# Annual Economic Review

## Year ended March 2013

## Executive Summary

During the Iranian year 1391 (21 March 2012 – 20 March 2013) the continuation of expansionary monetary and fiscal policies and the imposition of new unilateral sanctions in addition to the tightening of the old ones strained Iran's economy. As a result the economy ended the year with a high inflation rate, a severely depreciated national currency and probably negative GDP growth rate. New unilateral sanctions forced many countries to cut their oil imports from Iran. New sanctions also extended their reach to the Central Bank of the Islamic Republic of Iran (CBI) and limited Iran's access to its holdings in foreign banks. Under these sanctions, Iran could only export some oil to certain Asian countries and use its proceeds to import food, medicines and certain services, or keep the funds in those countries. Turkey was also banned from its recent practice of paying for its Iranian gas imports in gold and other precious metals.

CBI is the sole source of official statistics on Iran's economy. At the time this report is being prepared (June 2013), its comprehensive national accounts data do not go beyond the third quarter of the Iranian year 1390 (October-December, 2011). It is thus not possible to present a cohesive report on the economy for the year 1390 (that ended on 20 March 2012), and 1391. This report will, therefore, make what data is available from CBI publications as well as partial data offered by government officials and international organizations such as the World Bank and the International Monetary Fund (IMF) in order to present a more complete picture of the economy in the past year.

The Statistical Center of Iran (SCI) in a June 2013 statement reported its estimate of the GDP growth rate in 1390 (2011-2012) at 3.2 percent but the IMF and the World Bank have estimated it at 3.0 percent and 1.7 percent, respectively. Both of these multinational organizations have estimated that Iran's GDP has contracted by 1.9 percent in 2012.

Examination of the GDP components in 1391 indicates that economic sectors have been affected by the sanctions in varying degrees. Manufacturing products have expanded in industries such as petrochemicals, steel, cement and glass, but contracted in industries such as the auto-making that heavily depend on imported raw materials and intermediate goods. Agricultural production has also grown due mainly to favorable rainfalls. The picture is less clear for the oil sector where domestic sources report an average production of 3.7 million barrels per day while OPEC sources estimate it at 20 percent lower than this figure.

On the expenditure side, private consumption expanded at 10.1 percent p.a. during the first 9 months of 1390 (last nine months of 2011), most likely as a result of the cash subsidies the government distributed in that year, and that trend is likely to have continued in the past year. During the same nine months gross domestic capital formation expanded by only 1.2 percent p.a. and, given the expansionary monetary policy and the generally unfavorable business environment, must have contracted for the whole year in 1390 as well as 1391. This is a cause for concern about the continuation of recession.

The foreign sector was also negatively affected by the tightening of the existing United Nations and unilateral sanctions and the imposition of the new ones. Oil and gas exports during the first ten months of 1391 amounted to only $57.7 billion as compared to $101.6 billion in the first 10 months of the preceding year, indicating a drop by 43 percent. Petrochemical exports also fell by 33 percent in value during the same 10 months. But the depreciation of the Rial helped boost non-oil exports by 16.1 percent and contract merchandise imports by 17.6 percent. These developments led to a 50.8 percent drop in the current account surplus from $48.1 billion in the first 10 months of 1390 to $23.7 billion in the same period in 1391.

A noteworthy development in the foreign sector during the past decade is a radical change in the source of imports to Iran from mostly European countries to Iran's neighboring countries and Asian importers of Iranian oil. In 1381 (2002-3) the top five sources of imports were, respectively, Germany, UAE, Switzerland, Italy and France but in 1391 (2012-13) they were replaced by UAE, China, Republic of Korea, Turkey and Switzerland.

SCI estimates the unemployment rate in 1391 at 12.2 percent, almost unchanged from its estimate of 12.3 percent in 1390. 47.5 percent of the employed were in services, followed by 33.6 percent in agriculture and 18.9 percent in manufacturing sectors.

Government budget also suffered from the sanctions as its oil revenues fell by 155 trillion rials in the first 11 months of the year in comparison to the similar period in the preceding year to reach 360.5 trillion rials, and only 56 percent of the planned budget was realized. During the first 11 months of the year almost 90 percent of the budget was spent on current expenditures and only 10 percent was allocated to investments. During the above periods, despite the considerable increases in tax and other revenues, the budget deficit dropped only slightly from 351 trillion Rials to 340 trillion Rials. Reasons for budget deficit include the 44 percent shortfall in oil revenues, 48 percent shortfall in revenues generated from the subsidies reform program and the payment of 500,000 Rials for New Year bonuses to a large number of cash subsidies recipients. These forced the government to borrow from the CBI and the National Development Fund. This method of financing the budget deficit further accelerated liquidity growth and inflation rates in 1391.

In the Monetary sector, 1391 experienced a liquidity growth rate of 30.8 percent, mostly as a result of the government's budget deficit. From 1390 to 1391 the growth rate of the monetary base increased from 11.4 percent to 27.2 percent and the money multiplier increased from 4.61 to 4.74. On the sources of the monetary base, in1391 net foreign assets increased by 0.9 percent as a result of the decline in oil revenues and, unlike previous years, did not play an important role in the growth of the monetary base. Nevertheless, the persistence of budget deficit and its effects on the banking system -- CBI in particular -- caused a 161 percent increase in government's net debt to CBI. Banks' debts to the CBI also increased by 17.5 percent. The government budget deficit was thus mostly financed through the banking system which, in addition to increasing the liquidity growth, exacerbates inflation expectations and concerns about the persistence of stagflation should the decline of oil revenues continue in 1391.

Unless the relationship between the government and banks are revised and CBI supervisions are enforced, high levels of commercial bank debts to CBI (mainly excess withdrawals) and high default rates will continue. In the past two year the banking system's default rate has been around 15 percent in spite of the CBI efforts.

In December 2012, current account deposits were about 27 percent higher than in December 2011, signaling readiness to shield against high inflation expectations by shifting funds into markets such as real estate, gold and foreign exchange. In the last month of 1391 compared to the same month of previous year, the consumer price index in urban areas jumped by over 40 percent to register an inflation rate of 31.6 percent in 1391. This was the highest inflation rate in the past 17 years and placed Iran as the country with the 4th highest inflation rate in the world – next to those of Belarus, Southern Sudan and Sudan in 2012. Apart from the government expansionary policies noted above, other causes of this high inflation rate include the tightening of sanctions that limited consumer and intermediate goods imports as well as import-dependent domestic production. The significant depreciation of the rial against major currencies, including 90 percent depreciation against USD, also contributed to the price increases.

Negative factors such as imposition of sanctions, high inflation and currency devaluation channeled funds toward the capital market and brought about a 46.8 percent rise in the Tehran Stock Exchange (TSE) index. Main winners were mining companies, refineries, and petrochemical and chemical companies whose stocks grew by, respectively, 114, 211 and 95 percent in 1391. Among the large industries, banking was the only sector that could not keep its shareholders happy since financial sanctions and problems with money transfers caused a 4.1 percent drop in its stocks.

Despite the unsatisfactory economic conditions of the past few years, given the incoming president's emphasis on improving the business environment and Iran's relations with other countries, it is anticipated that the general economic conditions of the country will improve in 1392.

## 1. The Real Side

The latest CBI figures on Iran's GDP do not go beyond the third quarter of 1390 (October-December, 2011), and as such do not present a clear picture of the economy in 1390, or give any information about 1391. This report will, therefore, make use of what is available from CBI publications in conjunction with partial data offered by government officials and international organizations such as the World Bank and the IMF.

In recent years, the services sector has had the largest share in Iran's GDP, followed by oil and gas, manufacturing and mining, and agriculture. The shares of these sectors in Iran's GDP during 1385-1390 (2006-2011) are shown in Table 1.

**Table 1- GDP and Value-added of Sectors in Current Prices, 1387-90**

| | (Trillion rials) | | | | Share (percent) | |
|---|---|---|---|---|---|---|
| | 1387 | 1388 | 1389 | 1390** | 1389 | 1390** |
| Agriculture | 302.2 | 366.0 | 437.0 | 522.7 | 9.8 | 11.0 |
| Oil | 850.6 | 729.3 | 977.8 | 1,266.4 | 22.0 | 26.7 |
| Manufacturing and Mining | 632.3 | 653.8 | 837.5 | 917.4 | 18.8 | 19.3 |
| Services | 1,692.0 | 1,919.1 | 2,200.7 | 2,044.7 | 49.4 | 43 |
| GDP* | 3,477.1 | 3,688.2 | 4,453.0 | 4,751.2 | 100 | 100 |

Source: CBI, 1390 Annual Review
* In basic prices and prior to the deduction of imputed bank service charges
** First 9 months only

Table 2 presents the growth rates of the GDP and its components from 1385 to 1390 (2006-2011). According to the CBI, I ran's GDP growth rate stood at 4 percent during the first 9 months of 1390 (March-December, 2011). The SCI estimates the rate at 3.2 percent for the entire 1390 (March 2011-March 2012) but the IMF and the World Bank estimate it at 3.0 percent and 1.7 percent, respectively[1]. Both of these organizations have estimated that Iran's GDP has contracted by 1.9 percent in 2012. Iran's economic growth in 1390, therefore, is estimated to have been between 1.7 and 3.2 percent. As for 1391, the only available data are from the IMF and the World Bank that estimate contraction by 1.9 percent. Overall, it can be concluded that the growth rate of the Iranian economy slowed down in 1390 and probably turned negative in 1391.

**Table 2 - GDP Growth Rates (in percentages, based on constant 1376 prices)**

| | 1385 | 1386 | 1387 | 1388 | 1389 | 1390* |
|---|---|---|---|---|---|---|
| Agriculture | 4.7 | 6.4 | -11.8 | 13.5 | 8.8 | 4.8 |
| Oil | 3.6 | 1.3 | -2.0 | -3.9 | 1.9 | 6.6 |
| Manufacturing and Mining | 9.4 | 3.2 | 5.5 | 2.8 | 9.3 | 4.5 |
| Services | 6.7 | 6.0 | 2.4 | 2.2 | 4.0 | 2.8 |
| GDP | 6.6 | 5.0 | 0.8 | 3.0 | 5.8 | 4.0 |

Source: CBI, 1390 Annual Review
* First 9 months only

1. IMF, World Economic Outlook, April 2013; World Bank, Global Economic Prospects, June 2013

Figures on the gross domestic expenditures in Table 3 indicate that private consumption expenditures grew by 10.1 percent during the first 9 months of 1390 (last nine months of 2011), mainly due to the distribution of large cash subsidies by the government which increased household incomes and boosted consumer spending. Government consumption expenditures, however, contracted by 2.8 percent in 1389 and 2.7 percent in the first nine months of 1390.

**Table 3 - Gross Domestic Expenditure Growth Rates (in constant 1376 prices)**

| | 1385 | 1386 | 1387 | 1388 | 1389 | 1390* |
|---|---|---|---|---|---|---|
| Private Consumption Expenditures | 6.1 | 6.8 | -4.5 | -1.1 | 1.90 | 10.1 |
| Public Consumption Expenditures | 5.8 | -8.5 | 4.1 | 2.3 | -2.8 | -2.7 |
| Gross Fixed Capital Formation | 3.0 | 6.6 | 10.9 | -0.9 | 6.9 | 1.2 |
| Gross Domestic Expenditure | 6.2 | 6.4 | 0.6 | 4.0 | 5.9 | 3.7 |

Source: CBI, 1390 Annual Review
* First 9 months only

As per the objectives of the Fourth Five-Year Development Plan, in order to achieve the target GDP growth rate of 8 percent p.a., gross fixed capital formation has to grow by an average of 12.2 percent p.a. This can also be viewed as the minimum required investment for achieving the target growth rate in the Fifth Five-Year Development Plan. However, the gross fixed capital formation grew by only 6.9 percent and 1389 and 1.2 percent in the first nine months of 1390. The insignificant investment growth and the decline in Iran's GDP growth rate during the first nine months of 1390 raise concern over Iran's ability to create adequate employment opportunities in the coming years.

## 1-1- Agricultural Sector

The share of agriculture in the economy has been increasing since 1387, reaching 11.4 percent in the first nine months of 1390. The 18 percent rainfall growth during the first five months of 91-92 water year (September 2011 - August 2011), and the 2.8 percent rainfall growth in 1390-1391 water year contributed to agricultural production growth to 118 million tons in 1391.[2]

## 1-2- Oil and Gas Sector

Conflicting data are provided by various sources on Iran's oil and gas output in recent years. Local authorities estimate Iran's crude oil production in 1391 at 3.7 million barrels per day (bpd) while OPEC estimates it at around 3 million bpd. Local fuel consumption during the last month of 1391 (February-March, 2012) was about 1.7 million bpd, which

2. Report of the Deputy Governor of the Central Bank for Economic Affairs to the 23rd Annual Conference on Monetary and Foreign Exchange Policies, 26-27 May 2013, accessible at http://www.conf.mbri.ac.ir/conf23

is almost unchanged from the previous year. Further information on oil and gas sector will be presented in the Sanctions and External Balance of Payments sections of this Report.

## 1-3- Manufacturing and Mining Sector

Depending on whether they are foreign currency spenders or earners, different subsector within the manufacturing and mining sector have been impacted by the sanctions in varying degrees. Productions have expanded in industries such as steel, aluminum and glass, but contracted in the like of auto-making that heavily depend on imported raw materials and intermediate goods.[3]

### ● Petrochemical Industries

As demonstrated in Table 4, petrochemicals output experienced a growth of 6.4 percent by weight and 64.3 percent by value in 1390, reaching 42.7 million tons and 111.2 thousand billion rials, respectively. The value of Iran's petrochemicals export grew by 26.8 percent to reach USD 14.7 billion in 1390.

**Table 4 - Performance of Petrochemical Industries (1387-1391)**

| | Year | | | | | Growth rate (percent) | | |
|---|---|---|---|---|---|---|---|---|
| | 1387 | 1388 | 1389 | 1390 | 1391 | 1389 | 1390 | 1391 |
| Production (thousand tons) | 30,040 | 34,433 | 40,175 | 42,736 | 41,000 | 16.7 | 6.4 | -4.1 |
| Value of Exports (USD millions) | 7,843 | 9,147 | 11,559 | 14,662 | * | 26.4 | 26.8 | * |
| Value of Domestic Sales (Rls. bn.) | 40,056 | 46,766 | 67,692 | 111,244 | 156,933 | 44.7 | 64.3 | 41.1 |

Source: CBI, 1390 Annual Review; Majlis Research Center forecasts for 1391
* Data is unavailable

According to the Majlis (Parliament) Research Center, Iran's petrochemicals output declined to 41 million tons in 1391, mainly due to the tightening of sanctions and challenges Iran faced in the transportation and insurance sectors. This report points out that Iran currently holds 24 percent of the total petrochemicals output of the Middle East region, and once the new development projects come on stream by the end of the Fifth Five-Year Development Plan, Iran should hold 38 percent of the petrochemicals production capacity in the region. Out of Iran's total petrochemical production of 41 million tons in 1391, about 28 million tons were available for sale, from which 12.2 million tons were consumed locally and the remaining 15.8 tons were exported. Local sale of petrochemical products in 1391 amounted to 156.9 thousand billion rials.[4]

3. Speech of the Minister of Economic Affairs and Finance at the 23rd Conference on Monetary and Foreign Exchange policies, Tehran, 26-27 May 2013, accessible at http://dolat.ir/NSite/FullStory/News/?Serv=4&Id=227714
4. Majlis Research Center, Office of Energy, Industry and Mining, *Energy Developments Weekly*, No.19, 25/02/1392 (15 May 2013)

## Steel, Steel Products and Cement Industries

As shown in Table 5, production of raw steel, cement and steel products during the first six months of 1391 compared to the same period in 1390 grew by 9.3 percent, 4.1 percent, and 1.6 percent, respectively. And as for the first six months of 1390 compared to the same period of 1389, these industries growth rates were 15.6 percent, 14.6 percent and 12.5 percent, respectively.

**Table 5 - Productions of Steel, Steel Products and Cement (in thousand tons)**

| | First six months only | | | Change (percent) | |
|---|---|---|---|---|---|
| | 1389 | 1390 | 1391 | 1390 | 1391 |
| Raw Steel | 5,960 | 6,890 | 7,528 | 15.6 | 9.3 |
| Steel Products | 7,776 | 8,750 | 8,890 | 12.5 | 1.6 |
| Cement | 30,864 | 35,357 | 36,804 | 14.6 | 4.1 |

Source: Report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2)

## Automotive Industry

Data on Iran's car production in recent years is shown in Table 6. Car production in 1391 dropped by 44.5 percent to reach 788.4 thousand vehicles. One of the main reasons for the drop was the financial restrictions brought about by the sanctions that restricted local auto-part manufacturers' ability to acquire their required parts. In addition, fluctuations of the rial exchange rates and the non-allocation of much needed foreign currency to the automotive industry significantly increased the domestic production costs. On the other hand, the curtailment of business relations between the French car producer Peugeot and Iran-Khodro Company that was induced by the sanctions and other international limitations imposed on Iran, further exacerbated the difficulties of Iran's automotive industries.

**Table 6 - Number of Vehicles Produced, 1388-1391**

| | 1388 | 1389 | 1390 | 1391 | Change in 1391 (percent) |
|---|---|---|---|---|---|
| All Vehicles[5] | 1,424,551 | 1,603,251 | 1,651,115 | 921,380 | -44.2 |
| Passenger Cars | 1,193,240 | 1,359,593 | 1,420,612 | 788,390 | -44.5 |

Source: Association of Iran Vehicle Manufacturers

## Construction and Housing Sector

Table 7 presents data on construction permits issued for urban areas. During the first six months of 1390, in comparison to the same period of the preceding year, the number of construction permits increased by 9 percent and the total floor space in urban areas increased by 14.9 percent. During this period, total floor space registered in construction permits in different

5. Vehicles include passenger cars, vans, ambulances, minibuses, buses, trucks, tow trucks, and fire trucks

districts of Tehran and other large cities grew by 29.8 percent and 28.9 percent, respectively, which indicate favorable environment for construction in those areas.[6] In 1390, 565 thousand housing units were built by the private sector on a total floor area of 74 million square meters, indicating a growth of 2.5 percent and 4.2 percent from the preceding year, respectively.[7]
The increase in housing prices in the second half of 1391, as well as the increase in the profit rate of construction businesses accelerated the growth of construction permits in the third and fourth quarters of 1391. At the same time, the increase in housing prices was spread from large cities to small and medium urban areas. Accordingly, the performance of the construction permits in these areas has likely increased in the second half of 1391.

**Table 7 - Specifications of Construction Permits Issued by Municipalities in Urban Districts**

| | First six months | | | Change (percent) | |
|---|---|---|---|---|---|
| | 1389 | 1390 | 1391 | 1390 | 1391 |
| Number (thousands) | 80.3 | 86.2 | 94.0 | 7.3 | 9.0 |
| Total Space (million square meters) | 49.5 | 54.4 | 62.6 | 10.0 | 14.9 |
| Average Space (square meters) | 616 | 632 | 666 | 2.6 | 5.4 |

Source: Report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2)

Table 8 presents data on private investments in various urban constructions during the first half of 1391 and also compares their real and nominal growth rates in this period with those in the first half of 1390. It indicates that in the first six months of 1391 compared to the similar period in 1390, investments in new urban buildings have grown by 2.0 percent in constant prices and 37.8 percent in nominal prices, respectively, to reach 274.6 trillion rials. During this period, the growth rate of nominal investments in Tehran, large cities and other urban areas were estimated at 45 percent, 68 percent and 20.4 percent, respectively.

**Table 8 - Private Sector Investment in Construction and Housing (excluding land value)**

| | First six months of the year | | | | |
|---|---|---|---|---|---|
| | (Billion rials) | Nominal growth rate (percent) | | Real growth rate (percent) | |
| | 1391 | 1390 | 1391 | 1390 | 1391 |
| Tehran | 69,410.8 | 42.8 | 68.0 | 20.6 | 24.4 |
| Other Large Cities | 88,192.0 | 35.0 | 45.0 | 14.0 | 7.4 |
| Other Urban Areas | 117,034.9 | 24.8 | 20.4 | 5.4 | -10.8 |
| All Urban Areas | 274,637.6 | 30.7 | 37.8 | 10.3 | 2.0 |

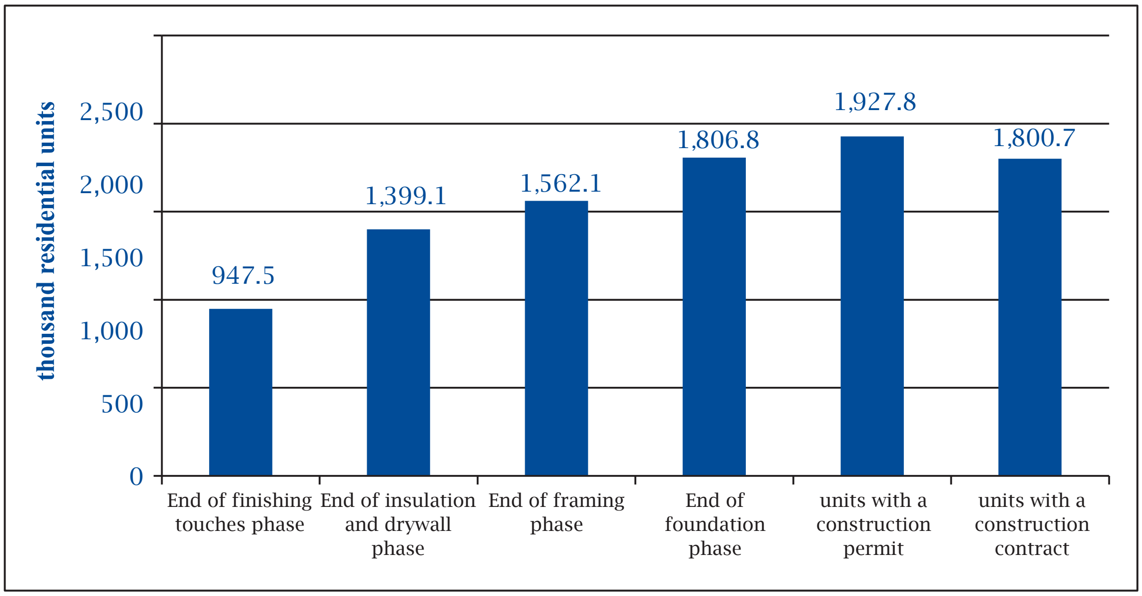
Source: Report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2)

A significant development in the housing sector relates to the "Mehr Housing Project". As seen in Figure 1, from the start of this project in 1386 up to the end of Azar 1391 (December 2012), permits have been issued for the construction of 1,927.8 thousand residential units,

6. Report of the Deputy Governor of the CBI for Economic Affairs (see footnote 2)
7. CBI, 1390 Annual Review

of which 1,806.8 thousand units were in different phases of construction. According to an Advisor to the Roads and Urban Development Minister, by the second month of 1392 (May 2013), approximately 600 thousand units had been handed over to homeowners.[8]

**Figure 1 - Performance of Mehr Housing Project, by Construction Phase (From start till end of Fall 1391 (20 December 2012))**




Source: Report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2)

## 1-4- Services Sector

In recent years services have accounted for nearly half of Iran's GDP, standing at 49.4 percent in 1389. The devaluation of the rial against major currencies slowed down foreign travels and boosted domestic tourism. Iran's Customs Office reports that in 1391, Iranians' travel abroad has dropped to 18.3 million from 21.7 million in 1390, showing a 15 percent decline. In contrast, the number of travelers to Kish Island has increased by 11 percent and to Qeshm Islands by 9 percent. The banking and insurance sector also experienced increased activity in 1391.[9]

## 1-5- Employment and Unemployment

According to the SCI data presented in Table 9, in 1391 economic participation rate stood at 37.7 percent, indicating that 37.7 percent of the 64 million population over 10 years of age were either employed or looking for a job. The SCI has estimated the unemployment rate in 1391 at 12.2 percent, indicating a declining trend from 13.5 percent in 1389 and 12.3 percent in 1390.

8. Iran Students News Agency (ISNA); "Only 50,000 Mehr Housing units have received title deeds", 24 Ordibehesht 1392 (14 May 2013)

9. Speech of the Minister of Economic Affairs and Finance, (see footnote 3)

**Table 9 - Economic Participation and Unemployment Rates, 1385-91 (in percentage points)**

| | 1385 | 1386 | 1387 | 1388 | 1389 | 1390 | 1391 |
|---|---|---|---|---|---|---|---|
| Labor force Participation Rate | 40.4 | 39.8 | 38.0 | 38.9 | 38.3 | 36.9 | 37.7 |
| Unemployment Rate | 11.3 | 10.5 | 10.4 | 11.9 | 13.5 | 12.3 | 12.2 |

Source: SCI, Summary Results of the Workforce Survey Project, 1391

It should be noted that the above-mentioned unemployment rates are based on sampling, which are usually different from unemployment rates derived from general censuses. According to the census of 1390, 3.6 million out of an active population of 24.1 million were unemployed, rendering an unemployment rate of 14.8 percent in 1390 which is much higher than the 12.3 percent derived from sampling.

In 1391, 47.5 percent of the employed were in the services sector, 33.6 percent in industries and 18.9 percent in agriculture. The share of the active workforce aged 15 and above with usual work of at least 49 hours per work stands at 40.6 percent, indicating that a large portion of Iran's workforce work longer hours than standard.

## 2. Economic Sanctions against Iran

Economic sanctions against Iran were first introduced by the United States in 1358 (1979). After Iran's nuclear file came into the picture, previous US sanctions were tightened and new ones were initiated by the US as well as by the UN Security Council and the EU throughout 2006 and 2007. The imposition of these sanctions were purported to curb Iran's attempts to obtain nuclear weapons, violation of human rights, and support of political groups in other countries of the region – accusations that have been repeatedly denied by Iran.

In 1391 unilateral sanctions against Iran were further intensified and followed by the implementation of the so-called "Iran Freedom and Counter-Proliferation Act" of 2012 as of 1 July 2013 that prohibits large transactions in Iranian rial and rial-denominated instruments. This Act also authorizes the imposition of sanctions on persons who knowingly engage in transactions for the sale, supply, or transfer to Iran of significant goods or services related to the automotive sector of Iran, and bans people in violation of these regulations from entering the United States.

## 3. Government Budget and Finance

Table 10 summarizes sources and uses of the government budget and indicates that the revenues obtained from sale of crude oil and oil products had a growing trend till the end of 1390 ( 20 March 2011). However, it experienced a significant drop during the first 11 months of 1391, and as a result the total disposal of capital (non-financial) assets also plunged by 30 percent compared to the similar period in its previous year. On the other hand, taxes grew by 15 percent during the first 11 months of 1391 compared to the similar period in 1390, showing an 80.6 percent realization. From the total government income of 861 thousand billion rials during the first 11 months of 1391, the share of disposal of non-financial assets, tax revenues, other revenues and disposal of financial assets from the total revenue were 42 percent, 38 percent, 13 percent, and 7 percent, respectively.

On the uses side, current expenditures constitute 90 percent of total expenses during the first 11 months of 1391, indicating a 9 percent growth compared to the similar period in its previous year. In contrast, acquisition of non-financial assets, which constitutes 10 percent of total expenses, dropped by 52 percent during the first 11 months of 1391 compared to the similar period in its previous year, and the share of acquisition of financial assets has also been insignificant.

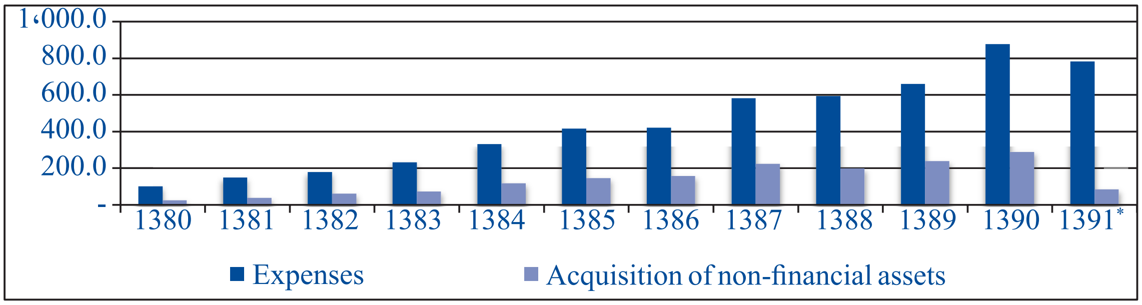
**Table 10 – Government Budget Sources and Uses, 1380-1391 (Rls. Trillion)**

| | Sources | | | | | Uses | | |
|---|---|---|---|---|---|---|---|---|
| Year | Revenues | | Disposal of non-financial assets | | Disposal of financial assets | Expenses | Acquisition of non - financial assets | Acquisition of financial assets |
| | Taxes | Other revenues | Oil | Receipts from sale of movable and immovable assets | | (Current Expenditures) | | |
| 1380 | 41.8 | 11.4 | 72.0 | 0.4 | 3.3 | 104.0 | 24.4 | 0.8 |
| 1381 | 50.1 | 12.0 | 102.6 | 0.5 | 47.9 | 148.3 | 37.2 | 27.6 |
| 1382 | 65.1 | 13.7 | 128.2 | 0.9 | 55.5 | 178.3 | 61.0 | 24.1 |
| 1383 | 84.4 | 19.2 | 150.4 | 1.0 | 80.7 | 231.9 | 72.3 | 31.5 |
| 1384 | 134.6 | 65.8 | 186.3 | 1.0 | 83.3 | 330.9 | 117.6 | 22.5 |
| 1385 | 151.6 | 79.5 | 181.9 | 0.9 | 161.1 | 415.8 | 145.6 | 13.6 |
| 1386 | 191.8 | 106.4 | 173.5 | 1.3 | 156.6 | 421.3 | 147.8 | 60.6 |
| 1387 | 239.7 | 139.6 | 215.7 | 1.0 | 246.2 | 582.7 | 223.0 | 36.5 |
| 1388 | 300.0 | 166.5 | 157.8 | 0.8 | 220.1 | 593.8 | 198.2 | 53.3 |
| 1389 | 284.5 | 99.8 | 434.5 | 1.3 | 63.2 | 659.3 | 212.8 | 23.9 |
| 1390 | 359.5 | 185.0 | 568.3 | 1.6 | 60.9 | 877.7 | 289.0 | 8.6 |
| 1390* | 284.7 | 88.2 | 515.4** | | 54.9 | 707.9 | 178.6 | 9.4 |
| 1391* | 326.7 | 109.5 | 360.5** | | 64.5 | 782.8 | 84.0 | 0.9 |

Source: CBI Annual Review (for 1380-1390); Report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2) for 1391 statistics
* First 11 months only
** Includes the sales of oil and oil products as well as the sale of assets

Figure 2 compares current expenses with acquisition of non-financial assets.

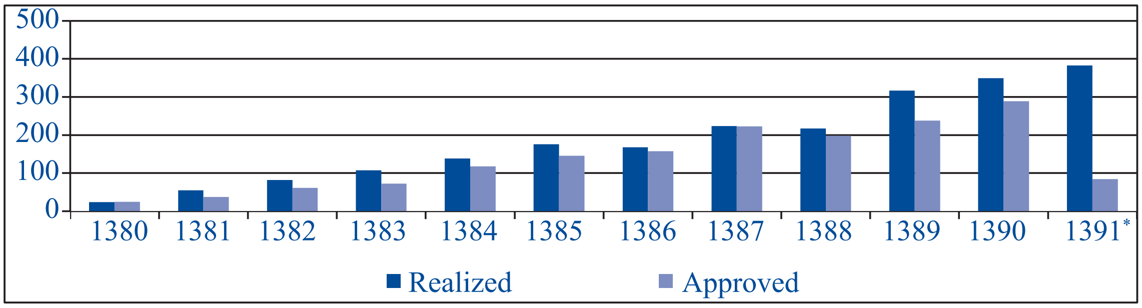
**Figure 2 - Comparison of Acquisition of Non-financial Assets and Expenses, 1380-1391 (Rls. Trillion)**




Source: CBI Annual Review for 1380-90 statistics and report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2) for 1391 statistics
* first 11 months

As shown in Figure 3, during the examined years, actual acquisition of non-financial assets (also known as development expenditures) has been lower than its approved amount, a trend which intensified during the first 11 months of 1391. It should be noted that transfer of acquisition of non-financial expenditures to the future would also increase forthcoming expenses since devaluation of the rial against hard currencies, would further increase production costs. In addition, the decline in the share of acquisition of non-financial assets would cease any progress in ongoing projects and the carried out expenses will only cover fixed costs, which in turn, will question the economic justification of projects.

**Figure 3 - Comparison of Approved and Realized Non-financial Assets, 1380-1391 (Rls. Trillion)**




Source: CBI Economic Report and Balance Sheet (for 1380-1388 statistics), CBI Annual Review (for 1388-1390 statistics), and report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2) for 1391 statistics
* first 11 months

Table 11 summarizes the approved and realized operating balance (the difference between current revenues and expenditures), net disposal of non-financial assets (the difference between disposal and acquisition of non-financial assets), and transaction of financial assets and liabilities (the sum of operating and non-financial balances) from 1381 till the end of the first 11 months of 1391. As shown in the table, the operating balance for the first 11 months of 1391 had a deficit of 340 trillion rials, i.e., a 3 percent decline compared to the similar period in its previous year.

**Table 11 – Comparison of Approved and Realized Budget, from 1381 to 1391 (Rls. Trillion)**

| Year | 1381 | 1382 | 1383 | 1384 | 1385 | 1386 | 1387 | 1388 | 1389 | 1390 | 1390* | 1391* |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Operating Balance** | | | | | | | | | | | | |
| Approved | -73.0 | -80.7 | -103.7 | -144.0 | -163.1 | -147.7 | -331.9 | -123.5 | -227.6 | -287.9 | -287.9 | -357.4 |
| Realized | -86.2 | -99.4 | -128.3 | -130.5 | -184.7 | -123.1 | -203.4 | -127.2 | -275.1 | -333.2 | -350.8 | -340.2 |
| Realization (percent) | 118.1 | 123.2 | 123.8 | 90.6 | 113.2 | 83.4 | 61.3 | 103.0 | 120.8 | 115.7 | 121.8 | 95.2 |
| **Net Disposal of Non-financial Assets** | | | | | | | | | | | | |
| Approved | 47.6 | 44.9 | 43.4 | 58.9 | 7.1 | 7.6 | 78.5 | -47.4 | 139.3 | 241.0 | 241.0 | 301.3 |
| Realized | 65.9 | 55.2 | 79.1 | 69.7 | 37.2 | 27.0 | -6.4 | -39.6 | 222.9 | 280.9 | 336.8 | 276.5 |
| Realization (percent) | 138.5 | 122.9 | 182.4 | 118.3 | 521.9 | 356.4 | -8.1 | 83.5 | 160.1 | 116.6 | 139.8 | 91.8 |
| **Operating and Non-financial Balance** | | | | | | | | | | | | |
| Approved | -25.4 | -35.8 | -60.3 | -85.1 | -155.9 | -140.1 | -253.5 | -170.9 | -88.4 | -47.0 | -47.0 | -56.1 |
| Realized | -20.3 | -31.4 | -49.2 | -60.9 | -147.4 | -105.6 | -209.8 | -166.8 | -77.1 | -52.1 | -14.0 | -63.7 |
| Realization (percent) | 79.9 | 87.6 | 81.6 | 71.5 | 94.6 | 75.3 | 82.8 | 97.6 | 87.3 | 111.0 | 29.7 | 113.5 |

Source: CBI Economic Report and Balance sheet (for 1381-1388 statistics), CBI Annual Review (for 1388-1390 statistics), and report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2) for 1391 statistics
* first 11 months

During the examined period, the operating balance has always been negative, due mainly to unrealistic forecasts of tax incomes and other revenues on one hand and stickiness of current expenditures or their random increase on the other. In spite of having positive capital balances for most of these years[10], transaction of financial assets and liabilities has always been negative, and part of this budget deficit has been financed through the sale of government bonds, transfer of the assets of public companies, as well as withdrawals from the Foreign Exchange Reserve or the National Development Fund.

## 3-1- Privatization

Despite all the efforts made, the process of privatization in Iran has not been implemented in line with the objectives of true privatization and Article 44 of the Islamic Republic of Iran's Constitution, and has therefore triggered criticism of the government. Some of the deviations include the transfer of public companies to quasi-governmental companies to clear their debts, which resulted from the government's increasing debts to the Social Security Organization as well as some retirement funds and public companies. In 1391, the non-governmental sector (i.e., private individuals and companies) had a minor 12

10. The reason for negative approved capital balance in 1388 is due to the non-inclusion of figures relating to the clarification of real energy prices and gasoline imports in the calculation of revenues from sales of crude oil and oil products.

percent share of the 181,052 billion rials transferred shares of public companies, and the remaining 88 percent pertained to clearance of government debts. Clearly this does not comply with the true essence of privatization or Article 44 of the Constitution. Unfortunately, this trend has also continued in the budget bill of 1392 and has allowed the government to transfer the shares, assets and belongings of public companies to settle its debts.

## 3-2- Budget Act of 1392

Table 12 presents the main components of 1391 and 1392 calendar year Budget Acts. Given the economic problems in 1390, which also continued through 1391, such as the non-realization of over 40 percent of the revenues, it seems that the anticipated resources may no longer be accessible in 1392. This will likely exacerbate the existing budget deficit, further reduce non-financial costs, and worsen the economic and living conditions.

**Table 12 – Comparison of the 1391 and 1392 Budget Acts (Rls. Trillion)**

| | Budget Act of 1391 | Budget Act of 1392 |
|---|---|---|
| Revenues | 685 | 910 |
| Expenses | 985 | 1,210 |
| Disposal of non-financial assets | 626 | 700 |
| Acquisition of non-financial assets | 383 | 560 |
| Disposal of financial assets* | 131 | 70 |
| Acquisition of financial assets | 73 | 80 |
| Total general government consumption | 1,441 | 2,104 |
| Special revenues | 200 | 256 |
| General government consumption | 1,641 | 2,360 |
| Budget consumption of public companies and private institutions affiliated to the government and banks | 3,651 | 5,358 |
| Iran's total budget consumption | 5,103 | 7,277 |
| Revenues from Subsidies Reform Program | 660 | 500 |
| Credited subsidies* | 138 | 210 |

Source: Prepared on the basis of statistics provided in 1391 and 1392 Budget Acts and Majlis Research Center reports

* 1392 statistics are those of the 1392 Budget Act

## 3-3- Foreign Reserve Account and National Development Fund

The Foreign Exchange Reserve Account was established in 1379 to stabilize the amount of revenues (in foreign and domestic currencies) obtained from the sale of crude oil, to convert the assets derived from the sale of oil into other types of reserves and investment, to reduce the dependence of the government budget on oil exports income, and to strengthen private sector manufacturers and exporters. From 1379 until 1389, over USD 160 billion were deposited in this account, of which almost 10 percent was allocated to the private sector as facilities and the government spent most of the remaining portion, mainly with the permission of the Majlis.[11] It is evident that the Majlis has not been committed to its approved bills and decrees, and the government has also shown an overwhelming tendency towards increasing its own expenses through oil income, and the mere existence of the Foreign Exchange Reserve Account has not brought about financial discipline in the government. One of the main consequences of constant government withdrawals from this account has been an increase in liquidity volume over the past few years. Moreover, government expenses have surpassed its revenues, implying that despite its abundant reserves, the Foreign Exchange Reserve Account has once again faced deficit and these sums have been practically injected to the economy.

Due to the weak performance of the Foreign Exchange Reserve Account from the beginning of the Fifth Five-Year Economic Development Plan, the government established the National Development Fund and a portion of oil revenues was arranged to be deposited into this fund for payment to the private sector in the form of foreign exchange (and domestic currency) facilities. In 1389 and 1390 calendar years, 20 percent of Iran's oil revenues were deposited annually into this account, which increased to 23 percent in 1391, and is supposed to reach 26 percent in 1392. There are no official data available on the revenues and expenses of this fund, however, according to the public media and the Managing Director of the National Development Fund, it was estimated at USD 49.6 billion in the second month of 1392 (April 2013).[12]

## 4. The Subsidies Reform Program

The Subsidies Reform Program (SRP), also known as the Targeted Subsidies Program, which started in Azar 1390 (December 2011), is one of the most significant programs called for by the Economic Restructuring Program. According to Articles 7, 8, and 11 of the SRP, revenues from the removal of indirect subsidies, forecasted at 660 trillion rials in 1391, were to be distributed as follows: 50 percent to the households, 20 percent to the government and 30 percent to domestic producers. The outcomes of the SRP, however, were different from what had been envisioned. Specifically, only 52 percent of the expected revenues were realized and the government decided to borrow from the Central Bank in order to meet some of its cash subsidy commitments. The budget bill of 1392

11. Majlis Research Centre, "Acquaintance with the Foreign Reserve Account and National Development Fund", Khordad 1391(June 2012)

12. http://www.mehrnews.com/detail/News/2047616

had also forecasted the revenue from the removal of direct subsidies to energy carriers to reach 1200 trillion rials, but due to inflationary concerns, this was not approved by the Majlis' Planning and Budget Commission.

Finally, in the budget bill of 1392, a 500 trillion rials revenue has been estimated from the SRP and direct cash handouts of 455 thousand rials per person (similar to its previous year) has been considered, which constitutes 82 percent of the total revenues of the subsidies amounting to 410 trillion rials. In the meantime, the total shares of the manufacturing, government, and public health sectors add up to only 18 percent (equivalent of 90 trillion rials) of the revenues gained through implementation of the SRP. Therefore, the government approved that in 1392 the price of energy would increase by 38 percent compared to its previous year.

## 4-1- Implementation Consequences of the First Phase of SRP

Statistics on consumption of oil products from 28 of Azar 1389 until the end of Aban 1391 (December 2010 - November 2012) is presented in Table 13. As can be seen, after implementation of the SRP, the consumption of liquid gas, gasoline, kerosene, and gas oil have declined, while the consumption level of heavy fuel oil has increased.

**Table 13 – Consumption of Oil Products Before and After the Implementation of the Subsidies Reform Program (million liters per day)[13]**

| | Before[13] | After | Change ( percent) |
|---|---|---|---|
| Liquid Gas | 12.8 | 6.0 | -53.0 |
| Gasoline | 64.3 | 57.2 | -11.0 |
| Kerosene | 14.0 | 13.4 | -7.2 |
| Gas Oil | 92.9 | 91.7 | -1.3 |
| Fuel Oil | 40.7 | 45.5 | 11.9 |

Source: National Iranian Oil Products Refining and Distribution Company

Although factors such as expansionary monetary and fiscal policies and the increase in the value of hard currencies in terms of the Iranian rial have contributed to the inflation rate, the implementation of the SRP has had a twofold impact on these factors. A comparison of inflation rates on the bases of consumer and producer price indices in Figure 6 indicates that the effects of an increase in the price of energy would, with a lag, raise the inflation rate mainly through an increase in the producer price index. Therefore, it is possible that the consumer prices inflation rate that reached its peak of the recent years in 1391, would, as a result of the continuation of expansionary monetary and fiscal policies and the

13. Data in this column refer to the average daily consumption from in the period between Khordad 1388 (June 2009) to Aban 1389 (November 2010).

depreciation of the rial, maintain its upward trend in 1392.

The Gini coefficient is measure of incomes distribution, which varies between 0 and 1. A low Gini coefficient indicates a more equal distribution, with 0 corresponding to complete equality, while higher Gini coefficients indicate more unequal distribution, with 1 corresponding to complete inequality. Based on the CBI's estimation, after implementation of the subsidies reform program, the Gini index in urban regions declined from 0.3800 in 1389 to 0.3740 in 1390.

As a result of the inflationary conditions originated from the fiscal and monetary policies as well as the inflationary consequences of cash handouts, tightened sanctions imposed against Iran and foreign exchange rate fluctuations, the welfare situation in practice did not improve in 1391. According to the data published by the CBI, the food sector, which includes the basic needs of the lower income population, has experienced price increases of 45.6 percent in Azar 1391 (December 2012) compared to Azar 1390 (December 2011). Also, the public health sector experienced a 32.6 percent growth during this period. Due to the high importance of these expenses in the consumption basket of low-income households, the growth of these indices indicates a reduction in households' welfare, especially among the lower-income population.

### 4-2- Second Phase of SRP

Implementation of the second phase of the SRP without a logical and objective support of the manufacturing sector could bring about difficulties for the banking sector in terms of growing financial claims. With the increase in manufacturer's costs to liberate prices, the company's survival in the short-run is subject to not complying with their commitments to banks. Financial institutions are therefore exposed to liquidity shortage and the CBI is obliged to inject cash into banks which would lead to liquidity growth and further increase in price levels. However non-implementation of the second phase of the SRP will also increase energy prices and therefore bring about energy demand pressure. Therefore it is better to give this subject matter more time and after the new government takes office an overall agreement can be reached on how best to implement this program.

## 5. Balance of Payments

With the tightening of economic sanctions and the severe devaluation of the Iranian rial against hard currencies, Iran's balance of payments underwent major changes in 1391. At the time of writing this report, official statistics on the balance of payments are only available for the first 10 months of 1391. Table 14 presents the most important of such data and compares them with those in the first ten months of 1390, and also presents the statistics for the whole of 1390. As can be seen, the most significant developments in the balance of payments are the declines by USD 43.8 billion in oil exports and USD 11.7 billion in merchandise imports. On the other hand, non-oil exports have increased by USD 3.3 billion. Mainly because of these changes in the first ten months of 1391 compared to the similar period in 1390, the positive balance of merchandise account fell by 51.9 percent to reach USD 26.8 billion and the positive balance of the current account fell by 50.8 percent decrease to reach USD 23.7 billion. According to the Economic Deputy Director of the CBI, foreign currency transactions in 1391 increased CBI's foreign assets by USD 9.1 billion.

**Table 14 - Balance of Payments in 1390 and 1391 (USD million)**

| | 1390 | 1390* | 1391* | Change (percent) |
|---|---|---|---|---|
| **Current Account Balance** | **59,383** | **48,143** | **23,708** | **-50.8** |
| Goods Account | 67,069 | 55,611 | 26,762 | -51.9 |
| Exports (f.o.b.) | 144,874 | 122,129 | 81,560 | -33.2 |
| Oil Exports[14] | 118,232 | 101,598 | 57,715 | -43.2 |
| Non-oil Exports | 26,642 | 20,530 | 23,844 | 16.1 |
| Imports (f.o.b.) | 77,805 | 66,518 | 54,797 | -17.6 |
| Gas and Oil Products[15] | 5,726 | 3,186 | 2,097 | -34.2 |
| Other Goods | 72,079 | 63,332 | 52,701 | -16.8 |
| Services | -8,432 | -7,971 | -4,212 | -47.2 |
| Incomes | 323 | 176 | 711 | 303.2 |
| Current Transfers | 423 | 328 | 447 | 36.4 |
| **Capital and Financial Account Balance** | **-37,974** | **-8,027** | **-12,844** | **60** |
| Errors and Omissions | -21,409 | -22,587 | -2,952 | -86.9 |
| **Overall Balance** | **-** | **17,529** | **7,912** | **-54.9** |

Source: CBI, 1390 Annual Review, and report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2)
* First ten months only

As for the outlook of the balance of payments, the acceleration of the inflation rate could raise the production costs, and thus jeopardize the competitive edge of Iranian exports and lower their profit margins. Some experts believe that the shocks of the July 2013 sanctions on oil exports has already been mostly absorbed and the remaining negative effects are mostly in the areas restrictions on financial transactions and ability to access foreign reserves.

14. Value of crude oil, oil products, natural gas, gas condensates and natural gas liquids (Tariff codes: 2709, 2710 and 2711) exported by National Iranian Oil Company (NIOC), National Iranian Gas Company (NIGC), National Iranian Oil Refining and Distribution Company (NIORDC), petrochemical companies, and others (customs and non-customs)
15. Value of oil products, natural gas, gas condensates and natural gas liquids (Tariff codes: 2709, 2710 and 2711) imported by NIOC, NIGC, NIORDC, and others (customs and non-customs)

## 5-1- Oil and Gas Exports

During the first ten months of 1391, the value of Iran's oil exports amounted to USD 57.7 billion, indicating a 43.2 percent drop from the USD 101.6 billion exports during the similar period in 1390. According to the US Energy Information Administration, the volume of Iran's exports of crude oil and gas condensates has dropped from 2.5 million bpd in 2011 to 1.5 million bpd in 2012, indicating a 39 percent decrease. This is the lowest level of oil and gas exports Iran has had since 1986 in the midst of the Iran-Iraq war.[16] In 2012 Iran's production of crude oil and gas condensates also fell by about 700,000 bpd, or 17 percent below that in 2011. Mainly as a result of the US and EU-imposed sanctions, Iran's annual oil income has decreased from USD 95 billion in 2011 to USD 69 billion in 2012. The average price of Iran's heavy oil reached USD 109.1 per barrel during 2012, showing a 2.8 percent increase from 2011.

## 5-2- Merchandise Exports

According to Iran's Customs Office statistics, the value of non-oil exports fell by 4.0 percent in 1391 to reach USD 32.5 billion. The sharpest drop took place in petrochemical exports whose share in non-oil exports plunged from 44.5 percent in 1390 to 31.0 percent in 1391, mainly because of the sanctions. Main non-oil exports in 1391 included methanol that was worth USD 1,185 million and value share of 3.7 percent, liquid propane worth USD 1,134 million and value share of 3.5 percent, and oil bitumen worth USD 1,090 million and value share of 3.4 percent.

Table 15 presents the main destinations of Iranian exports in 1391 and shows that Iraq, with imports of USD 6,250 million and value share of 19.3 percent, was the main destination for Iranian goods. After that, China and the UAE with total imports of USD 5,501 million and USD 4,213 million from Iran, respectively, stood in the second and third places.

**Table 15 – Value of Non-oil Exports[17] to Top Five Destinations (USD millions)**

| | 1390 | 1391 | Share in 1391 (percent) |
|---|---|---|---|
| Iraq | 5,179 | 6,250 | 19.3 |
| China | 5,557 | 5,501 | 17.0 |
| United Arab Emirates | 4,509 | 4,213 | 13.0 |
| Afghanistan | 2,253 | 2,874 | 8.9 |
| India | 2,754 | 2,607 | 8.0 |
| Other Countries | 13,566 | 11,008 | 33.9 |
| Total | 33,819 | 32,454 | 100.0 |

Source: Iran Customs Office, Preliminary Foreign Trade Statistics for 1391

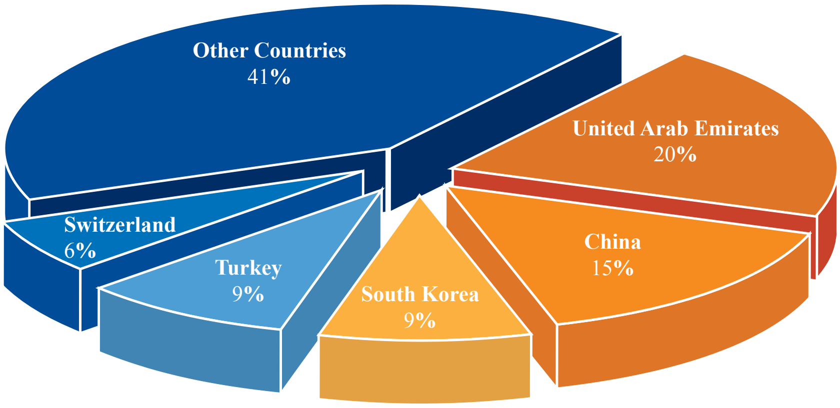
16. U.S. Energy Information Administration, "Sanctions Reduced Iran's Oil Exports and Revenues in 2012", 26 April 2013

17. Non-oil exports in this able do not include gas condensates.

## 5-3- Merchandise Imports

The value of Iran's merchandise imports fell by 13.7 percent in 1391 to reach USD 53.3 billion. Top imports in 1391 included durum wheat seed worth USD 2,574 million and value share of 4.8 percent, iron and non-alloy steel in ingots or other primary forms worth USD 2,015 million and value share of 3.8 percent, yellow maize worth USD 1,801 million and value share of 3.4 percent, oil-cake and other solid residues worth $1,532 million and value share of 2.9 percent, and rice worth USD 1,309 million and value share of 2.5 percent. During this year, "transportation machinery and equipment", "food products and live animals", and "iron and steel" product groups constituted 63.5 percent of the value of imported goods.
Iran's sources of imports have undergone a major change in recent years. While in 1381 four out of the five top exporters to Iran were European, in 1391 Switzerland was the only one. Germany, with value share of 17 percent in 1381, was the first source of Iran's imports, but it ranked 6th in 1391 with a value share of 5.3 percent. On the other hand, China, which held the 6th place in 1381 with a value share of 4.7 percent, jumped to the second place in 1391 with value share of 15.3 percent. As a result of such developments, as can be seen in Figure 4, the UAE with 20 percent share was Iran's major source of imports in 1391, followed by China, Republic of Korea, Turkey and Switzerland.

**Figure 4 - Top Five Country Sources of Iran Imports and their Shares**




Should the economic sanctions continue, countries that import oil from Iran will only be allowed to barter it with essential goods such as food products and medicine. In such a case major importers of Iranian oil in 1392 will also become the major sources of imports into Iran.

# 6. Foreign Exchange Market

In 1391 the Iranian rial depreciated significantly against hard currencies. The value of the USD increased from about 18,000 rials at the beginning of 1391 to about 34,050 rials at the end of the year, indicating a depreciation of the rial by over 90 percent against the USD. At some point during the year this exchange rate had even reached the unprecedented level of 40,000. To date, the fixed, multiple and managed floating exchange rate systems have been adopted in Iran. Until 1381 a managed floating exchange rate system was in place and several exchange rates existed in the market, causing significant economic problems. Given that despite the wide gaps between high domestic inflation rate and low foreign inflation rates, the rial exchange rate against major hard currencies had remained almost unchanged throughout the 1380s, foreign exchange shortages and a massive depreciation of the seemed inevitable. The first signs of foreign currency troubles appeared in September 2010 when certain countries refused to settle their accounts with Iran. In addition, the imposition of new sanctions gravely impacted the foreign exchange market in 1391 and played a significant role in the continuation of this depreciation.

The rial depreciation against hard currencies can be considered from both the supply and demand perspectives. On the supply side, sanctions on oil and gas sectors reduced Iran's export revenues in late 1390 and throughout 1391, and the sanctions on the banking system and the CBI made financial transactions with overseas difficult and costly, and thus limited foreign currency earnings. Moreover, the allocation of a large portion of the oil revenues to the import of goods and services throughout 1380s prevented foreign currency reserves from growing in proportion to the increase in oil incomes. Additionally, the sanctions on the banking sector limited Iran's access to even these reduced foreign currency earnings.

The demand for foreign currency can be considered from the two perspectives of transactions and speculation. The expansion of the liquidity volume, caused partly by the implementation of the subsidies reform program, has been among the main reasons for the sharp growth in foreign currencies demand and depreciation of the rial in the past two years. Also, further to the tightening of sanctions and appearance of inflationary expectations in 1391, speculative demand for foreign currencies grew in the market. The rising inflation rate and significant depreciation of the rial induced many to convert their rial assets into foreign currencies in the hope of protecting the value of their assets. This exacerbated speculative demand so much that, according to the Governor of the CBI, in November 2012 Iranians kept about USD 18 billion worth of foreign currency in their homes.

Another major development in the foreign currency market was the establishment of the Foreign Exchange Transaction Center and the ranking of imported goods for the assignment of foreign currencies at preferential exchange rates. The so-called "non-reference foreign exchange rate" for the USD was first set at 23,622 rials in October 2012 and gradually grow to 24,580 rials by 20 March 2013.[18] The creation of this Foreign

18. CBI website

Exchange Transaction Center brought about a three-tier exchange rate system, namely, the free market rate, the official rate and the non-reference rate. The official or governmental foreign exchange rate is set and announced by the CBI on a daily basis and is used by the government and banks for the conversion of their foreign currency holdings into rial. In 1391, the CBI took steps to put the foreign currency market in order. These steps included limiting the offering of foreign exchange to travelers at official exchange rate to between USD 400-1,000, depending on the means and destinations of their travel; and limiting travelers' currency import and export to USD 5,000. Furthermore, a number of so-called "foreign currency market agitators" were arrested and the purchase and sale of foreign exchange outside the banking system and other authorized foreign exchange centers was declared illegal.

## 7. Monetary and Credit Policies

In recent years, the government's fiscal expansion helped by marge oil revenues has weakened CBI's monetary and exchange rate policy-making instruments. Government's control over the banking sector has also significantly limited banks' competitiveness and ability to rationally allocate their resources. Significant remaining instruments of improving the performance of the monetary sector include financial discipline and the rationalization of government budget expenditures.

One of the major economic management responsibilities in any country is guidance and control of major economic variables such as liquidity, inflation, economic growth and employment -- whose recent data are presented in Table 16. These variables can be influenced by economic policies including fiscal and monetary policies.

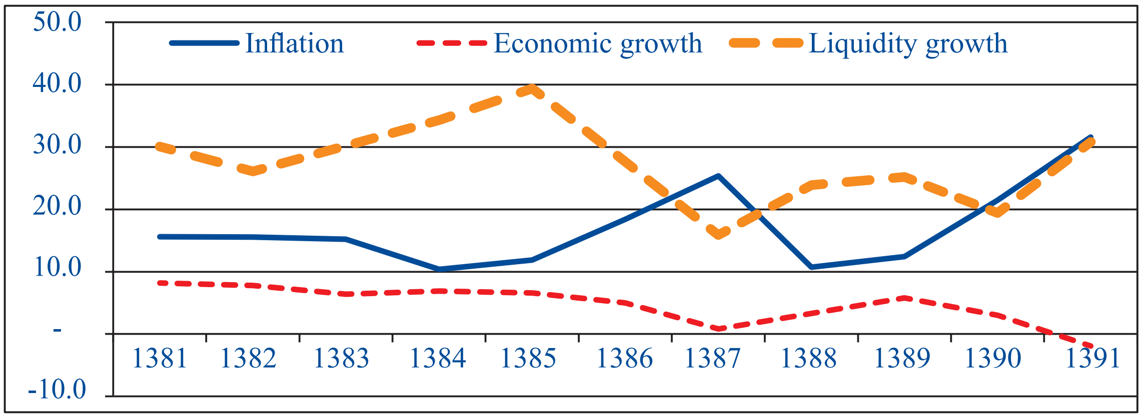
**Table 16 – Growth Rates of some Macroeconomic Variables (in percentage points)**

| Year | GDP | Liquidity Growth | Inflation | Unemployment |
|---|---|---|---|---|
| 1381 | 8.2 | 30.1 | 15.6 | 12.8 |
| 1382 | 7.8 | 26.1 | 15.6 | 11.8 |
| 1383 | 6.4 | 30.2 | 15.2 | 10.3 |
| 1384 | 6.9 | 34.3 | 10.4 | 11.5 |
| 1385 | 6.6 | 39.4 | 11.9 | 11.3 |
| 1386 | 5.0 | 27.7 | 18.4 | 10.5 |
| 1387 | 0.8 | 15.9 | 25.4 | 10.4 |
| 1388 | 3.0 | 23.9 | 10.7 | 11.9 |
| 1389 | 5.8 | 25.2 | 12.4 | 13.5 |
| 1390 | 3.2 | 19.4 | 21.5 | 12.3 |
| 1391 | -1.9 | 30.8 | 31.6 | 12.2 |

Source: CBI for statistics on inflation, GDP growth (from 1381 to 1389) and liquidity; SCI for unemployment rate, GDP growth rate in 1390; and the International Monetary Fund for GDP growth in 1391

Liquidity growth can bring about economic growth. However, due to the improper implementation of monetary policies, recent liquidity expansions have not led to economic growth, and instead have further increased prices levels so much that Iran's highest inflation rate in the past decade was recorded in 1391. Meanwhile, as indicated in Figure 5 and elsewhere in this report, despite the growth of the liquidity volume in recent years, the economy actually contracted in 1391.

**Figure 5 - Growth Rates of GDP, Liquidity and Inflation in 1381-91(in percentage points)**




Source: CBI Annual Review for 1381-90 statistics, and report by the Deputy Governor of the CBI for Economic Affairs (refer to footnote 2) for 1391 statistics

## 7-1- Liquidity and its Affecting Factors

Iran's liquidity growth is associated with the government's fiscal and budgetary policies which, through the use of oil incomes, affect the monetary base components. Data in Table 17 show that liquidity has been expanding in recent years and grew by 30.8 percent 1391 to reach 4,609 trillion rials. In 1391 the monetary base and money multiplier expanded by 27.2 and 2.8 percent, respectively.

**Table 17 - Liquidity and its Determinants, 1384-91**

| Year | 1384 | 1385 | 1386 | 1387 | 1388 | 1389 | 1390 | 1391 |
|---|---|---|---|---|---|---|---|---|
| Monetary base (Rls. Trillion) | 220.5 | 280.0 | 365.5 | 539.4 | 603.8 | 686.4 | 764.6 | 972.9 |
| Money multiplier | 4.2 | 4.6 | 4.5 | 3.5 | 3.9 | 4.3 | 4.6 | 4.7 |
| Liquidity (Rls. Trillion) | 921.0 | 1,284.2 | 1,640.3 | 1,901.4 | 2,355.9 | 2,948.9 | 3,522.2 | 4,606.9 |

Source: CBI Economic Trends for 1384-1390 statistics, and report by the Deputy Governor of the CBI for Economic Affairs for 1391 statistics (refer to footnote 2)

On the monetary base side, in 1391 although the net foreign assets grew by 0.9 percent, the reduction in oil incomes prevented it from having a significant role in monetary base growth. The main cause of the accelerated growth in monetary base was a 161 percent growth in the net indebtedness of the public sector to the CBI in 1391. This was due to factors including the decline in government's oil incomes and the resulting 8 percent decrease in the government's deposits with the CBI; the 43.1 percent increase in the public sector's debt to the CBI and the sustained budget deficit. The government's strict supervision and control of the banking sector have affected banks' resources and their indebtedness to the CBI. Due to policies such as providing facilities to SMEs, the Mehr Housing Project and imposing ceilings on credits to economic sectors, banks' indebtedness to the CBI has increased in recent years. In 1391 it increased by 17.5 percent which, although showing a slight decline from the growth rates in preceding years, still affected the monetary base growth.

The change in deposits configuration and their growth rates depend on factors such as the savings accounts interest rate, inflation expectations and macroeconomic policies. During the first 9 months of 1391, the non-sight and sight bank accounts grew by 33.7 percent and 25.9 percent, respectively. The growth in sight accounts implies that asset holders anticipated profit opportunities in markets such as real estate and housing, property, gold and foreign exchange to hedge their assets against inflation.

A look at the liquidity composition during this period indicates a decline in the share of money from 23.7 percent in 1390 to 22.7 percent in 1391. Table 18 presents data on some monetary and credit variables.

**Table 18 – Monetary and Credit Variables, 1380-1391 (Rls. Trillion)**

| Year | 1380 | 1381 | 1382 | 1383 | 1384 | 1385 | 1386 | 1387 | 1388 | 1389 | 1390 | 1391 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Banks claims on public sector* | 138.5 | 206.2 | 221.9 | 235.9 | 235.6 | 256.2 | 280.6 | 291.5 | 364.6 | 553.4 | 677.6 | 532.1 |
| Government* | 72.2 | 128.9 | 143.0 | 148.7 | 135.8 | 160.3 | 188.7 | 206.9 | 284.9 | 468.9 | 527.5 | 509.4 |
| Public corporations and institutions* | 66.3 | 77.3 | 78.9 | 87.2 | 99.8 | 96.0 | 91.9 | 84.6 | 79.7 | 84.5 | 150.1 | 22.6 |
| Central Bank claims on Public sector | 82.4 | 131.6 | 136.0 | 132.4 | 123.2 | 131.4 | 131.8 | 130.3 | 135.0 | 222.6 | 218.9 | 313.3 |
| Government | 64.6 | 111.6 | 117.1 | 111.9 | 101.3 | 104.1 | 97.8 | 91.4 | 92.2 | 173.0 | 518.9 | - |
| Public corporations and institutions | 17.7 | 19.9 | 18.9 | 20.4 | 22.0 | 27.3 | 33.9 | 38.8 | 42.7 | 49.6 | 157.6 | - |
| Banks indebtedness to Central Bank | 12.1 | 24.3 | 23.5 | 21.5 | 35.9 | 54.9 | 137.7 | 239.7 | 168.9 | 329.7 | 418.3 | 491.4 |
| Banks and credit institutions' claims on non-public sector* | 242.5 | 327.1 | 454.8 | 142.0 | 865.3 | 1,226.2 | 1,663.7 | 1,866.6 | 2,137.4 | 2,929.2 | 3,524.5 | 3,917.6 |
| Monetary base | 97.2 | 119.6 | 133.1 | 152.0 | 220.5 | 280.0 | 365.5 | 539.4 | 603.8 | 686.4 | 764.6 | 972.9 |
| Money* | 143.0 | 182.7 | 217.4 | 252.6 | 317.9 | 280.0 | 535.7 | 525.5 | 601.7 | 758.7 | 874.2 | 976.4 |
| Liquidity | 321.0 | 417.5 | 526.6 | 685.7 | 921.0 | 1,284.2 | 1,640.3 | 1,901.4 | 2,355.9 | 2,948.9 | 3,522.2 | 4,606.9 |

Source: CBI Economic Trends (for 1380-1390 statistics), and report by the Deputy Governor of the CBI for Economic Affairs for 1391 statistics; (refer to footnote 2)

* The 1391 statistic is for the first 9 months only.

## 7-2- Monetary and Banking Sectors Challenges

Administrative setting of bank interest rate, non-competitiveness of a large part of the banking industry, administrative assignment of loans, non-independence of the CBI and the Money and Credit Council that sets monetary policies, dominance of fiscal policies over monetary policies, and the lack of fiscal and budgetary discipline bring about an environment where banks cannot operate efficiently and it is very difficult to rein in inflation and bring about economic growth. This part of the report will study the above-mentioned issues in greater details.

### Bank Rates Determinants

The most important indicator used to manage liquidity and foreign exchange markets is the efficiency of the financial and real assets markets as reflected in bank interest rates for lending and deposit. Every period during which markets parallel to money and capital --such as foreign exchange, gold and property markets--have had high rates of return (mainly due to economic policies), liquidity has been directed into non-productive activities and slowed economic growth.

As presented in Table 19, the real (interest) rate of deposits has mostly been negative during the studied period and due to inflation and execution of instructed interest rates, account holders have practically suffered a loss, though in some years the loans real interest rate has also been negative. This implies that the money obtained from account holders (through taxation) has been paid to loans/subsidies recipients.

**Table 19 - Nominal and Real Deposits, Loans, and Inflation Rates, 1380-90 (percent)**

| Year | Nominal Rate (weighted average) | | Inflation Rate | Real Rate (weighted average) | |
|---|---|---|---|---|---|
| | Deposits | Loans | | Deposits | Loans |
| 1380 | 12.0 | 17.4 | 11.3 | 0.7 | 6.1 |
| 1381 | 12.1 | 17.3 | 15.6 | -3.5 | 1.7 |
| 1382 | 12.2 | 17.5 | 15.6 | -3.4 | 1.9 |
| 1383 | 12.6 | 18.3 | 15.2 | -2.6 | 3.1 |
| 1384 | 12.9 | 18.5 | 10.4 | 2.5 | 8.1 |
| 1385 | 11.5 | 14.5 | 11.9 | -0.4 | 2.6 |
| 1386 | 12.9 | 12.0 | 18.4 | -5.5 | -6.4 |
| 1387 | 14.4 | 12.0 | 25.4 | -11.0 | -13.4 |
| 1388 | 13.3 | 12.0 | 10.7 | 2.6 | 1.3 |
| 1389 | 12.1 | 17.2 | 12.4 | -0.3 | 4.8 |
| 1390 | 15.2 | 16.2 | 21.5 | -6.3 | -5.3 |

Source: CBI

## The High Ratio of Loans Balance to Bank Deposits Balance

In recent years the ratio of loans balance to bank deposits balance has been close to one and even in 1389 and 1390 it reached above 1. Though the ratio in 1391 dropped to 99.7 percent, in Iran's banking system where there exists is a Reserve Requirement (RR) as well as precautionary reserves, this ratio should be around 85 percent. The higher level of banks consumptions compared to their resources could be related to excessive withdrawals from the CBI. Overall, due to the government's interference in the banking system, banks resources and consumption in practice do not have a healthy relationship.

## Non-current Claims of the Banking System

Financial institutions with deposits and loans interest rates which are generally lower than the inflation rate face high demand for loans. The excessive demand for bank loans and inefficient methods of evaluating bank customers' credits have caused an unusual increase in the ratio of non-current claims to banks total claims, in such a way that in 1390 and 1391 the noted ratio was about 15 percent. According to the World Bank figures, the average of the mentioned ratio in 2011 among 105 countries worldwide was only 7 percent.[19]

## The 1385 Law on Rationalizing Bank Interest Rates

Certain Majlis degrees that have been issued without regards to important macroeconomic variables have weakened money market mechanisms and brought about discord in the market. A case in point is the "law on the rationalization of bank interest rates in accordance with the rate of return in various economic sectors" that has created obstacles on the way of CBI's achievement of its policy objectives.[20] This law obliged the CBI to set a single digit interest rate for loans in all economic sectors before the end of the Fourth Economic Development Plan while the inflation during this period has consistently been at two-digit rates. One of the negative consequences of this law was driving banks towards executing partnership contracts, as banks refused to grant loans to transactional contracts (which had a lower interest rate than that of partnership contracts).

## Increase in Banks' Indebtedness to CBI

As a result of implementation of assigned credit policies, in recent years the liquidity condition of banks and credit institutions has suffered from difficulties, and in order to provide the current liquidity, banks have been forced to use credit lines and withdraw

19. http://data.worldbank.org/indicator/FB.AST.NPER.ZS
20. The "Law of the rationalization of bank loan rates in accordance with the rate of return in various economic sectors" requires the government and the CBI to mobilize and allocate bank resources during the Fourth Five-Year Economic, Social and Cultural Development Plan of the I.R. Iran in such a way as to bring down the expected rate of return of bank facilities in contracts with fixed rate of return to single-digit levels by the end of the Plan.

excessively from the CBI. Consequently, the banks indebtedness to the CBI, which is one of the components of the money base sources, has had a growing trend. As presented earlier in Table 18, banks indebtedness to the CBI in the first years of the 1380s experienced a slight growth, but starting from 1385, excessive withdrawal of banks from the CBI has intensified. Banks indebtedness to the CBI in 1389 and 1390 grew by 95 percent and 89 percent, respectively, however due to some positive steps taken by the CBI in 1391 its growth rate declined to 17.5 percent.

### Financial and Trade Restrictions

Given the reduction of Iran's oil revenues due to the sanctions and the government's borrowing from the CBI to finance its budget deficit, issues such as high inflation rate, low levels of foreign exchange, and declines in investment, employment and production are to be expected. The continuation and tightening of sanctions against Iran, through reducing oil income and further limiting CBI's access to foreign exchange, and banks' inability to exchange trade documents in time, can lead to further increases in transaction costs and credit risks.

## 8. Prices and Inflation

The Consumer Price Index (CPI) in Iran is published by both CBI and SCI but, since they use different consumption baskets and base years, their indices are usually slightly different from each another. According to the CBI statistics, the monthly point-to-point inflation rate has mostly had an upward trend in 1391 reaching 40.7 percent in the last month of 1391 (March 2013) from 23.9 percent in the first month of the year (April 2012). Table 20 presents annual CPI inflation rates in urban areas from 1386 to 1391 as published by the two authorities. The inflation rate calculated by the CBI has been on the rise since 1388 to reach 31.6 percent in 1391. Table 21 shows that the annual inflation rate in the Food, Beverages and Tobacco group -- which constitutes 25.7 percent of the consumption basket of urban households --was 46.5 percent, much higher than the average.

**Table 20 – Annual Inflation Rates, 1386-91 (in percentage points)**

| Year | According to SCI | According to CBI |
|---|---|---|
| 1386 | 17.2 | 18.4 |
| 1387 | 25.5 | 25.4 |
| 1388 | 9.5 | 10.8 |
| 1389 | 13.9 | 12.4 |
| 1390 | 26.4 | 21.5 |
| 1391 | 31.5 | 31.6 |

Sources: SCI and CBI

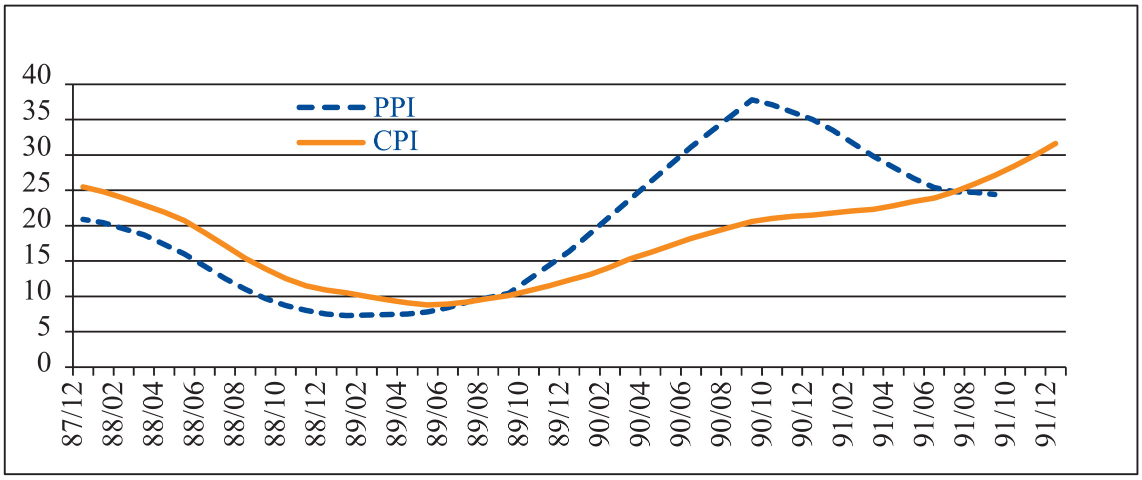
**Table 21- Annual Changes in Urban Households' CPI and its Main Components, and the Weights of those Components, 1382-91 (percent)**

| | Food and Beverages and Tobacco | Clothing and Footwear | Housing, Electricity, Gas and other Fuels | Furnishing, Household Equipment and Routine Household Maintenance and Repair Services | Health | Transport | Communication | Recreation and Culture | Education | Restaurants and Hotels | Miscellaneous Goods and Services | Special Groups | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | | | | | | | | | | Goods | Services |
| 1382 | 15.0 | 7.9 | 17.7 | 7.9 | 13.7 | 10.0 | 10.8 | 6.4 | 6.6 | 14.8 | 16.7 | 11.6 | 16.8 |
| 1383 | 15.0 | 10.5 | 17.5 | 13.2 | 14.9 | 10.0 | 7.9 | 10.9 | 13.9 | 14.2 | 15.5 | 12.7 | 16.9 |
| 1384 | 10.4 | 12.5 | 14.4 | 12.6 | 19.2 | 6.6 | 4.1 | 9.4 | 10.4 | 11.3 | 14.6 | 9.7 | 14.8 |
| 1385 | 12.9 | 9.1 | 19.1 | 8.4 | 16.3 | 6.2 | 0.3 | 4.8 | 4.8 | 10.7 | 18.8 | 10.2 | 17.5 |
| 1386 | 19.6 | 9.9 | 22.5 | 10.6 | 11.2 | 11.1 | 0.2 | 7.2 | 3.4 | 14.0 | 17.1 | 14.7 | 19.7 |
| 1387 | 32.3 | 16.0 | 30.4 | 22.4 | 14.8 | 13.3 | 0.5 | 9.1 | 4.6 | 22.5 | 19.6 | 24.1 | 26.9 |
| 1388 | 13.2 | 9.3 | 8.1 | 6.6 | 10.2 | 4.8 | 1.1 | 6.5 | 8.4 | 12.9 | 14.5 | 10.3 | 8.6 |
| 1389 | 22.9 | 8.4 | 9.2 | 6.7 | 12.1 | 12.6 | 0.4 | 9.5 | 12.6 | 14.3 | 23.8 | 20.3 | 7.8 |
| 1390 | 32.7 | 15.4 | 27.7 | 12.3 | 11.1 | 21.3 | 3.7 | 14.5 | 10.9 | 17.0 | 42.5 | 39.8 | 12.0 |
| 1391 | 46.5 | 35.3 | 16.9 | 37.5 | 22.0 | 21.8 | 10.0 | 38.5 | 9.8 | 30.7 | 67.7 | 40.4 | 18.8 |
| April | 36.1 | 24.7 | 17.6 | 20.3 | 13.4 | 12.3 | 5.5 | 28.2 | 10.7 | 23.2 | 66.1 | 33.3 | 14.9 |
| May | 37.6 | 25.4 | 15.5 | 21.9 | 14.1 | 12.9 | 5.6 | 27.8 | 10.6 | 23.9 | 46.9 | 31.1 | 15.7 |
| June | 35.8 | 25.3 | 14.9 | 21.9 | 13.8 | 12.7 | 2.2 | 27.8 | 10.9 | 24.3 | 45.5 | 29.6 | 15.5 |
| July | 43.6 | 26.1 | 14.4 | 21.9 | 17.1 | 12.6 | 4.5 | 28.9 | 11.1 | 24.8 | 54.0 | 34.2 | 15.9 |
| August | 46.1 | 27.1 | 14.2 | 23.2 | 18.2 | 13.6 | 4.7 | 30.9 | 11.2 | 25.8 | 52.8 | 34.3 | 17.7 |
| September | 45.0 | 29.2 | 16.6 | 26.3 | 19.3 | 14.7 | 5.2 | 31.8 | 9.9 | 28.4 | 49.5 | 36.2 | 17.5 |
| October | 48.1 | 35.5 | 17.7 | 36.0 | 25.4 | 20.1 | 8.7 | 39.9 | 8.9 | 31.1 | 97.6 | 43.1 | 19.5 |
| November | 53.3 | 42.0 | 18.7 | 47.7 | 27.3 | 25.1 | 9.5 | 43.7 | 8.7 | 34.5 | 92.1 | 47.8 | 20.9 |
| December | 49.9 | 45.3 | 17.3 | 52.5 | 28.0 | 25.6 | 18.2 | 45.0 | 8.1 | 35.7 | 85.2 | 45.3 | 21.2 |
| January | 48.6 | 46.1 | 17.9 | 55.9 | 28.8 | 28.2 | 18.3 | 50.3 | 8.9 | 38.0 | 82.6 | 45.3 | 21.9 |
| February | 54.8 | 48.3 | 18.8 | 60.6 | 29.2 | 42.0 | 18.7 | 52.8 | 9.2 | 39.0 | 76.6 | 51.4 | 22.5 |
| March | 58.5 | 49.0 | 18.8 | 62.1 | 29.8 | 42.2 | 18.6 | 54.4 | 9.3 | 39.9 | 63.1 | 52.9 | 22.8 |
| Weight | 26.7 | 6.7 | 32.6 | 5.9 | 6.1 | 11.5 | 2.5 | 3.1 | 1.6 | 2.2 | 2.9 | 55.0 | 45.0 |

Source: SCI

According to the IMF, Iran's high inflation rate places it as the 4th country with the highest inflation rates in the world in 2012 -- following Belarus, Southern Sudan and Sudan.[21]
Following the sharp increase of domestic energy prices in December 2010 and the non-payment of cash subsidies to manufacturers, the Producer Price Index (PPI) increased rapidly and surpassed the CPI. According to the CBI statistics, the PPI inflation rate reached 34.2 percent in 1390, which was 13 percentage points above the CPI inflation rate. Although statistics on PPI inflation rate has not been published for 1391, data for the first nine months of this year indicate that the PPI inflation rate is declining. The PPI inflation rate for the first 9 months of 1391 was 25.7 percent, which is lower than the CPI inflation rate of 29.1 percent over the same period. The trends of the annual consumer and producer price inflation rates since the 12 months ending in March 2009 are presented in Figure 6.

**Figure 6 - Trends of the CPI and PPI Inflation Rates, 1387-1391 (percent)**




Source: CBI

Some of the reasons for the high inflation rates in 1391 include the effects of the subsidies reform program; the 30.8 percent liquidity growth; the decline in imports due to the tightened sanctions; and the weakened purchasing power of the rial. High inflation expectations, and thus the increase in speculative demand for goods, gold and foreign exchange are among other inflationary factors in 1391.

## 9. Capital Market

In 1391 the Tehran Stock Exchange (TSE) witnessed a 46.8 percent growth; its general price index (TEPIX) that had closed 1390 at 25,905.6, rose to close 1391 at 38,040.8. The year 1391 was a bumpy year for the capital market during which the high inflation and

21. IMF, World Economic Outlook, April 2013, Table A7

currency depreciations impacted many companies' revenues, especially during the second half of the year. The net effect was generally positive for companies with hard foreign currency revenues and negative for others. Besides, the tightening of the sanctions and their extension to energy exports and financial transactions also negatively impacted the capital market. Table 22 presents various capital market indices and their growth rates in 1391.

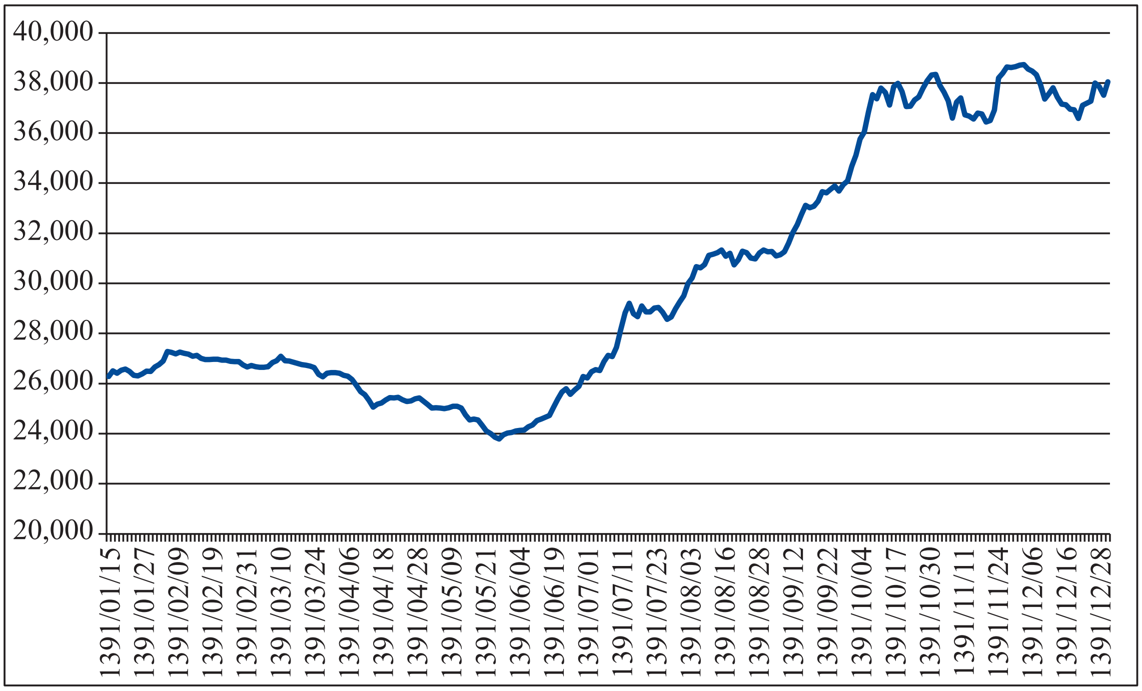
**Table 22 - Various Capital Market Indices and Market Capitalization at Year-ends 1390 and 1391**

| | 1390 | 1391 | Growth rate (percent) |
|---|---|---|---|
| General index | 25,905.6 | 38,040.8 | 46.8 |
| Primary market index | 21,643.3 | 30,030.7 | 38.8 |
| Secondary market index | 34,348.2 | 62,839.9 | 82.9 |
| Industrial index | 60,191.5 | 60,811.6 | 1.0 |
| Financial index | 105,398.0 | 154,771.0 | 46.8 |
| Dividend and Price index | 20,697.7 | 32,891.7 | 58.9 |
| Top 50 performers index | 1,247.1 | 1,617.7 | 29.7 |
| Market capitalization (Rls. Trillion) | 1,282.5 | 1,707.5 | 33.1 |

Source: TSE

As exhibited in Figure 7 below, the TEPIX passed 27,000 by mid-April, weakened and had a declining trend, reaching 23,787.3 on 8 August 2012, but then started a rising trend to reach 32,018.1 on 21 November 2012, when market capitalization surpassed 1,456 thousand billion rials for the first time.

**Figure 7 – Trend of the Main Tehran Stock Exchange Index (TEPIX) in 1391**




Source: TSE

In early February 2012, some the stocks of companies that had been frozen were reopened and as a result the TEPIX surpassed 37,000. The offering of the Isfahan Oil Refinery stocks, which had been frozen since 16 April 2012, all by itself resulted in a 3.5 percent jump of the TEPIX on 9 February 2013. The TSE closed the year on 18 March 2013, at 38,040.8.

A noteworthy capital market development in 1391 was the offering of Put Options for certain stocks. Another major event was the initial offering of 5 percent of the shares of the Persian Gulf Holding Company that was the largest privatization under the new interpretation of Article 44 of the Constitution of the Islamic Republic of Iran. While the maximum value of its shares were estimated at 7,000 rials, they were offered at 9,950 rials and only 11,000 of the 1,239.4 million shares were purchased. At the end those 11,000 trades were voided and the share offering was postponed to 1392, when on 7 April 2013 they were offered at 7,500 rials. More than 55 percent of these shares were purchased by private companies and the rest by individuals.

In 1391, stocks of many large companies enjoyed considerable growth. A look at the most profitable industries at the TSE shows that mining companies with 114 percent growth, refining companies with 211 percent growth, and chemical industries (that includes petrochemical and chemical companies) with 95 percent growth, experienced the highest returns. The only large industry whose stocks did not do well was banking the shares of which fell by 1.4 percent, mainly as a result of the extension of sanctions to the banking system and the limitations they imposed on foreign exchange transfers.