



Iran's Economy Report

Year 1395

(March2016-Feb.2017)

Aug.2017

SMART INVEST IRAN

Iran's Economy at a Glance

Year 1395 (March2016-Feb2017)

Participation and unemployment rate (percent)							
	1394	1395Q1	1395Q2	1395Q3	1395Q4	1395	1396Q1
Participation (10 years and over)	38.2	39.5	40.4	38.9	38.9	39.4	
Unemployment (10 years and over)	11.0	12.2	12.7	12.3	12.5	12.4	
Unemployment (Youth ages 15-24)	26.1	27.8	30.2	30.4	28.1	29.2	
Real Growth Rates of GDP and its Subsectors (percent)*							
Gross Domestic Product (GDP)	-1.6	7.5	12.9	16.8	12.9	12.5	-
Oil	7.2	57.6	66.2	77.7	47.1	61.6	-
Agriculture	4.6	3.5	4.1	5.0	4.4	4.2	-
Industries and Mines	-6.1	-5.1	3.0	4.1	6.4	2.2	-
Services	-2.3	-0.7	4.2	6.0	4.9	3.6	-
GDP (Excluding Oil)	-3.1	-1.8	3.9	5.4	5.6	3.3	-
Gross Fixed Capital Formation	-12.0	-16.3	3.1	-9.5	3.1	-3.7	-
Oil (thousand barrels per day)							
Production	3,231	3,544	3,963	3,894**	3,760		-
Export	1,574	2,008	2,157	2,426			-
Inflation Rates (percent)							
Growth Rate of Consumer Price Index	11.9	7.2	8.9	9.2	10.7	9.0	11.7
Growth Rate of Producer Price Index	4.9	2.7	3.0	5.2	8.8	5.0	8.9
Balance of Payments (USD millions)							
Oil Exports	33,569	11,640	13,167	15,070	-	-	-
Non-Oil Exports	31,028	7,264	6,073	7,078	-	-	-
Imports of Goods	52,419	12,382	15,114	16,761	-	-	-
Goods Account (Net)	12,177	6,522	4,126	5,387	-	-	-
Non-Oil Goods Account (Net)	-19,158	-4,817	-8,718	-9,135	-	-	-
Current Account	9,016	5,231	3,459	3,225	-	-	-
Capital Account	-2,513	-5,022	-814	-3,298	-	-	-
Change in Foreign Reserves	2,233	-6,171	-1,473	-231	-	-	-
Foreign Exchange Rates (USD/IRR daily average)							
In Free Market	34,481	34,691	35,326	36,987	38,581	36,487	37,494
In Interbank Market	29,632	30,358	31,014	31,845	32,380	31,458	32,445
Monetary and Credit Aggregates (end of period - in IRR trillions)							
Monetary Base (M0)	1,533.6	1,585.2	1,655.1	1,704.7	-	-	-
Liquidity (M2)	10,172.9	10,595.0	11,227.1	11,848.6	-	-	-
Money (M1)	1,367.1	1,364.4	1,480.3	1,540.7	-	-	-
Government Budget (IRR trillions)							
Total Revenues	1,797.2	255.5	580.9	473.5	892.7	2,202.6	-
Tax Revenues	791.9	184.9	248.2	221.9	359.7	1,014.7	-
Oil Revenues	670.3	43.6	201.5	176.8	316.9	738.8	-
Other	335.0	27.1	131.1	74.8	216.1	449.1	-
Total Expenditures	1,993.6	416.0	674.7	488.2	911.2	2,490.0	-
Current Expenditures	1,706.9	368.8	582.2	449.2	672.8	2,073.0	-
Development Expenditures	277.0	1.4	120.9	36.0	258.7	417.0	-
Budget Balance	-196.4	-160.4	-93.8	-14.7	-18.4	-287.4	-
Tehran Stock Exchange (end of period)							
Overall Index (TEDPIX)	80,219	72,615	76,451	80,123	77,230	77,230	78,736
Financial Index	158,225	145,481	155,263	151,049	131,865	131,865	1330,664
Industrial Index	66,994	60,464	63,495	67,466	66,100	66,100	67,681
Market Capitalization (IRR trillions)	3,448.4	3,080.6	3,168.1	3,373.7	3,220.4	3,220.4	3,201.4

1. Real Sector

The latest official statistics on the real sector of the economy published by the Central Bank of Iran (CBI) is for the fourth quarter of 1395 (1395Q4, almost overlapping with 2017Q1), and indicates the persistence of high economic growth that was observed in its preceding three quarters. For the year 1395 as a whole, economic growth rate reached its maximum of the past quarter of a century, mostly due to the fast expansion of the oil sector, although other sectors did well, too. The implementation of the Joint Comprehensive Plan of Action (JCPOA) between Iran and the group of 5+1 world powers helped eliminate trade restrictions and reduced uncertainties that resulted in a surge in production and exports of both oil and non-oil commodities and products. The considerable rise in gas production that led to increased exports of petrochemicals was the other important factor that contributed to the high economic growth. All in all, it was the fast utilization of unutilized capacity in various sectors that resulted in high growth despite the fact that gross fixed capital formation had vastly contracted in the past few years. Given the unbalanced nature of the growth and weak links between most activities with the oil and petrochemicals sectors, the boom, however, was not capital felt in all corners.

On the basis of CBI's preliminary estimates, economic growth rate in 1395 stood at 12.5 percent, and if oil is taken out, at 3.3 percent. The oil sector grew by 61.6 percent and accounted for 9.8 percentage points of the 12.5 percent overall growth. The services sector, which is the largest economic sector in Iran, grew by 3.6 percent and accounted for 1.9 percentage points of the overall economic growth. The industries and mining sector experienced 2.2 percent growth, despite the 13.1 percent contraction of the construction sector and accounted for 0.6 percentage points of the economic growth. And finally the agriculture sector grew by 4.2 percent and contributed 0.3 percentage points to the overall growth. Agriculture is the only sector that has consistently experienced about 5 percent annual growth in recent years. Table 1 shows the 1395 economic growth rates on a quarterly basis. As observed in this Table, preliminary estimates point to an improvement in the non-oil GDP growth rates which has improved from negative 3.1 percent in 1394 and negative 1.8 percent in 1395Q1 to positive 3.9, 5.4, and 5.6 percent in the last three quarters of 1395

Table 1 Growth Rates of GDP and its Subgroups at Constant 1390 Basic Prices (percent) and their Share in Economic Growth (percentage points)

	1394	1395					Share in 1395 Growth
		Q1	Q2	Q3	Q4	YEAR	
Agriculture	4.6	3.5	4.1	5.0	4.4	4.2	0.3
Oil	7.2	57.6	66.2	77.7	47.1	61.6	9.8
Industries and Mining	-6.1	-5.1	3.0	4.1	6.4	2.2	0.6
Mining	-10.5	-7.8	-4.3	10.7	10.4	2.1	0.0
Manufacturing	-4.6	1.4	5.3	11.2	9.4	6.9	0.8
Water, electricity, gas	3.3	1.7	6.2	7.3	12.3	6.8	0.5
Construction	-17.0	-27.6	-4.0	-16.8	-6.8	-13.1	-0.8
Services	-2.3	-0.7	4.2	6.0	4.9	3.6	1.9
Gross Domestic Product	-1.6	7.5	12.9	16.8	12.9	12.5	12.5
Non-oil Gross Domestic Product	-3.1	-1.8	3.9	5.4	5.6	3.3	2.8

Considering the 1395 GDP from the expenditures side, private consumption grew by 3.8 percent; government expenditures by 3.7 percent; and export of goods and services, thanks to the oil sector's high growth, by 41.3 percent. Given the negligible rise in imports, this resulted in a 63.8 percent rise in the net exports of goods and services. Net exports accounted for 1.6 percent of the GDP of 1395. As can be seen in Table 2, gross fixed capital formation contracted by another 3.7 percent in 1395 following the contraction in three out of its four preceding years, causing the real value of investment in 1395 to equal only two-thirds of its 1390 level. This drop encompasses 7.4 percent drop of gross fixed capital formation in the construction sector and 5.6 percent increase of gross fixed capital formation in machinery that resulted from increased imports of capital goods.

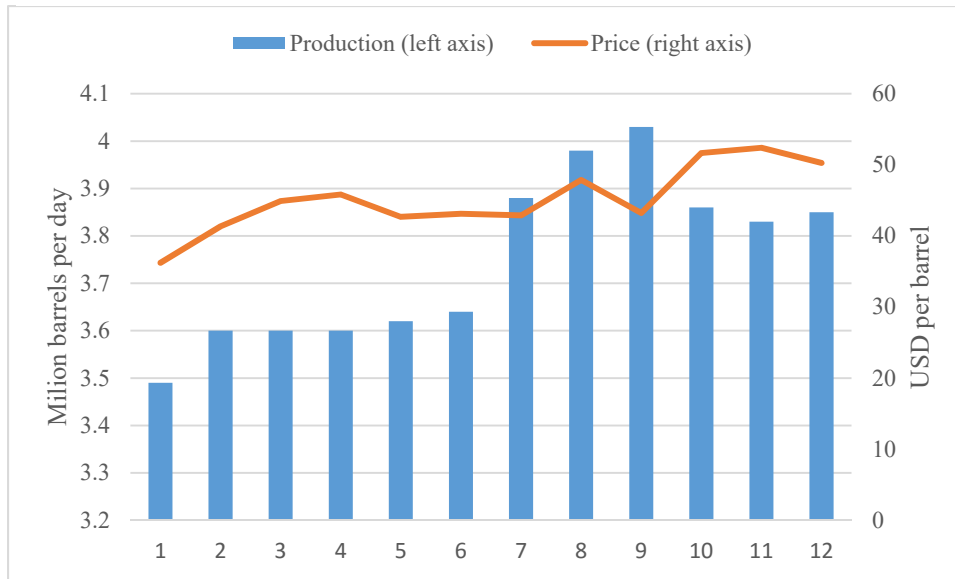
Table 2 GDP Growth Rate from the Expenditures Side at Constant 1390 Prices (percent)

	1394	1395				
		Q1	Q2	Q3	Q4	Year
Private Consumption	-3.5	0.7	1.7	6.7	6.2	3.8
Government Consumption Expenditures	4.8	-1.3	12.2	5.4	0.3	3.7
Gross Fixed Capital Formation	-12.0	-16.3	3.1	-9.5	3.1	-3.7
- in Machinery	-15.2	2.6	3.4	10.9	5.4	5.6
- in Construction	-10.7	-24.8	3.0	-17.5	2.2	-7.4
Exports of Goods and Services	12.1	50.7	48.6	37.4	30.8	41.3
Imports of Goods and Services	-20.2	-7.2	3.5	22.0	6.0	6.1
Gross Domestic Product	-1.3	9.0	11.7	17.1	16.0	13.4

1.1 Energy

In 1395Q3 crude oil production reached its maximum so far in the 1390s, surpassing 4 million barrels per day (bpd) in the latter days of that quarter before slightly falling to 3.9 million bpd in 1395Q4, which was still 15.0 percent higher than the average daily production a year earlier. In 1395 as a whole, exports of oil grew faster than its production, and the sum of crude oil exports and net oil product exports reached 2.4 million bpd in 1395Q3, indicating 55.4 percent increase from 1394Q3. Apart from the rise in the volume of oil exports, the price of Iran's heavy crude oil that had fallen to below USD37 in early 1395 also gradually increased to USD51.8 in 1395Q4, which is 83.6 percent higher than a year earlier.

Figure 1 Monthly Crude Oil Production and its Average Price in 1395*



1.2 Housing

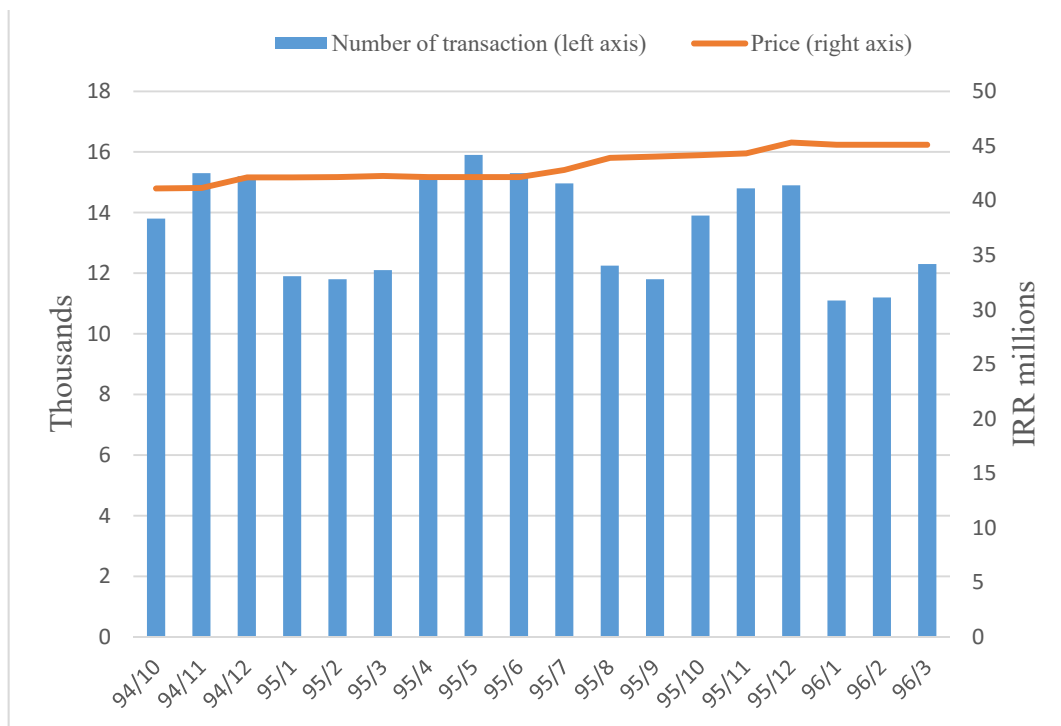
Although in 1395 the housing market was not as bad as in 1394, it still experienced drops in both value-added and private investment. Preliminary statistics indicate that private investment in urban buildings fell by 14.1 percent at current prices, based on which the real growth in the value-added of housing in the private sector is estimated to have contracted by 20.1 percent. The average price of residential units in various cities grew by less than the inflation rate, indicating a drop in their real values. As an example, while the annual inflation rate in urban areas in 1395 was 9.0 percent, the average price of a square meter of residential units in Tehran went up by only 5.4 percent to IRR43.9 million.

Figure 2 exhibits the price and the number of residential units sold in Tehran in 1395 and the first quarter of 1396. It indicates that the moving average of the price of a square meter of residential units slightly increased in 1395 and grew at a faster pace in

1395Q4, but then reversed course in 1396Q1 when both the price and the number of transactions fell. This could have been due to uncertainties associated with the

presidential election in 2/1396 that caused prospective home buyers to postpone their purchases until after the election. The average price of a square meter of residential units traded in 1396Q1 was IRR44.9 million, which is 0.7 percent lower than in 1395Q4 but 4.9 percent higher than in 1395Q1. The number of residential unit transactions was as usual the highest in summer 1395, and it was higher in winter than in the fall. During 1395 approximately 162 thousand of residential units were sold in Tehran, 5.4 percent more than in its preceding year; and in 1396Q1, 37 thousand residential units were sold, showing 0.1 percent rise from 1395Q1.

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



2. Prices and Inflation

The point-to-point consumer price inflation rate that had reached its low of 6.8 percent at the end of 1395Q1, reversed course and gradually rose to 12.6 percent in 1/1396 before coming down in the next two months to reach 11.0 percent in 3/1396. In line with the point-to-point consumer prices inflation rate, the average annual inflation rate, which had become single-digit in the last month of 1395Q1, reached as low as 8.6 percent in 8/1395 and stayed there for three months before gradually increasing to 10.2 percent at the end of 1396Q1.

The point-to-point producer price inflation, which is a precursor to the consumer price inflation, had increased from 1.6 percent in 3/1395 to 9.1 percent at the end of that year

and rose by another 0.1 percentage point to reach 9.2 percent in 1/1396, before gradually falling to 8.7 percent in 3/1396.

Considering the depreciation of the IRR against major foreign currencies in the fall and winter of 1395, and the growth of monetary aggregates, further rises in consumer price inflation rate to about 12 percent is expected.

Considering the influence of the inflation in the price of imported items on domestic CPI, a decomposition of the domestic CPI inflation into tradable and non-tradable goods should be illuminating. The inflation rate of tradable goods rose gradually from 7.5 percent in 8/1395 to 12.7 percent in 2/1396, partly as a result of IRR depreciation against foreign currencies in the fall and early winter of 1395. The point-to-point inflation rate of non-tradable goods fell slightly from 10.9 percent in 8/1395 to 10.7 percent in 2/1396.

Latest statistics on the consumption basket of goods and services reveals that among major groups, the point-to-point CPI inflation rate in the group of food and beverages, which has the second largest group weight in the consumption basket, considerably increased during 1395Q4 to reach 17.8 percent at the end of the year, and 19.9 percent in 1/1396, but then reversed course and reached 15.2 percent at the end of 1396Q1. The point-to-point CPI inflation in tobacco experienced the lowest point-to-point inflation rate in the basket with 0.6 percent. The point-to-point inflation rate in housing, water, electricity, gas and other fuels with the highest weight in the basket dropped by 0.5 percentage points and reached 8.9 percent. Accordingly, the rise in point-to-point inflation in food and beverages accounted for the highest share in the rise in point-to-point CPI inflation in 1396Q1. Table 3 shows monthly point-to-point inflation rates in major groups of the consumption basket during the six months of 1395Q4 and 1396Q1.

Table 3 Monthly Point-to-point Inflation Rates in Major Groups of the Consumption Basket (percent)

	Weight in the Basket	Point-to-Point					
		10/1395	11/1395	12/1395	1/1396	2/1396	3/1396
139Overall	100.0	9.6	10.6	11.9	12.6	11.8	11.0
Food and Beverages	27.38	9.8	12.9	17.8	19.9	17.6	15.2
Tobacco	0.35	10.7	10.7	10.9	10.8	0.9	0.6
Clothing and Footwear	4.94	6.4	6.0	6.1	6.5	6.7	6.7
Housing, Water, Electricity, Gas and other fuels.	32.82	9.2	9.2	9.2	8.9	9.4	8.9
Household Equipment and Routine Household Maintenance	5.13	6.3	6.8	7.1	7.0	7.0	7.7
Health	6.98	17.2	17.1	16.9	16.9	16.3	15.3
Transport	9.87	7.8	8.3	8.0	8.2	6.9	6.6
Communication	2.38	6.1	6.3	6.5	6.8	6.5	6.6
Recreation and Culture	2.85	8.4	8.2	7.9	7.6	7.7	7.9
Education	2.24	11.3	11.2	10.8	10.8	40.5	11.0
Restaurants and Hotels	1.86	9.3	9.7	10.3	10.5	10.4	10.3
Miscellaneous Goods and Services	3.20	9.6	11.5	9.5	9.2	9.2	9.0

3. Balance of Payments

In 1395Q3 oil exports (including crude oil, and net exports of oil products) rose by 55.4 percent and reached 2.4 million bpd. In that quarter the average price of Iran's crude oil also rose by 22.5 percent to about USD47.0 per barrel. Accordingly, the value of oil exports (including crude oil, oil products, natural gas, natural gas condensates and liquids) rose by 114.4 percent and amounted to USD15.1 billion.

Despite the gradual increase in Iran's crude oil price from the low of USD24.1 in 10/1394, its average price during the first 3 quarters of 1395 fell by 11.2 percent. The volume of exports, however, rose by 45.9 percent during those three quarters and so the value of oil exports experienced a 47.2 percent increase to USD39.9 billion. The value of oil imports (including oil products, natural gas, natural condensates and liquids) in 1395Q3 fell by 11.8 percent and during the first three quarters of the year by 31.5 percent. As a result the oil trade balance increased by 126.7 percent in Q3 and by 52.5 percent in the first three quarters of 1395.

In 1395Q3, the value of non-oil exports fell by 27.3 percent while that of non-oil imports rose by 36.4 percent to USD7.1 billion and USD16.2 billion, respectively. During the first 9 months of 1395, their values fell by 12.3 percent and rose by 16.9 percent, respectively, registering USD20.4 billion and USD43.1 billion. Hence, mainly because of the severe drop in non-oil exports and a surge in imports, the non-oil trade balance

deficit rose by 325.1 percent in 1395Q3 and by 66.9 percent in the first three quarters of the year.

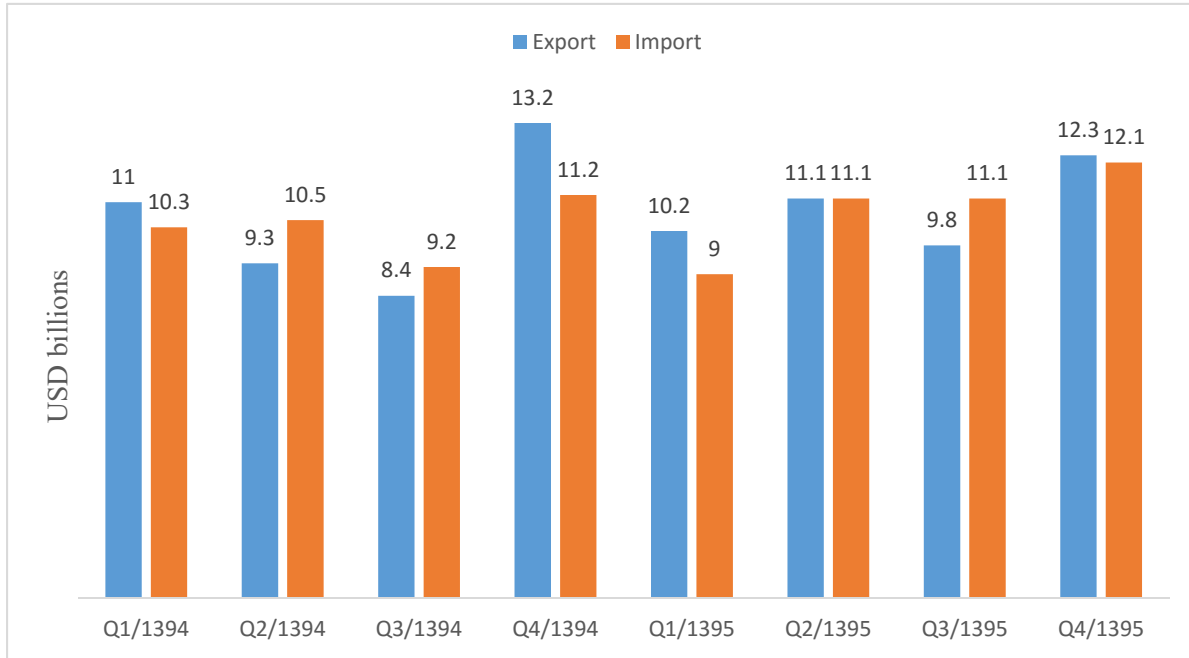
The 19.7 percent rise in the value of goods exports coupled with the 14.7 percent rise in the value of goods imports during the first 9 months of 1395 increased the goods account surplus by 35.9 percent to USD16.0 billion. The services account deficit in those nine months rose faster by 71.6 percent and reached USD5.2 billion, due mainly to the significant rise in imports of services coupled with very little drop in its exports. Taking into account these developments and only minor changes in income account and current transfers account, the net current account experienced 19.7 percent rise to USD11.9 billion during the first 9 months of 1395. Table 4 shows the current account components from 1394Q1 to 1395Q3.

Table 4 Current Account Components (USD millions)

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

In 1395Q4 the values of customs exports and imports (that exclude oil and suitcase trade) rose by 24.8 percent and 8.2 percent, respectively, from its preceding quarter and by negative 8.3 percent and positive 7.2 percent from 1394Q4. Figure 3 shows the value of customs trade from 1394Q1 to 1395Q4. The value of customs exports and imports in 1395 increased by 3.5 percent and 5.2 percent and reached USD43.9 billion and USD43.7 billion, respectively.

Figure 3-Value of Customs Exports and Imports



Looking at the components of customs exports, in 1395 the value of petrochemicals rose by 9.2 percent and exports of natural gas condensate rose by 56.4 percent despite the fall in their prices. In contrast, exports value of natural gas and other goods dropped by 2.8 percent and 10.2 percent, respectively, despite the rise in their exports volume. In other words, the massive rise in the volume of natural gas condensates and petrochemicals exports in 1395 prevented the country's exports value from falling. Table 5 exhibits detail of total exports during 1394 and 1395.

Table 5 Customs Exports Statistics

	1394				1395			
	Weight (1000 tons)	Value (USD millions)	Share in total (percent)		Weight (1000 tons)	Value (USD millions)	Share in total (percent)	
			Weight	Value			Weight	Value
Petrochemicals	22,988	13,134	24.5	31.0	32,434	14,340	25.0	32.6
Natural Gas Condensates	10,495	4,680	11.2	11.0	18,663	7,320	14.4	16.7
Natural Gas	5,817	2,139	6.2	5.0	9,726	2,079	7.5	4.7
Other Goods	54,608	22,475	58.2	53.0	68,825	20,192	53.1	46.0
Total Export	93,907	42,429	100.0	100.0	129,648	43,930	100.0	100.0

Natural gas condensate was the main export item in 1395 in terms of value, followed by USD2.5 billion in light crude oil except gasoline, USD2.1 billion in natural gas, USD1.2 billion in liquefied propane, and USD1.2 billion in liquefied oil gas. The main export destinations were China, UAE, Iraq, Turkey, and South Korea. The main import items were cattle-feed corn valued at USD1.4 billion, soybean at USD909 million, 1500-2000 cc motor vehicles at USD893 million, auto parts at USD782 million and rice at USD690 million. China, UAE, South Korea, Turkey, and Germany were the main origins of imports. In 1395 the share of imports from Germany increased whereas that from the UAE fell.

According to the Islamic Republic of Iran Customs Administration (IRICA), in 1/1396 the value of customs exports fell by 9.4 percent and that of imports rose by 18.6 percent to USD2.7 billion and USD2.3 billion, respectively. Among Iran's trade partners, the ones with the highest trade surplus were Iraq, Afghanistan, China, India, and UAE. Petrochemicals accounted for 38.2 percent of the total value of exports, natural gas condensate for 18.1 percent, and other goods for 43.7 percent. Among imported items, in 1/1396 intermediate goods accounted for 67.1 percent of the total value of imports, consumption goods for 17.5 percent, and capital goods for 15.4 percent.

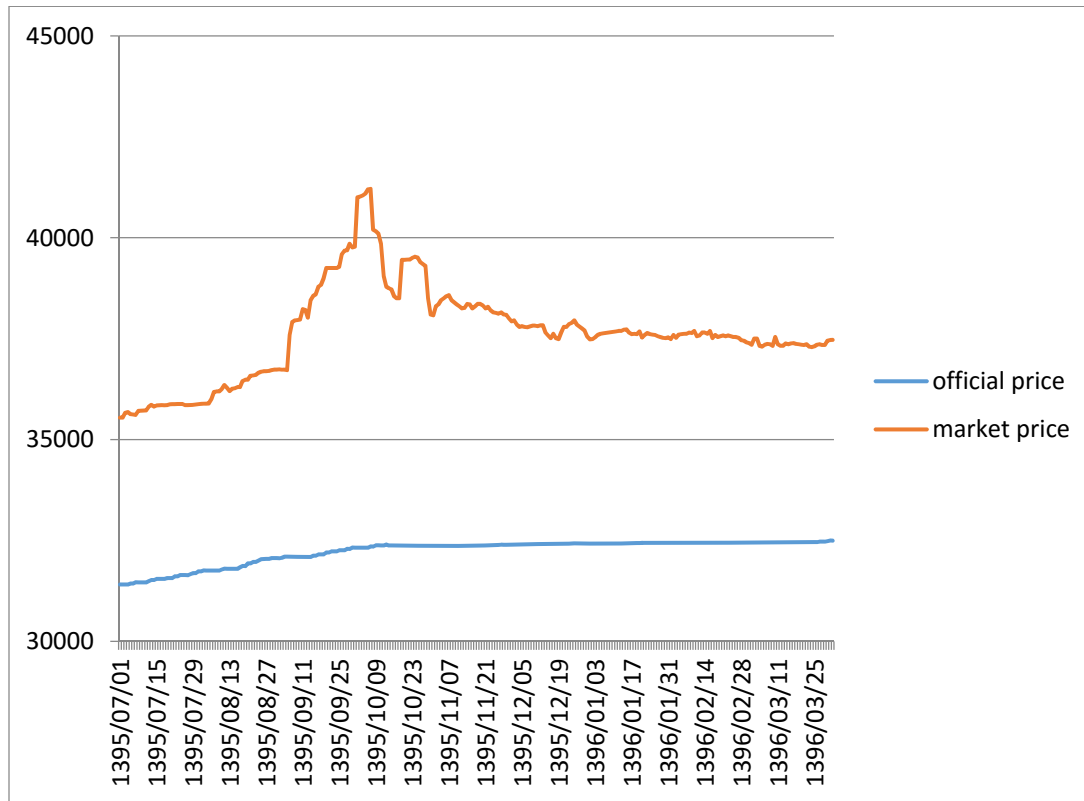
4. Foreign Exchange Market

The free market USD/IRR exchange rate surpassed IRR40 thousand in the beginning of 1395Q4, but then came down and was hovering around IRR37,700 in the remainder of the year and into 1396. It reached IRR37,600 in the first month of 1396 but again fell slightly following the presidential election in 2/1396. Figure 4 exhibits the daily free market and official USD/IRR exchange rates from the beginning of 1395Q3 to the end of 1396Q1

As this Figure exhibits, at the end of 10/1395 the USD/IRR exchange rate started a downward trend and its fluctuations gradually diminished. In 1396Q1 this exchange rate was 8 percent higher than in 1395Q1 but 3 percent lower than in 1395Q4. The standard deviation of this exchange rate, which is a measure of its fluctuations, shows that the rate has experienced low fluctuations in the springs of this year and the last. It can also be seen that unlike the stock exchange, the USD/IRR exchange rate did not react much to the Tehran terrorist attacks in 3/1396, rising by only IRR50.

Unlike the free market USD/IRR exchange rate, its official rate did not experience much change in 1396Q3, rising on average by only 0.03 percent a month. This is very different from the free market exchange rate that on average fell by 0.34 percent a month during that quarter. Consequently, the gap between the official and free market exchange rates, which had reached 16 percent at the end of 1395, narrowed by 1 percentage point to 15 percent.

Figure 4 Daily USD/IRR Exchange Rates



5. Monetary and credit Aggregates

The latest monetary statistics are for 11/1395 and show that the monetary base stood at IRR1,734.1 trillion, indicating 18.1 percent growth from a year earlier. This growth rate is about 1.0 percentage points higher than at the same point in 1394. The major factor in this increase is a 35.3 percent rise in CBI claims on banks, itself mainly attributed to a 193.9 percent increase in CBI claims on non-public banks and non-bank credit institutions. Accordingly, in 11/1395 the share of non-public banks and non-bank credit institutions in CBI claims rose to 35.1 percent, from 16.2 percent in 11/1394, while the share of specialized banks fell from 66.2 percent to 52.2 percent in the same period. Excessive withdrawal of banks from the CBI that led to that 35.3 percent rise in CBI claims on banks was attributed to the persistence of the banking systems problems such as overdue government debts to the banks, persistence of the high share of non-performing loans (NPLs), and illiquidity of investments by the banks. Should these problems persist, the competition among banks and authorized and unauthorized credit institutions for attracting depositors will further intensify and prevent a reduction of interest rates on non-public deposits, and thus lower private sector investments.

The 0.1 percent rise in CBI's foreign assets and 6.6 percent fall in its foreign exchange liabilities in 11/1395 resulted in 6.3 percent rise in net foreign assets of the CBI, which is the second factor in the monetary base expansion, accounting for 7.6 percentage points

of its 18.1 percent growth. Table 6 shows the monetary base components in different quarters of 1394 and 1395, and in 11/1395.

Table 6 *Monetary Base Components (end of period- in IRR trillions)*

	1394				1395				11/1395 to 11/1394	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	11/1395	Growth Rate (percent)	Share in Growth (percentage point)
Monetary Base	1,317.2	1,375.0	1,427.8	1,553.6	1,585.2	1,655.1	1,704.7	1,734.1	18.1	18.1
CBI's Net Foreign Assets	1,653.4	1,769.8	1,806.6	1,936.4	1,876.6	1,859.4	1,898.2	1,880.9	6.3	7.6
CBI Net Claims on Public Sector	112.7	107.2	120.0	182.2	238.9	325.3	233.1	185.1	-6.0	-0.8
CBI claims on Banks	813.7	806.0	829.9	836.3	895.1	942.2	1,047.9	1,154.9	35.3	20.5
other	-1262.6	-1,308.0	-1,328.7	-1,421.3	-1,425.4	-1,474.5	-1,486.8	-1,486.8	10.0	-9.2

The 6.0 percent drop in net CBI claims on public sector accounted for 0.8 percentage points of the fall in the monetary base growth. An examination of the components of public sector's debt reveals that CBI's net claims on public sector has fallen by 13.4 percent because of the higher growth of government deposits with the CBI than the CBI claims on the government. Also, CBI net claims on public corporations and institutions fell by 7.2 percent as a result of the fall in their debt to CBI and the rise in their deposits with it.

At the end of 11/1395 CBI claims on the public sector accounted for 28.4 percent of the banking system's total claims on this sector and the rest included banks and non-bank credit institutions' claims. The heading "Banks and Non-bank Credit Institutions Claims on the Public Sector" includes not only their direct claims on the public sector, but also the overdue claims of banks on public and non-public sectors which are guaranteed by the government. According to the CBI's report on banks claims on the public sector¹, the accumulation of a large amount of participation bonds from previous years coupled with considerable claims of "Bank Maskan" on the public sector in terms of guaranteed interest payment for extended facilities aimed at financing the "Mehr Housing Project" accounted for a considerable portion of the balance and changes of banks claims on the public sector. The interest payments and principals of overdue loans guaranteed by different administrations coupled with their overdue penalties are also included in the banks claims on the public sector. According to that report, the increased documentary obligations of the government and using revolving funds of the treasury were the major factors in the rise in CBI claims on the public sector in recent years.

The M2 money multiplier rose by 5.1 percent to reach 7.0 at the end of 11/1395. In this period, the fall in the ratio of notes and coins with the public to total deposits, and the ratio

of excess reserves to total deposits resulted in a rise in M2 money multiplier, while the rise in the ratio of legal reserves to total deposits resulted in a fall in it. As a result of the growth in monetary base and M2 money multiplier in this period, the balance of M2 liquidity rose by 24.1 percent at the end of 11/1395 and reached IRR12,110.9 trillion. Among the M2 liquidity components, M1 money rose by 23.3 percent and quasi-money by 24.2 percent, accounting for 2.9 and 21.1 percentage points of the M2 liquidity growth. Besides, the notes and coins with the public and sight deposits as the components of M1 money rose by 6.9 and 28.6 percent, respectively, in the same period, accounting for 1.7 and 21.6 percentage points of M1 money growth. Accordingly, M1 money and quasi-money shares in the M2 liquidity reached 12.6 and 87.4 percent at the end of 11/1395, respectively. Table 7 exhibits the M2 money multiplier and M2 liquidity components during 1394Q1 to 1395Q3 and in 11/1395.

Table 7-M2 Money Multiplier and M2 Liquidity Components (end of period- in IRR trillions)

	1394				1395				11/1395 to 11/1394	
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	11/1395	Growth Rate (percent)	Share in Growth (percentage point)
M2	8,166.7	8,727.5	9,251.7	10,172.8	10,595.0	11,227.1	11,848.6	12,110.9	24.1	24.1
M1	1,123.8	1,180.2	1,158.1	1,367.0	1,364.4	1,480.3	1,540.7	1,522.6	23.3	2.9
Notes and Coins with the Public	297.6	306.4	301.2	371.9	311.6	329.2	327.7	321.7	6.9	1.7
Sight Deposits	826.2	873.8	856.9	995.1	1,052.8	1,151.1	1,213.0	1,200.9	28.6	21.6
Quasi-money	7,042.9	7,547.3	8093.6	8,805.8	9,230.6	9,746.8	10,307.9	10,588.3	24.2	21.1
M2 Money Multiplier	6.2	6.3	6.5	6.6	6.7	6.8	7.0	7.0	5.1	-

The balance of extended facilities by the banking system rose by 19.2 percent in 1/1396. Also, the balance of deposits before and after deduction of legal reserves rose by 16.9 percent and 16.2 percent, respectively. Hence, the ratio of extended facilities to deposits (after taking out the legal reserves) rose by 3.1 percentage points to reach 85.7 percent. This ratio was consistently falling from the beginning of 1394 and reached the low of 82.1 percent in 3/1395, but reversed course from then on. Also, according to the banking statistics, the average of legal reserve ratio rose by 0.7 percentage points to 10.4 percent at the end of 1/1396.

According to CBI, extended facilities by the banking system rose by 31.4 percent in 1395 to reach IRR5,483.7 trillion. Extended facilities aimed at financing working capital accounted for 64.0 percent of the total extended facilities and 82.3 percent of the facilities extended to the industries and mining sector. The main recipients of the

facilities extended for working capital were industries and mining with 37.7 percent, services with 33.9 percent, and commerce with 14.8 percent. The share of agriculture and housing and construction has risen at the expense of the slight fall in share of the 3 aforementioned sectors in 1395 compared to its preceding year. Extended facilities aimed at financing creation plans ranked second in extended facilities with 9.7 percent of the total, with services accounting for the highest share at 43.8 percent. Besides, the services sector has the highest share of facilities extended aimed at development plans and private consumption. In the same year, the value of extended facilities in commerce and services has risen in all subdivisions.

CBI statistics reveal that in the first two months of 1396, approximately IRR569.7 trillion facilities was extended to different sectors of the economy, indicating 16.4 percent growth. In the same period working capital accounted for approximately 67.8 percent of the total extended facilities, showing 19.1 percent rise. The share of the industries and mining sector was 42.6 percent of the facilities extended for working capital, accounting for 87.9 percent of total facilities extended to this sector.

6. Government Budget

Government tax revenues rose by 28.1 percent in 1395 and reached IRR1,014.7 trillion. These revenues experienced stable growth in all quarters of the year and equaled 97.7 percent of the legislated figure, indicating low divergence from the Budget Law. Tax revenues in 1394 rose by 11.6 percent and equaled 89.6 percent of the legislated. In 1395, other current revenues of the government rose by 34.1 percent and the total current revenues of the government amounted to 92.8 percent of the legislated. Current expenditures also rose by 21.4 percent, corresponding to 97.0 percent of the legislated amount. Accordingly, the operation balance deficit in 1395 reached IRR613.2 trillion which was a bit higher than the legislated IRR563.8 trillion.

Oil revenues reached IRR738.8 trillion in 1395. The 10.2 percent rise in this revenues is only slightly higher than the 9.0 percent annual inflation rate and indicates that the real growth of these revenues was very low. This seems contradictory to the considerable rise in oil exports coupled with the slight rise in Iran's crude oil price that led to 47.2 percent growth in value of oil exports in the first 9 months of 1395. This contradiction is due to the fact that in order to settle its borrowing from the CBI in 1394, which was referred to as the "pre-sale" of oil, the government spent a portion of its 1395 oil revenues, and hence this portion was not reflected in its 1395 oil revenues. Despite the low growth of oil revenues available to the government, development expenditures rose by 50.6 percent in 1395, covering 72.5 percent of the legislated amount. Out of the IRR417.0 trillion of development budget in 1395, more than 55 percent was allocated in 12/1395 alone, mostly financed via the disposal of Islamic treasury bills to contractors. However, the Securities and Exchange Organization of Iran has severely restricted admission of government debt securities, therefore, contractors may face difficulty in trading them in the capital market. In addition to the disposal of Islamic treasury bills, the considerable

rise in government revenues especially in oil revenues, in 1395Q4 was a driver of the 253.0 percent rise in development expenditures in that quarter. Overall, the surplus of the net disposal of non-financial assets reached IRR325.8 trillion in 1395 which is far below the operating balance deficit and is approximately 1.5 times of the legislated amount. In fact, IRR325.8 trillion of the intergeneration oil resources has been spent on current expenditures in 1395. Despite the considerable rise in 1395 development expenditures, it is still below the 1390 levels at constant prices, while the current expenditures at constant prices is increasing at a high pace.

The budget deficit in 1395 reached IRR287.4 trillion, indicating 46.3 percent growth. Table 8 shows the budget performance of the government in 1395.

Table 8- Government Revenues and Expenditures in 1395 (IRR trillions- percent)

	Q1		Q2		Q3		Q4		Year		Performance (percent of approved)
	Amount	Growth	Amount	Growth	Amount	Growth	Amount	Growth	Amount	Growth	
Revenues	255.5	-12.9	580.9	28.3	473.5	13.7	892.7	40.6	2,202.6	22.6	93.2
Tax Revenues	184.9	30.0	248.2	29.3	221.9	27.6	359.7	26.7	1,014.7	28.1	97.7
Other Current Revenues	26.3	-47.9	130.2	62.4	73.8	7.5	214.8	62.1	445.1	34.1	83.1
Oil Revenues	43.6	-56.5	201.5	12.4	176.8	2.0	316.9	45.7	738.8	10.2	99.2
Other Non-financial Revenues	0.7	131.0	1.0	-25.1	1.0	88.3	1.3	25.0	4.0	25.1	8.8
Expenditures	416.0	8.5	674.7	37.6	488.2	1.8	911.2	42.3	2,490.0	24.9	91.8
Current Expenditures	368.8	2.7	582.2	48.2	449.2	25.3	672.8	12.8	2,073.0	21.4	97.0
Development Expenditures	1.4	263.6	120.9	41.0	36.0	-69.4	258.7	253.0	417.0	50.6	72.5
Budget Balance	-160.4	77.8	-39.8	149.7	-14.7	-76.7	-18.4	234.0	-287.4	46.3	82.5

In order to finance the budget deficit, the government has mostly relied on issuing Islamic Treasury bills which accounted for 69.9 percent of the total disposal of the financial assets in 1395. IRR342.3 trillion out of the IRR436.8 trillion of the bills in the year was issued in winter, mainly aimed at financing development expenditures. The disposal of state-owned companies accounted for only 12.5 percent of the total disposal of financial assets which was even below the share of "Others". Despite the approval of a loan from Russia in the amended 1395 Budget Law, the loan has not yet been obtained. Table 9 exhibits the statistics on the financial performance of the government budget in 1395.

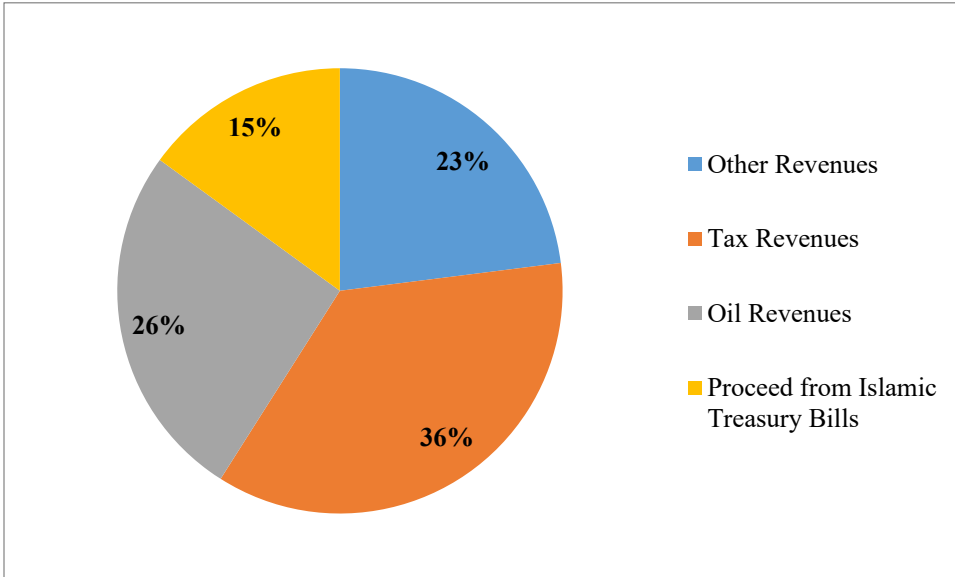
Table 9 Financial Performance of the Government Budget (IRR trillions- percent)

	Q1		Q2		Q3		Q4		Year		Performance (percent of approved)
	Amount	Growth	Amount	Growth	Amount	Growth	Amount	Growth	Amount	Growth	
Disposal of Financial Assets	165.0	82.8	109.2	190.5	69.7	190.3	280.7	313.2	624.7	184.2	107.8
Sales of Islamic financial instruments	0.0	-100.0	60.0	-	34.5	-	342.3	226.0	436.8	315.7	158.8
Foreign borrowing	0.0	-	0.0	-	0.0	-	0.0	-	0.0	-	0.0
Privatization revenues	8.0	-67.7	15.5	-7.2	23.1	-1.3	31.8	-8.2	78.4	-21.3	48.8
Return from previous years	1.4	-30.0	0.8	-30.0	0.6	20.0	1.0	8.9	3.9	-16.8	99.6
Others	155.6	145.4	32.9	67.0	11.5	10,354.5	-94.3	29.9	105.7	896.2	76.2
Acquisition of Financial Assets	4.6	-	15.5	-	55.0	5,400.0	262.2	1,070.4	337.3	1,341.4	145.7

In 1395 Budget Law, although no arrangement was considered for the repayment of the principals of the Islamic treasury bills matured in 1395, IRR51.5 trillion was spent in order to repay them. This caused the acquisition of financial assets to be 1.5 times of the legislated amount. As the issuance of government debt securities rose by 315.7 percent in 1395 to IRR436.8 trillion, the government has to pay large amounts to settle the claims due in 1396. The government finances interest payments and principal of the Islamic treasury bills by issuing new series of them which is not a financially sound practice, as interest payments should be financed by sources of current expenditures.

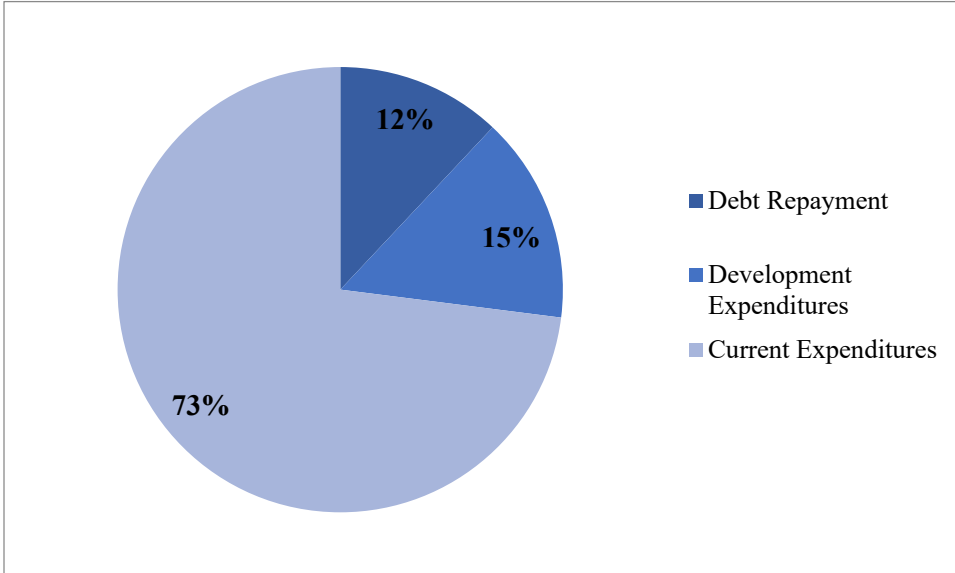
The national development fund is the source of IRR6.0 trillion of financing the 1395 budget deficit which is one of the undesirable uses of intergeneration resources. Another point to be mentioned is that in the last month of the year, the disposal of financial assets was 8 times the average of its preceding 11 months, attributed to the 8.6-fold increase in the issuance of government debt securities. On the expenditures side, the development expenditures was 6.2-fold of the average of its preceding 11 months. Overall, the share of oil revenues in budget resources has dropped while the share of issuance of government bonds has increased in the budget performance of 1395. Figure 5 shows the share of various sources of government budget in 1395.

Figure 5 Share of Sources of Government Budget



On the expenditures side, the current expenditures still accounts for the highest share. Besides, as the repayment of previous obligations surged in 1395, its share in the budget expenditures rose. Figure 6 exhibits the share of various expenditures in 1395.

Figure 6 Share of Expenditures of Government Budget



7. Capital Market

The overall index of the Tehran Stock Exchange (TSE) opened on the first trading day of 1396 at 77,490 and closed the first quarter at 78,880. The index was increasing in the first two months of the year and touched its high of 81,190 on the last day of 2/1396 but reversed course and fell by more than 1,300 points in the last month of the first quarter. The biggest fall was by 550 points that occurred following the Tehran terrorist attacks on 17/3/1396, but some of the fall was regained on the first two days of the following week. During 1396Q1 the value of traded shares and preemptive rights reached IRR136.3 trillion, indicating IRR6.0 trillion and IRR19.4 trillion drops compared to 1395Q4 and 1395Q1 respectively. The aggregate value of traded shares and preemptive rights in the last month of spring was IRR27.8 trillion which is the lowest monthly value since the beginning of 1395.

Iran's capital market includes the Over the Counter (OTC), too, that has the same structure as the main stock exchange but with an easier trading mechanism. The OTC index followed the same trend as the TSE overall index in spring 1396. It opened the year at 880 and by 5.3 percent rise reached 927 at the end of 2/1396 but fell by 23 points to close the season at 904. It fell by 11 points after the Tehran terrorist attacks but rose by 3 points on the next two trading days. The overall value of OTC in 1396Q1 reached IRR97.8 trillion, indicating 10.6 percent drop from 1395Q1. In the last day of spring it reached IRR1,082 trillion, out of which Islamic treasury bills, lease bills, participation bonds, Murabaha, and mortgage bonds accounted for 18.0.



For more information contact us:



www.smartinvestiran.com