Table 1, in addition to the extraction of oil and natural gas, other subsectors of the industry sector also experienced positive growth in 1396Q1, with construction growing the fastest. Construction value-added rose by 7.1 percent in the footsteps of another 4.0 percent growth in its preceding quarter, which occurred after contractions in eighteen consecutive quarters from 1391Q2 to 1395Q3. Given that the long recession in the construction sector had led to unused capacities in construction-related industries such as basic metals and non-metal ores, the turnaround in the construction sector should have activated a portion of those unused capacities, too.

In 1396Q1 the agriculture sector continued its growth in recent years by growing at 3.1 percent, and the services sector which accounts for the highest share of the GDP, grew by 8.3 percent. Among the subsectors of services, financial intermediation accounted for the highest growth of 32.2 percent which was not unexpected given that it had grown by 66.3 percent during its preceding three quarters following a 25.0 percent contraction in 1395Q1.

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

	1395					1396
	Q1	Q2	Q3	Q4	Year	Q1
Industry	**13.3**	**18.8**	**20.1**	**18.1**	**17.6**	**4.9**
Manufacturing	2.7	5.0	6.5	11.7	6.5	5.8
Mining	26.0	38.9	40.5	27.1	32.9	4.6
Extraction of Oil and Natural Gas	27.9	41.6	43.4	28.5	35.0	4.7
Other Mines	-6.4	-3.6	-2.8	3.1	-2.5	4.2
Water, Gas, and Electricity Supply	20.3	14.2	28.9	16.7	20.1	2.3
Construction	-15.1	-3.8	-30.6	4.0	-11.3	7.1
Agriculture	**10.7**	**0.7**	**3.1**	**0.5**	**3.3**	**3.1**
Services	**-0.9**	**3.3**	**5.7**	**15.7**	**5.8**	**8.3**
Gross Domestic Product	**5.8**	**9.8**	**11.9**	**16.3**	**11.0**	**6.5**
Non-oil Gross Domestic Product	**1.1**	**4.0**	**6.2**	**13.8**	**6.3**	**7.0**

Source: Statistical Center of Iran, Report of National Accounts

An examination of the GDP from the expenditures side reveals that in 1396Q1, as in its preceding quarter and unlike in other quarters since 1391, gross fixed capital formation grew in both machinery and construction. Private consumption expenditures rose by 6.9 percent and government consumption expenditures by 6.5 percent-- the latter is mainly attributed to the 48.8 percent rise in government current expenditures in that quarter. Net exports of goods and services contracted by 7.3 percent for the first time in the past 15 quarters, due mainly to a significant increase in the value of imports. Table 2 presents real quarterly growth rates of GDP components in 1395 and 1396Q1.

Table 2 - GDP Growth Rates from the Expenditures Side at Constant 1390 Prices (percent)

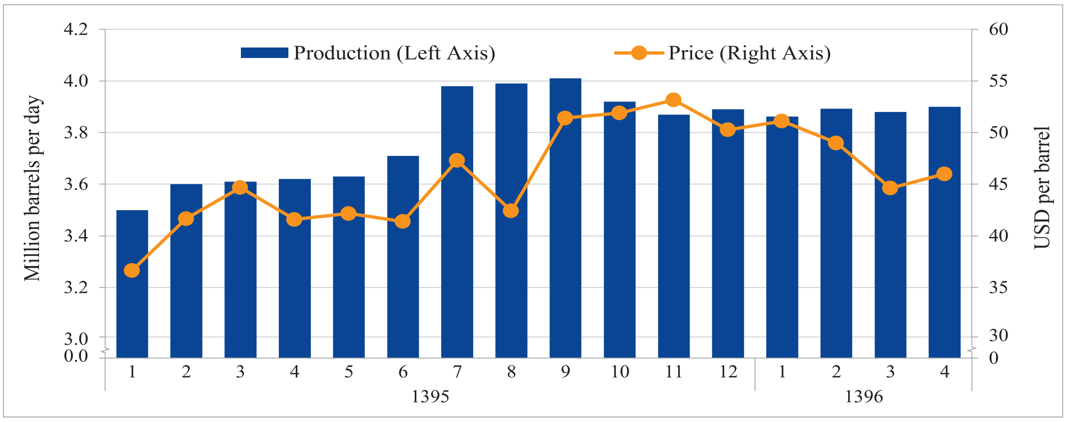
	1395					1396
	Q1	Q2	Q3	Q4	Year	Q1
Private Consumption	**1.4**	**2.8**	**1.6**	**7.5**	**3.4**	**6.9**
Government Consumption Expenditures	**3.5**	**3.5**	**3.5**	**3.5**	**3.5**	**6.5**
Gross Fixed Capital Formation	**-11.0**	**-2.6**	**-15.6**	**6.2**	**-5.8**	**7.1**
- in Machinery	-5.9	-1.0	4.0	8.5	1.3	6.9
- in Construction	-15.5	-3.8	-30.5	4.3	-11.3	7.3
Net Exports of Goods and Services	**81.6**	**84.5**	**132.4**	**68.7**	**89.0**	**-7.3**
Exports	57.6	64.2	83.0	42.3	60.7	-1.6
Imports	5.4	7.8	12.0	-9.9	3.4	20.1
Gross Domestic Product at Market Prices	**5.8**	**9.8**	**11.9**	**16.3**	**11.0**	**6.5**

Source: Statistical Center of Iran, Report of National Accounts

1.1 Energy

During the first four months of 1396 Iran's crude oil production averaged 3.9 million barrels per day (bpd) as reported by OPEC. The price of Iran's heavy crude oil was generally falling in spring and touched its low of the recent seven months at USD44.6 per barrel at the end of that season. The price rose slightly in the early summer, as shown in Figure 1, and surpassed USD50 per barrel at the end of that quarter[1]. According to the latest data, oil exports increased by almost 30 percent and averaged 2.3 million bpd in 1395Q4.

Figure 1 - Monthly Crude Oil Production and its Average Price*



Source: OPEC monthly reports, available at: http://www.opec.org/opec_web/en/publications/338.htm
*OPEC statistics are based on Gregorian calendar years and their conversion into Persian calendar years are only approximate.

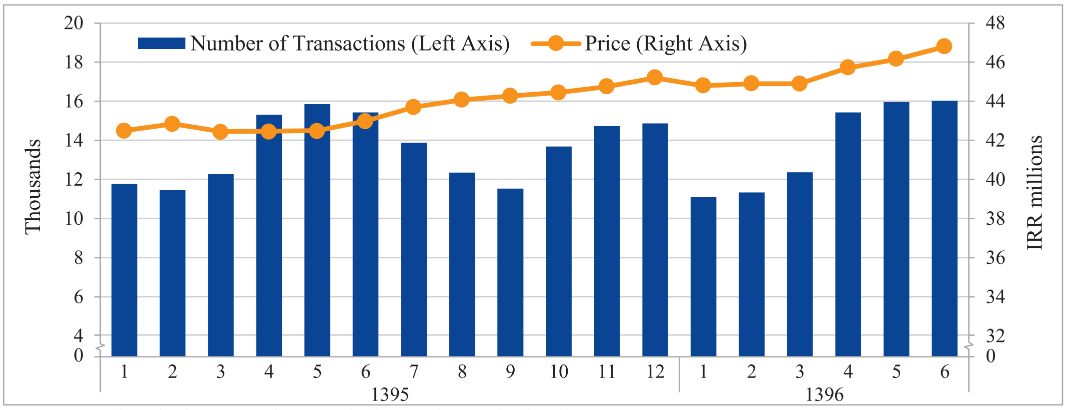
In the early 1396Q2 the National Iranian Oil Company and a consortium led by Total of France signed a USD4.8 billion contract commonly referred to as IPC (Iranian Petroleum Contract). This 20-year contract is the largest investment by foreign companies in Iran since the signing of the JCPOA. The consortium shares are 50.1 percent by Total of France, 30.0 percent by CNPC of China, and the remaining 19.9 percent by Petro-Pars of Iran. The project is for a daily production of 56 million cubic meters of sour gas from the South Pars Field in the Persian Gulf that is shared with Qatar.

1.2 Housing

On the basis of the latest SCI statistics, the value-added of construction that has been contracting continually during eighteen consecutive quarters from 1391Q2 to 1395Q3, reversed course in 1395Q4, and rose by 7.1 percent in spring of this year. Construction sector of Iran's national accounts encompasses housing, roads, tunnels, canals, airports, ports, and other construction-related activities, and housing subsector per-se seems not to have accounted for a significant share of this 7.1 percent growth.

Latest housing statistics are for residential units in Tehran in the first half of 1396 (1396H1) and indicate that the number of transactions and the average price of a square meter of residential units in Tehran have risen by 2.8 and 6.2 percent, respectively. However, these growth rates do not signal a significant change in the expectations of the market players in this period and so investment in housing and its value-added are not expected to have risen. Figure 2 depicts the trend of average price of a square meter of residential units traded and the number of transactions in Tehran. As can be seen the trend of the number of transactions in 1396H1 is very similar to that in 1395H1. Also, the average price of a square meter of residential units has fallen slightly in the first month of the year, which is often the case, but has started to rise at a rate below the inflation rate during the recent 15 months and registered IRR46.7 million in the middle of the summer.

Figure 2 - Moving Average of the Price of a Square Meter of Residential Units and the Number of Transactions in Tehran



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

1. The oil prices released by unofficial sources are available at: http://oilprice.com/oil-price-charts

1.3 Labor Force

In 1396Q1 the unemployment rate rose by 0.4 percentage points to 12.6 percent despite the net job creation of 700 thousand from a year earlier, indicating a 3.1 percent rise in the number of the employed population. These numbers point to the higher growth of active population than the employed population. Active population grew by 3.6 percent in the same quarter which corresponds to 920 thousand individuals. In other words, the unemployment rate rose due to the oversupply of the labor force. The underemployment ratio also rose by 1.7 percentage points to 10.2 percent in the same quarter, as 2.4 million employed individuals worked less than 44 hours a week despite having been willing to work more hours. Table 3 exhibits quarterly labor market indices since 1395Q1.

Table 3 - Labor Market Indices for the Population Aged 10 and Over (percent)

	1395					1396
	Q1	Q2	Q3	Q4	Year	Q1
Unemployment Rate	12.2	12.7	12.3	12.5	12.4	12.6
Economic Participation Rate	39.5	40.4	38.9	38.9	39.4	40.6
Share of Underemployment	8.5	9.5	11.3	10.9	10.3	10.2

Source: Statistical Center of Iran, Summary results of the workforce survey

The results of the census carried out in 1395 reveal that among the various age groups, population aged 30-34 and 25-29 respectively account for the highest shares of the country's population and a majority of them are highly educated but unemployed. In terms of education, the new entrants to the labor market are almost evenly distributed by gender. The latest workforce survey reveals that the participation rate of females has grown faster than that of the males, especially in recent years. Hence, not only a considerable number of young educated job seekers are entering the labor market, but the gender ratio of the new entrants is rising in favor of the females. Data by various classifications of unemployed reveal that females' unemployment rate is above that of the males' and the unemployment rate is higher for the youth and for the more educated individuals. It signals that job creation programs should focus more on educated youth.

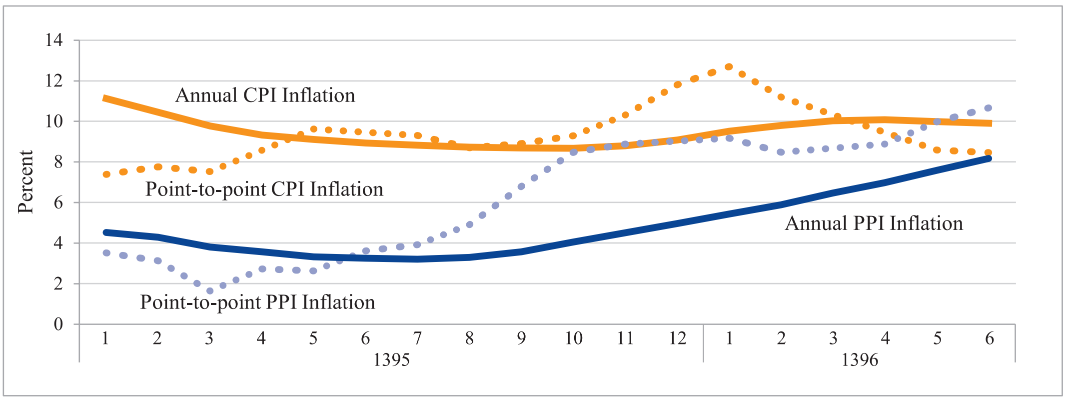
2. Prices and Inflation

In 1396Q2 the CBI changed the base year for its computations of the inflation rate from 1390 to 1395. It did so because as households' incomes, tastes and preferences, and the relative prices of goods and services, change over time, so does the basket of goods and services consumed by the typical households. As a result, a revision of the consumption basket and the weights assigned to each good or service in the basket becomes necessary in order to increase the accuracy of the inflation computations. The latest change of the base year resulted in a change in monthly consumer price indices (CPI) of recent months but only very slightly and did not alter any of the trends.

In 1396Q2, the point-to-point CPI inflation continued its downward trend that had started at the beginning of this year and reached 8.4 percent in 6/1396 from 12.7 percent in 1/1396. Due to the rise in the point-to-point CPI inflation rate in the last 9 months of the past year, the annual inflation rate at the end of each month that was 9.1 percent at the end of 1395, started to increase and from 2/1396 to 5/1396 was hovering around 10.0 percent but registered 9.9 percent at the end of summer.

The point-to-point producer price index (PPI) inflation rate fell by 0.7 percentage points in 2/1396 but again started to rise and eventually registered the high of 10.7 percent in 6/1395. Given the lagged effect of PPI inflation on CPI inflation, the upward trend of the former could result in the rise of the latter in coming months. Figure 3 exhibits the point-to-point and annual CPI and PPI inflation rates at the end of each month from the beginning of 1395 to the end of the summer of 1396.

Figure 3 - Monthly CPI and PPI Inflation Rates from 1395 to the end of 1396Q2



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

The point-to-point inflation rate of tradable goods fell to 10.4 percent in 4/1396 from 14.2 percent in 1/1396 which may be attributed to the appreciation of the IRR against foreign currencies during this period. The point-to-point inflation rate of non-tradable goods also fell from 10.8 percent to 9.5 percent over those three months.
As a result of changing the base year from 1390 to 1395, the weights assigned to "Housing, Water, Electricity, Gas and other Fuels", "Health", and "Tobacco" have risen and those assigned to other categories have fallen. The groups of "Housing, Water, Electricity, Gas and other Fuels", "Food and Beverages", and "Transport" are still the top three in the consumption basket in terms of weight.
The latest report of the consumption basket of goods and services reveals that during 1396Q2, out of 12 major groups, the point-to-point inflation rate in 4 groups has risen and in 8 groups has fallen, hence had helped the point-to-point CPI inflation rate fall to 8.4 percent at the end of summer. During 1396Q2, the point-to-point inflation rate in "Housing, Water, Electricity, Gas and other Fuels" rose by 0.2 percentage points while that of the "Food and Beverages" and "Transport" fell by 5.6 and 0.9 percentage points, respectively. Table 4 exhibits the point-to-point CPI inflation rates in the major groups of consumption basket during spring and summer of this year.

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

	Weight in the Basket	Q1			Q2		
		1/1396	2/1396	3/1396	4/1396	5/1396	6/1396
Overall	**100.0**	**12.7**	**11.2**	**10.3**	**9.4**	**8.6**	**8.4**
Housing, water, electricity, gas and other fuels	37.05	8.2	7.7	7.4	7.2	7.4	7.6
Food and Beverages	25.51	23.5	19.6	16.7	14.1	11.7	11.1
Transport	8.90	8.4	6.9	6.6	6.2	5.8	5.7
Health	7.83	16.0	15.3	14.2	9.8	8.4	8.2
Clothing and Footwear	4.62	5.4	5.6	5.8	5.6	5.6	5.6
Household Equipment and Routine Household Maintenance	4.33	6.8	6.7	7.6	8.0	8.2	8.6
Miscellaneous Goods and Services	3.17	8.5	8.7	8.4	8.7	9.1	9.4
Communication	2.30	8.4	7.7	8.0	7.9	7.9	6.8
Recreation and Culture	2.07	10.0	10.1	10.1	9.8	9.8	9.4
Education	2.03	10.3	10.2	10.6	10.6	10.5	10.5
Restaurants and Hotels	1.82	10.2	10.2	10.0	11.0	11.3	11.8
Tobacco	0.37	12.2	1.1	0.6	0.2	0.4	0.3

Source: Central Bank of Iran, Consumer Price Index Reports

3. Balance of Payments

According to CBI statistics, in 1395Q4 oil production and exports[2] grew by 15.7 and 29.6 percent, respectively, to 3.9 million and 2.3 million bpd. As for prices, according to OPEC sources the price of Iran's heavy crude oil averaged USD51.8 per barrel during that period, indicating an 83.6 percent rise from a year earlier. These developments helped raise Iran's oil export[3] revenues in winter of 1395 by 145.1 percent from a year earlier to USD15.9 billion.
The gradual increase in oil prices that had started in early 1394Q4, persisted in 1395 during which the average price of Iran's heavy crude oil grew by 4.1 percent to USD45.4 per barrel. The volume of oil exports grew by 41.3 percent in 1395 to an average of 2.2 million bpd, mostly as a result of the JCPOA implementation. Overall, Iran's oil exports in 1395 grew by 66.1 percent in value and reached USD55.8 billion. At the same time the value of Iran's oil imports[4] fell by 58.6 percent in 1395Q4 and by 37.8 percent in the whole year. Accordingly, the oil trade balance improved by 163.0 percent in 1395Q4 and by 73.5 percent in the year 1395.
In 1395Q4 the value of non-oil exports and imports grew by 1.0 and 40.2 percent, respectively, and reached USD7.8 billion and USD18.7 billion. In 1395 as a whole, the value of exports fell by 9.0 percent while that of imports rose by 23.0 percent. As a result, the non-oil trade balance deficit grew by 94.6 percent in 1395Q4 and by 75.0 percent in the year 1395. Notwithstanding the 20.4 percent rise in goods imports, the 30.0 percent rise in goods exports, mostly oil, caused the goods account surplus to rise by 71.2 percent and reach USD20.8 billion. On the other hand, since services exports grew little while their imports rose by 10.7 percent, the services account deficit increased by 32.8 percent. When the changes in income account and current transfers account are also included, the net current account surplus in 1395 amounts to USD16.4 billion, showing an 81.7 percent growth. Table 5 presents quarterly statistics on components of the current account during 1394 and 1395.

2. Includes crude oil and net exports of oil products
3. Includes crude oil, oil products, natural gas, natural gas condensates and liquids
4. Includes oil products, natural gas, natural gas condensates and liquids

Table 5 - Current Account Components (USD millions)

	1394				1395			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Goods Account	4,778	2,765	4,258	377	6,522	4,127	5,387	4,807
Services Account	-1,206	-1,077	-759	-1,430	-1,610	-1,184	-2,428	-719
Income Account	237	360	189	-23	198	360	127	243
Current Transfers Account	138	142	128	139	121	156	139	142
Current Account Balance	**3,947**	**2,190**	**3,816**	**-937**	**5,231**	**3,459**	**3,225**	**4,473**

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

The capital account reveals that during 1395 the net outflow of capital has reached USD18.3 billion. The net capital account encompasses short run and long run capital account. The former indicates USD18.4 billion capital outflow and the latter indicates USD145 million capital inflow during 1395. It should be noted that the capital account consists of various groups including foreign direct investment, portfolio investment, and other investments. The group of other investments itself includes trade credits, loans, currency and deposits, and other. Hence, the capital outflow could have come about as a result of an increase in direct investments or portfolio investment by Iranian nationals abroad, or a repatriation of old foreign investments in the country. As detail statistics on net capital account has not been published by the CBI since 1394, the components of capital outflow in 1395 cannot be accurately assessed. Considering the changes in current account, capital account, and USD5.8 billion errors and omissions, the balance of foreign reserves in 1395 amounted to USD120.7 billion, indicating USD7.7 billion fall from 1394.

Statistics published by the Ministry of Industry, Mine, and Trade indicate that in 1396Q1 exports of the subsectors of industry (that includes manufacturing, petrochemicals, and liquid gas), mining, natural gas condensates, agriculture, carpet and handicrafts have fallen in terms of weight, and except in the case of mining, also in terms of value. At the same time, in that quarter the value of imports have increased in various subsectors of industry, mining, carpet and handicrafts in terms of weight; only agriculture imports have fallen slightly, and import values have risen in all of those subsectors. These statistics indicate that compared to a year earlier, in 1396Q1 the share of capital goods imports was unchanged in terms of weight but fell a lot in terms of value. As for the imports of intermediate goods its share fell in terms of weight but rose in terms of value, while regarding imports of consumer goods, its shares increased in both weight and value terms.

On the basis of the latest customs statistics, exports and imports[5] in the first five months of the year experienced 5.0 percent fall and 16.5 percent rise, respectively, to reach USD17.2 billion and USD19.4 billion. As for exports components, exports value of natural gas condensates has fallen due to the fall in both weights and prices. On the other hand, exports value of petrochemicals rose due to the rise in average price and despite the fall in weight. Exports value of “others goods” also fell considerably due to the fall in both weight and average price. Table 6 exhibits details of customs exports during the first five months of 1395 and 1396.

Table 6 - Customs Exports Statistics

	First Five Months of 1395				First 5 Months of 1396				Percentage Change	
	Weight (1000 tons)	Value (USD millions)	Share in Total (percent)		Weight (1000 tons)	Value (USD millions)	Share in Total (percent)			
			Weight	Value			Weight	Value	Weight	Value
Petrochemicals	12,316	5,880	23.6	32.5	11,977	5,999	24.9	34.9	-2.8	2.0
Natural Gas Condensates	7,851	3,087	15.0	17.1	7,445	2,920	15.5	17.0	-5.2	-5.4
Other Goods	32,070	9,122	61.4	50.4	28,619	8,274	59.6	48.1	-10.8	-9.3
Total Export	**52,237**	**18,089**	**100.0**	**100.0**	**48,041**	**17,193**	**100.0**	**100.0**	**-8.0**	**-5.0**

Source: Islamic Republic of Iran Customs Administration, Preliminary Statistics for 1395 and 1396

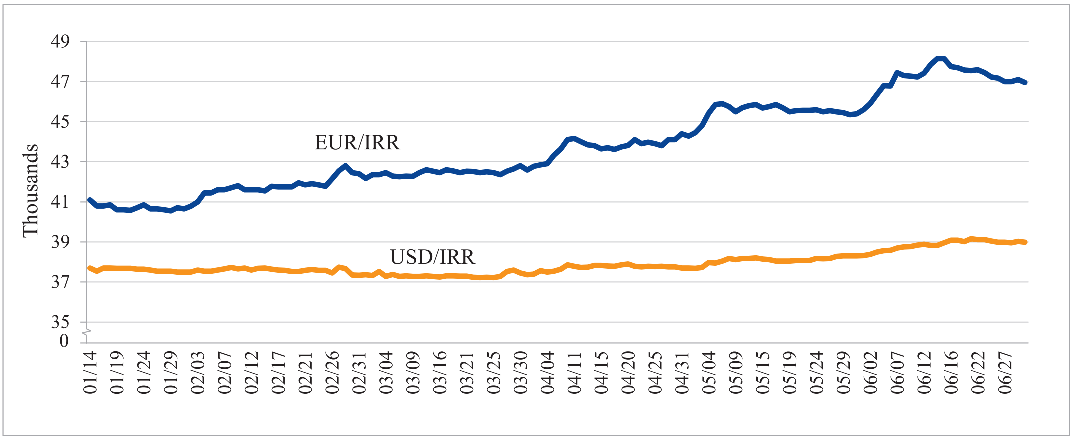
During the first five months of 1395, natural gas condensates was the largest exports item in terms of value, followed by polyethylene film grade valued at USD652 million, liquefied propane valued at USD576 million, light oil crude oil (except gasoline) valued at USD555 million, and methanol valued at USD498 million. During this period China, Iraq, UAE, South Korea, and India were the main exports destinations in that order. Rice valued at USD963 million, cattle-feed corn at USD612 million, 1500-2000cc motor vehicles at USD515 million, auto parts at USD434 million, and soybean at USD410 million were the major imported items during the first five months of 1396. China, UAE, South Korea, India and Turkey were the major origins of imports into Iran. During that period the weight share of intermediate, capital, and consumer goods in total imports were respectively 80.7, 2.1, and 13.2 percent in terms of weight, and 60.1, 14.9, and 22.9 percent in terms of value.

4. Foreign Exchange Market

The downward trend of the free market USD/IRR exchange rate in 1396Q1 reversed course at the beginning of 1396Q2 and the rate surpassed 39,000 in late summer from 37,320 at the end of 1396Q1. In line with the strengthening of the EUR/USD exchange rate in global markets, the free market EUR/IRR exchange rate in Iran continued its upward trend of 1396Q1 and rose steeply to 46,950 in late 1396Q2 from 42,780 at the beginning of this quarter and 40,712 in early 1396Q1. Figure 4 exhibits the daily USD/IRR and EUR/IRR exchange rates in the free market during the first two quarters of 1396.

5. Excludes crude oil, mazut and kerosene, as well as suitcase trade

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



Source: Central Bank of Iran and Royal Exchange

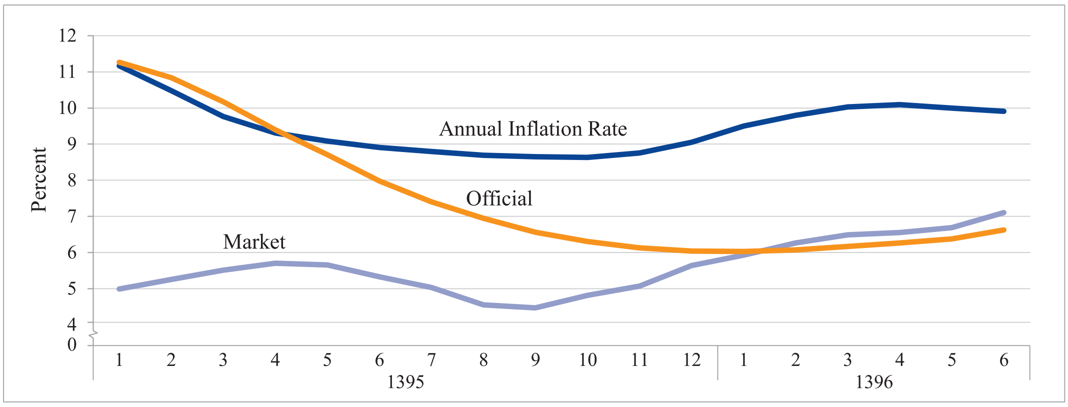
The upward trend of the free market USD/IRR exchange rate that had started from the beginning of 1396Q2, speeded up in 5/1396 as a result of increased demand for foreign currencies by pilgrims and tourists and the possibility of JCPOA violation by the new US administration. The continuation of the steep upward trend in 6/1396 may be attributed to CBI's requiring of the banks to lower interest rates to 10 percent on short term deposit and up to 15 percent on long term deposits. This diverted some depositors to the foreign exchange market and exerted upward pressure on foreign exchange rates. Repealing the sale of USD to overseas travelers at official exchange rate raised the demand for USD in free market.

The recent rise in Eurozone GDP growth rate contributed to the appreciation of Euro in international markets. The euro appreciated more in terms of USD as a result of US political conflicts with North Korea, etc. During 1396H1, in Iran's free market the euro appreciated by 16 percent against the IRR while the US dollar appreciated by only 3.1 percent. In 1396Q2 the average free market USD/IRR exchange rate rose by 1.9 percent from 1396Q1 and by 8.2 percent from 1395Q2. The fluctuation of the USD/IRR exchange rate was also more in summer of this year compared to its preceding quarter and the summer of last year.

The official USD/IRR exchange rate surged from the middle of summer but as its monthly average growth rate was much lower than that of the free market rate, the gap between the two rates widened and reached 16.7 percent at the end of summer from 15.9 percent in the first month of the year. This will make the CBI's declared goal of exchange rate unification harder to implement.

Figure 5 exhibits the annual inflation rate and annual growth rates of the official and free market USD/IRR exchange rates in years ending in each month from 1395 to the end of 1396H1.

Figure 5 - Annual Inflation Rate and Growth Rates of Official and Market USD/IRR Exchange Rates



Source: Central Bank of Iran and Research Calculations

5. Monetary and Credit Aggregates

In 4/1396 the monetary base grew by 16.6 percent to IRR1,863.7 trillion, 3.7 percentage points up from its level a year earlier. The 18.7 percent rise in CBI claims on banks, mainly due to the 227.9 percent rise in balance of CBI claims on non-public banks and non-bank credit institutions, was the major cause of this growth of the monetary base. On the other hand, CBI claims on state-owned commercial and specialized banks fell by 55.9 percent and 12.6 percent, respectively. Accordingly, compared to a year earlier, at the close of 4/1396 the share of state-owned banks and non-bank credit institutions in CBI claims on banks rose from 16.6 percent to 45.8 percent while that of commercial banks fell from 19.8 percent to 7.4 percent.

The rise in CBI claims on banks could be attributed to the government's requiring of the banks to finance a portion of its guaranteed purchase of wheat in 1395, the persistence of government reliance on banking resources to finance its supportive schemes, and the CBI's requiring of banks to provide credit lines aimed at saving certain unauthorized financial institutions. 44.0 percent of the guaranteed purchase of wheat, amounting to IRR69.6 trillion has been financed through the banking system, out of which IRR40 trillion was financed through extended facilities and IRR29.6 trillion through the sale of Murabaha bills issued by the CBI to eight banks. During 1395H1 the average number of interbank market transactions increased but the banks' borrowings from the CBI remained unchanged. However, as a result of participation of banks in guaranteed purchase of wheat scheme in 7/1395, the number of transactions fell but the borrowings from the CBI kept rising. This process intensified in 9/1395 and 10/1395 as a result of the purchase of Murabaha bills by banks, and borrowings from the CBI peaked in 11/1395. This intensified competition among banks for attracting deposits and raised the interest rates, thereby further exacerbating the credit crunch in 1395H2.

The second cause of the monetary base growth was the 6.0 percent fall in net "Other" category. Net foreign assets of the CBI grew by 0.4 percent to IRR1,854.5 trillion and constituted the third cause of the monetary base growth. Finally, the 0.8 percent rise in net CBI claims on the public sector was the last cause of the monetary base growth, accounting for 0.1 percentage points of the 16.6 percent growth. This rooted in 61.1 percent rise in net CBI claims on government due to the 1.2 percent rise in CBI claims on government and 2.9 percent fall in government deposits with the CBI. On the other hand CBI net claims on state-owned companies and institutions fell by 4.9 percent during the period under review as a result of a 2.2 percent fall in CBI claims on them and 14.0 rise in their deposits with the CBI, and considerably offset the rise in net CBI claims on the government. Despite the fall in net CBI claims on state-owned companies and institutions, it still accounts for 86.2 percent of the net CBI claims on the public sector. Table 7 exhibits the monetary base components in various quarters of 1395 and 1396 and in 4/1396.

Table 7 - Monetary Base Components (end of period- in IRR trillions)

	1395				1396		4/1396 to 4/1395	
	Q1	Q2	Q3	Q4	Q1	4/1396	Growth Rate (percent)	Share in Growth (percentage points)
Monetary Base	**1,585.2**	**1,655.1**	**1,704.7**	**1,798.3**	**1,851.9**	**1,863.7**	**16.6**	**16.6**
CBI's Net Foreign Assets	1,876.6	1,859.4	1,898.2	1,924.6	1,853.9	1,854.5	0.4	0.5
CBI Net Claims on Public Sector	238.9	325.3	233.1	202.6	282.0	263.8	0.8	0.1
CBI Claims on Banks	895.1	942.2	1,047.9	996.9	1,013.7	1,078.7	18.7	10.6
Other	-1,425.4	-1,471.8	-1,474.5	-1,325.8	-1,297.7	-1,333.3	-6.0	5.4

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

The M2 money multiplier grew by 5.8 percent to 7.2 at the end of 4/1396. The fall in the ratios of bank legal reserves to total deposits, cash and coins with the public to total deposits, and sight deposits of banks with the CBI to total deposits were the reasons for the rise in M2 money multiplier. As a result of the rise in both the M2 money multiplier and the monetary base during this period, the balance of M2 liquidity grew by 23.3 percent to IRR13,337.4 trillion; 6.7 percent below the growth rate a year earlier. Table 8 exhibits the M2 money multiplier and M2 liquidity components during various quarters of 1395-96 as well as in 4/1396.

Table 8 - M2 Money Multiplier and M2 liquidity Components (end of period- in IRR trillions)

	1395				1396		4/1396 to 4/1395	
	Q1	Q2	Q3	Q4	Q1	4/1396	Growth Rate (percent)	Share in Growth (percentage Points)
M2	10,595.0	11,227.1	11,848.6	12,533.9	13,149.1	13,337.4	23.3	23.3
M1	1,364.4	1,480.3	1,540.7	1,630.3	1,647.1	1,595.1	14.4	1.9
Notes and Coins with the Public	311.6	329.2	327.7	393.3	340.1	341.5	5.1	0.2
Sight Deposits	1,052.8	1,151.1	1,213.0	1,237.0	1,307.0	1,253.6	17.2	1.7
Quasi-money	9,230.6	9,746.8	10,307.9	10,903.6	11,502.0	11,742.3	24.6	21.4
M2 Money Multiplier (ratio)	6.7	6.8	7.0	7.0	7.1	7.2	5.8	-

Source: Central Bank of Iran, Selected Economic Indicators

Among the M2 liquidity components, M1 money rose by 14.4 percent and quasi-money by 24.6 percent, accounting for 1.9 and 21.4 percentage points of the M2 liquidity growth, respectively. Also, notes and coins with the public and sight deposits components of M1 money rose by 5.1 and 17.2 percent, respectively, accounting for 0.2 and 1.7 percentage points of the M2 liquidity growth. Accordingly, the share of M1 money and quasi-money in M2 liquidity at the end of 4/1396 reached 12.0 and 88.0 percent, respectively.

In 4/1396 the balance of deposits grew by 21.8 percent, the balance of deposits after the deduction of legal reserves by 21.3 percent, and extended facilities by 22.8 percent. As a result, the ratio of facilities to deposits after the deducting legal reserves rose by 1.0 percentage point to 84.0 percent. This ratio rose gradually from 3/1395 to the end of the year, but reversed course at the beginning of 1396. Besides, the point-to-point growth of the balance of deposits after the deduction of legal reserves touched its low at the end of 1395, but reversed course from the beginning of 1396 while the point-to-point growth of the facilities also fell gradually. It is worth mentioning that the average legal reserves ratio grew by 0.4 percentage points to 10.4 percent at the end of 4/1396. During the first 5 months of this year IRR2,082.4 trillion facilities has been extended to loan applicants, indicating a 17.4 percent increase. Agriculture sector has accounted for 7.3 percent, industries and mining for 30.1 percent, housing and construction for 7.4 percent, commerce for 14.4 percent, and services for 40.7 percent of the extended facilities. During the same period, working capital accounted for 64.1 percent of the extended facilities and for 85.6 percent of the facilities extended to industries and mining sector. Out of the extended facilities aimed at financing working capital, 40.3 percent was extended to industries and mining, 32.2 percent to services, and 17.3 percent to commerce. The extended facilities aimed at working capital in housing and construction and services fell during the first five months of the year compared to a year earlier, but rose in other sectors.

Next to the working capital, extended facilities aimed at financing creation plans ranked as second at 8.2 percent share of the extended facilities, out of which 46.9 percent was allocated to services. Extended facilities aimed at financing creation plans has risen in all sectors compared to the first five months of last year. On the other hand, the share of extended facilities aimed at purchasing personal goods fell in all sectors and so did its value in industries and mining, housing and construction, and services compared to the same period of last year.

6. Government Budget

Government revenues appear to have grown by 26.3 percent during the first four months of 1396 thanks to as much as 147.0 percent rise in oil revenues. But this high growth of oil revenues is the result of its underreporting during the same period of last year when a part of oil revenues was not reported and was instead used to settle CBI claims on government. In reality during the first four months of this year actual oil revenues amounted to only 67.5 percent of the legislated amount. In the same period tax revenues remained unchanged in nominal terms from the same period of last year and equaled 75.1 percent of the legislated amount. Overall, during the first four months of 1396 total government revenues were about 64.0 percent of the legislated amount -- while in 1395 they equaled 92.8 percent of the legislated figure in the Law. Oil revenues had exceeded tax revenues in 1396Q1 for the first time since 1393Q2, but reversed course in the fourth month of the year. In 1393Q2 oil revenues amounted to IRR221.6 trillion and tax revenues to IRR193.4 trillion, but in 1396Q1 they dropped, respectively, to IRR188.9 trillion and IRR181.9 trillion. Hence in a reversal from the past 11 quarters, the government again relied more on oil revenues than on tax revenues.

In tax revenues, “Tax on Legal Entities” and “Tax on Goods and Services” accounted for the highest share in the “Direct Tax” and “Indirect Tax” subgroups, respectively. The tax on legal entities fell by 9.1 percent in the first four months of 1396 and was one of the major factors preventing tax revenues from rising. Given that the deadline for tax returns of 1395 is the last day of 4/1396, tax revenues from legal entities performance in 1395 are not reflected in these statistics. Therefore, the fall in tax revenues from legal entities may be mostly attributable to the consequences of the recession in 1394. On the other hand, revenues from tax on goods and services during the first four months of the year rose by only 2.2 percent, far below the inflation rate. The 15.0 percent rise in VAT proceeds was mostly offset by the 20.9 percent fall in tax revenues on the sales of oil products. Table 9 compares the components of tax revenues in the first four months of 1395 and 1396.

Table 9 - Components of Tax Revenues (IRR trillions - Percent)

	First Four Months of 1395			First Four Months of 1396		
	Amount	Share	Growth	Amount	Share	Growth
Tax Revenues	**297.0**	**100.0**	**26.9**	**296.9**	**100.0**	**0.0**
Direct	**166.2**	**56.0**	**25.3**	**159.8**	**53.8**	**-3.8**
Legal Entities	107.8	36.3	23.0	98.0	33.0	-9.1
On Income	50.1	16.9	31.3	53.5	18.0	6.8
On Wealth	8.3	2.8	20.3	8.4	2.8	0.4
Indirect	**130.8**	**44.0**	**29.1**	**137.1**	**46.2**	**4.8**
On Imports	21.3	7.2	5.6	25.2	8.5	18.4
On Goods and Services	109.5	36.9	35.0	111.9	37.7	2.2
On Value Added	69.3	23.3	4.7	79.7	26.8	15.0
On Sales of Oil Products	22.7	7.6	141.6	17.9	6.0	-20.9

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

Current expenditures remained close to the legislated figure as usual at 86.0 percent during the first four months of the year. Since government organizations typically spend their legislated credits regardless of the government’s current revenues, should the revenues not materialize the operational balance deficit increases.

Development expenditures grew by 23.5 percent in the first four months of the year, which may be attributable to the weak performance of the government in this regard in the year before. These expenditures only equaled 5.3 percent of the legislated amount for this period.

Overall, the operating balance deficit which is the difference between current expenditures and revenues, rose by 83.9 percent to IRR411.2 trillion, far above the legislated IRR270.8 trillion. A portion of this deficit was covered by the IRR249.2 trillion surplus in net disposal of non-financial assets, and the rest which is referred to as budget deficit was financed through the disposal of financial assets such as government securities or revolving funds of the treasury. Accordingly, the budget deficit during the first four months of the year grew by 26.8 percent to IRR161.9 trillion, 48.2 percent up from the legislated amount. No new data on the financing of the budget deficit were released at the time of preparing this report, but it seems that as before, in the beginning of the year, the government finances its deficit by the revolving funds of the Treasury which is a type of borrowing from the CBI, and at the end of the year, by issuing debt securities that settles the revolving funds and covers its deficit. However, the issuance of government securities while the Budget Law prohibits the CBI from trading, would put upward pressure on interest rates in contradiction to the CBI's declared goal. Table 10 exhibits the government's fiscal performance in springs and the first four months of 1395 and 1396.

Table 10 - Government Fiscal Performance (IRR trillions - Percent)

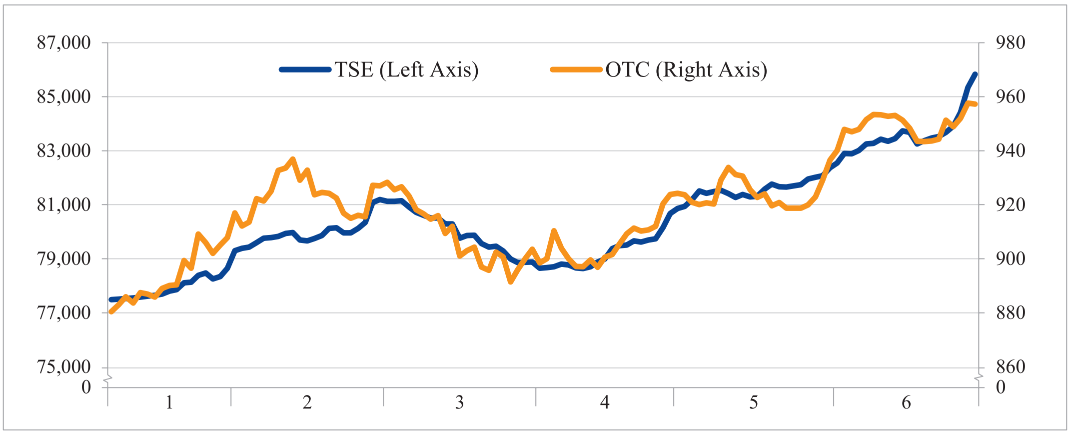
	1395				1396				Performance of the first four months of 1396*
	Q1		First Four Months		Q1		First Four Months		
	Amount	Growth	Amount	Growth	Amount	Growth	Amount	Growth	
Revenues	**255.5**	**-12.9**	**504.4**	**10.8**	**426.1**	**66.8**	**636.9**	**26.3**	**64.0**
Tax Revenues	184.9	30.0	297.0	26.9	181.9	-1.6	296.9	0.0	75.1
Other Current Revenues	26.3	-47.9	100.5	25.7	54.5	107.0	77.9	-22.5	39.8
Oil Revenues	43.6	-56.5	105.7	-24.9	188.9	333.2	261.0	147.0	67.5
Other Disposal of Non-financial Assets	0.7	131.0	1.2	156.6	0.8	13.5	1.0	-17.4	5.8
Expenditures	**416.0**	**8.5**	**632.2**	**15.6**	**600.8**	**44.4**	**798.8**	**26.4**	**72.3**
Current Expenditures	368.8	2.7	604.9	21.4	548.8	48.8	741.3	22.6	86.0
Development Expenditures	1.4	263.6	10.4	-28.3	8.2	489.0	12.8	23.5	5.3
Budget Balance	**-160.4**	**77.8**	**-127.7**	**39.5**	**-174.7**	**8.9**	**-161.9**	**26.8**	**148.2**
Operating Balance	-202.7	6.5	-223.5	2.4	-356.2	75.7	-411.2	83.9	151.8
Net Disposal of Non-financial Assets	42.2	-57.8	95.8	-24.4	181.4	329.8	249.2	160.0	154.2

Source: Central Bank of Iran, Selected Economic Indicators, various issues
* Compared to the legislated figure for those four months
Note: The difference between the sum of current and development expenditures and total expenditures is that the revolving funds were not yet settled.

7. Capital Market

In 1396Q2 the overall index of Tehran Stock Exchange (TSE) grew by 8.8 percent to end summer at 85,830. The value of traded shares and preemptive rights in that quarter totaled IRR107.3 trillion, indicating 21.3 percent fall from 1396Q1 and 10.9 percent fall from 1395Q2. Among the TSE listed industries, the highest rates of returns belonged to "Extraction of Metal Ores" with 39.2 percent and "Base Metals" with 29.2 percent. The over the counter (OTC) market's overall index grew by 6.0 percent during that quarter and closed at 957 on the last trading day of the summer. At the end of 1396Q2, debt securities which mostly included Islamic treasury bills accounted for IRR238.5 trillion, equal to about 20.9 percent of the OTC market capitalization. Figure 6 depicts the developments of TSE and OTC indices during 1396H1. As can be seen, the OTC overall index has been more volatile than that of the TSE but both have followed similar trends.

Figure 6 - TSE and OTC Overall Index during 1396H1



Source: available at: http://new.tse.ir and http://fbi.ir

Trading of the latter series of the Islamic treasury bills were transferred to the banking system at the end of 1395 after they were not admitted to the capital market for the fear of adversely affecting the stock market. Series 1 to 7 of the "banking" Islamic treasury bills with maturities of 6 to 24 months were issued at the end of 1395, aimed at settling government debts to contractors. The bills became tradable in mid-summer, but because of the lack of an organized secondary market, sellers and buyers had to meet at selected branches of "Melli Bank". Sellers often had to advertise their bills in the cyberspace to find potential buyers. Except series 1 of the bills that matured in the late summer, at the request of the Minister of Economic and Financial Affairs, the six remaining series valued at IRR123 trillion were gradually admitted to the OTC market beginning in late summer and became tradable. As a result, the rate of return of these bills that had occasionally even surpassed 30 percent in the unorganized market, fell considerably. For instance the rate of return on series 2 of these bills stood at about 17.5 percent in the last week of 1396Q2.

8. Other Developments

In late summer, CBI instructed banks and other credit institutions to limit the interest rate on time deposits to 15 percent and on sight deposit to 10.0 percent. In the ten-day period between the announcement of the directive and its enforcement, many depositors rushed to lock into the much higher prevailing rates of over 20 percent and some banks stayed open even on Friday to accommodate their customers.

Most economists agree that interest rates need to come down in the current environment but there is no consensus on how to implement it. Undoubtedly bringing interest rates down and keeping them down requires reforming the banking system, which is a long term solution. Policies to lower interest rates in the short run can be implemented (i) by decree, (ii) through open market operations (OMO), or (iii) by direct fund injection. CBI seems to have currently opted for the first method, and has alluded that it may also appeal to the third method by lowering the discount rate to 18 percent, to which it has alluded, it would be using the third method as well. It seems clear that interest rates would not come down by decree despite the fact that CBI has tried to put a cap on rates of return in parallel markets as well. If the decree is accompanied by injecting funds, it can bring interest rates down but because of the ensuing monetary base growth it could well be inflationary. But OMO which is the policy of choice in more developed economies is a much preferable policy as it entails less inflationary pressures.

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