



Monetary and Banking Research Academy

Affiliated to the Central Bank of Iran

Project LINK Fall Meeting

New York, November 2004

Country Report: Iran

(Based on Macroeconometric Model of Iran Ver. 6.00)

Bijan Bidabad

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1. Recent Trends

In a different way from the previous plans, Iran's 3rd development plan (2000-2004) aimed for structural reforms in Iran's economy. Partial privatization of financial markets, balanced government budget, foreign exchange reserve fund/account (to stabilize the economy from oil price fluctuations), unification of exchange rate, and movement from fixed to managed float exchange rate system, revision of direct tax law to lower tax rates and indirect levies integration, revising foreign investment protection and inducement law, abolition of export surrender requirement, removing some non-tariff foreign trade barriers and changing the government budget booking to GFS standards, strengthening the capital market (Tehran Stock Exchange), expansion of financial sector, taking some steps in privatization of government's companies are the main reforms of the 3rd development plan. However, high oil price put the economy in a stable and surplus position of income receipts.

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Population & Labor Force (1383) (1)

Population	67.7 million
Urban	44.9 million
Rural	22.8 million
Population Growth	1.5 percent
Population Density	41 per Sq Km
Active Population	21.6 million
Unemployment rate (1382:Q4) (2)	11.3 percent
Literacy Rate (1381):	
6 years and over	84.9 percent
6-29 years	95.6 percent

(1) Estimates of Management and Planning Organization

(2) Statistical Center of Iran

Source: Economic trends, Central Bank of Iran, No. 36, <http://www.cbi.ir/publications/PDF/etno36.pdf>

Accordingly, the average rate of GDP growth for the period of 2000-2003 was equal to 5.5%. The average inflation rate was 13.8% which is nearly half of the second plan average. The following tables show the main macroeconomic variables after the revolution period.

Main economic variables during after the revolution period

%		1 st plan		2 nd plan	3 rd plan
Gregorian Calendar	1979-1988	1989-1993	1994	1995-1999	2000-2003
Hijri Shamsi Calendar	1358-1367	1368-1372	1373	1374-1378	1379-1382
Inflation rate	18.9	18.4	35.2	25.1	15.9
Economic growth rate	-1.9	7.4	0.5	3.2	5.5
Investment growth rate	-6.5	9.2	-14.2	8	11
Liquidity (M2) growth rate	23.1	23.6	35.8	44.6	28.6
Dollar/Rial % changes	29	12.1	58.6	24.6	-0.8

Source: A quart of century ups and downs, review of Iran's economic changes, Ministry of Finance and Economic Affairs. 2004, Tehran, Iran.

Hijri Shamsi calendar starts at 21st March. 21 March 2004 Gregorian is 1st day of 1383 Hijri Shamsi.

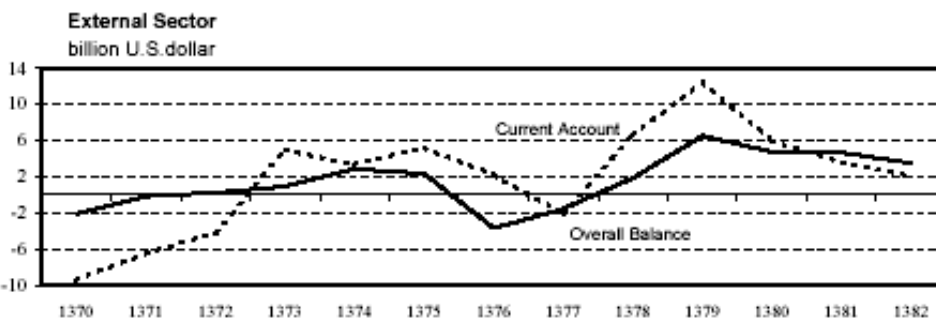
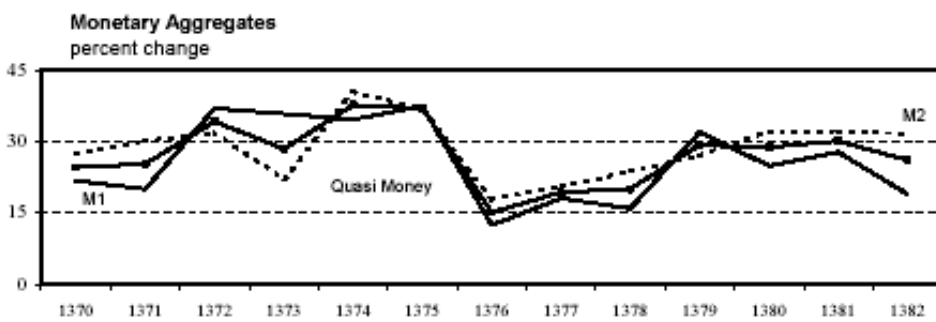
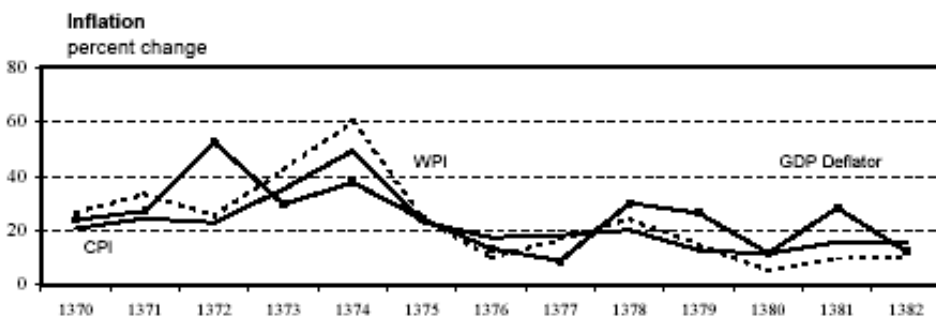
Main economic variables during the after revolution period

Billion Dollars		1 st plan		2 nd plan	3 rd plan
Gregorian Calendar	1979-1988	1989-1993	1994	1995-1999	2000-2003
Hijri Shamsi Calendar	1358-1367	1368-1372	1373	1374-1378	1379-1382
Oil export	14.6	15.5	14.6	15.4	22.6
Non-oil export	0.6	2.3	4.8	3.1	4.5
Import	11.7	22.2	11.8	13.7	20.1

Source: A quart of century ups and downs, review of Iran's economic changes, Ministry of Finance and Economic Affairs. 2004, Tehran, Iran.

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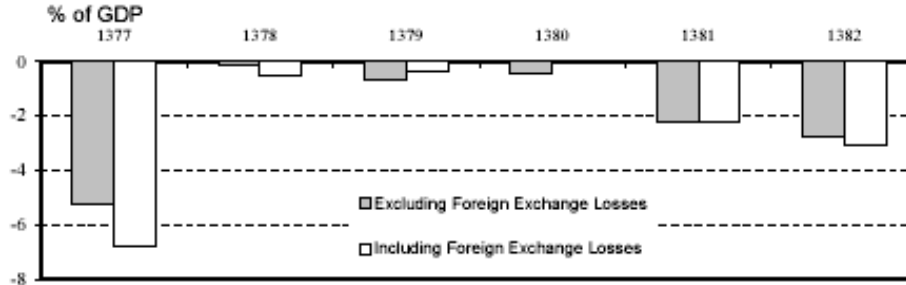
Major Economic Trends



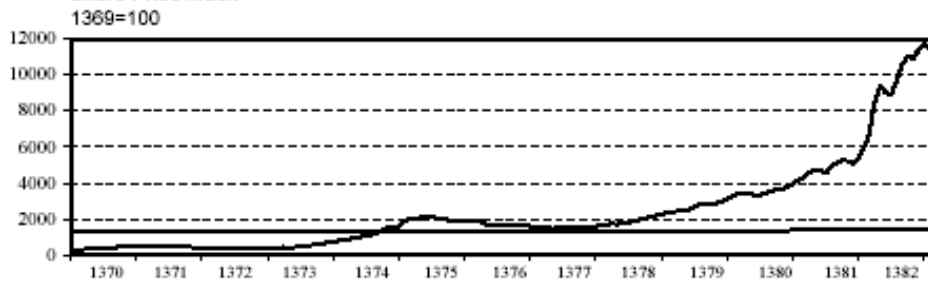
Source: Economic trends, Central Bank of Iran, No. 36, <http://www.cbi.ir/publications/PDF/etno36.pdf>

Major Economic Trends

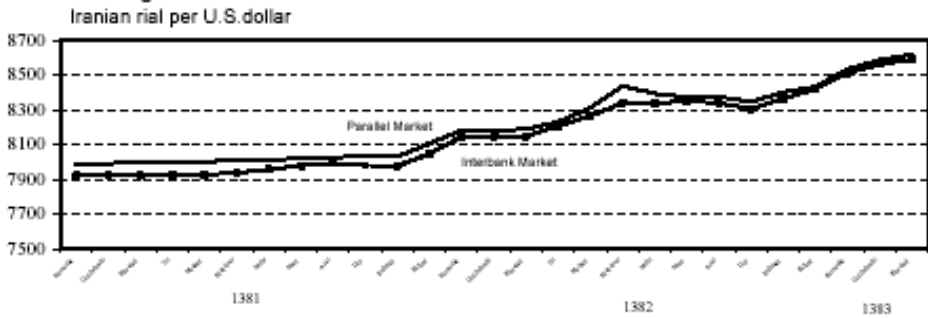
Government Budget Deficit



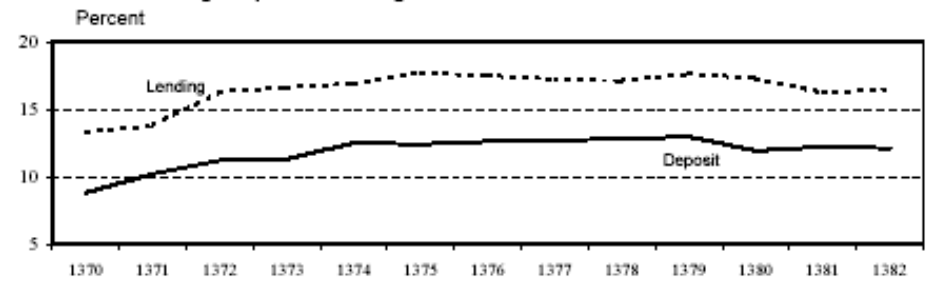
Share Price Index



Exchange Rate



Banks' Average Deposit & Lending Rates



Source: Economic trends, Central Bank of Iran, No. 36, <http://www.cbi.ir/publications/PDF/etno36.pdf>

2. National policy assumptions

Foreign Exchange System

The currency of Iran is Iranian Rial. Prior to March 21, 2002, the exchange rate system consisted of two official rates, the “oil-notional rate” used for government budget and some external transactions. The “non-oil export” or “certificate of deposit” rate was effectively equivalent to market exchange rate at Tehran Stock Exchange (TSE rate) and applied to non-oil export receipts and regular import transactions.

From the beginning of Iranian fiscal year March 21, 2002, a unified managed float foreign exchange system was adopted. Exchange rates unification was launched along with elimination of all exchange restrictions on current account transactions prior to March 2002. Therefore all foreign exchange transactions that formerly took place in TSE were shifted to a newly established interbank market. The basic official rate (oil-notional) was eliminated, and the exchange rate was unified to the rate prevailing at TSE market before unification.

In the subsequent years, exchange rate is determined under a managed floating system. Thus, all foreign exchange regulations in the areas of transactions of goods, services, and banking operations were revised with the aim of complying with the new regime. In this market, in addition to the central bank, other banks can buy and sell foreign currencies. Thus, exporters are availed with full options in managing their foreign exchange resources. But there are some restrictions on foreign exchange capital account.

It is assumed that this system will go on during the forecast period.

Trade Reforms

According to imports and exports regulations, imports are classified as "authorized", "conditional" and "prohibited" goods. Import of "authorized" goods require no special license and permission, while import of "conditional" goods requires licensing by respective authorities. "Prohibited" goods are those which are

forbidden by laws. As a whole, elimination of certification issuance procedures for almost all import items in conditional category was reduced to make more liberalization in foreign trade system.

To remove barriers to trade and restricting the smuggling, Ministry of Commerce announced a list of permitted intermediate goods and capital goods as well which are importable without foreign exchange transfer. To maintain coordination between foreign exchange and trade policies, the Ministry of Commerce revised the regulations pertaining to duties and tariffs. In this regard, downward adjustments were put into effect by a ratio of 5/22 as of March 21, 2002 and all import duties, taxes, and charges (except commercial profit tax) were unified for the March 21, 2003 and a 4 percent duty rate is levied as a base for custom duties. New conditions were also set for using short-term credit lines (refinance) for importers. Thus, the import of spare parts and manufacturing machinery by private sector are authorized through this facility.

To promote non-oil exports, the Export Promotion Funds was established. To further liberalize the non-oil exports, export of all goods and services was exempted from surrender requirement as March 21, 2002. This was a very important improvement in Iran's non-oil export. To compensate incurred losses of exporters due to exchange rate fluctuations, such as drastic fall of world prices of exported goods, some protections were defined through Export Guarantee Fund. Accompanying with these arrangements, Ministry of Commerce announced a new export rewards payments since 2002. Accordingly, goods with 10 to 100 percent of their domestic value-added, receive a reward of 1 to 3 percent of export values. In addition, 1 to 3 percent of export value shall be rewarded for marketing and export of new commodities. In other development, the comprehensive export promotion program was approved. The main targets of this program revolve around market competitiveness, reduction in public sector ownership, grant of explicit subsidies, reduction of tariffs and extension of banking facilities to export sector.

It is expected that this will be going on during the forecast period.

Foreign Investment

The “Law for Attraction and Protection of Foreign Investment” was revised in 2002. In the revised version, the maximum share of foreign investment in all economic sectors is set to 25 percent and in all activity to 35 percent. The oil sector is exempted from these limits.

It is expected that there will not be any upheaval in Iran’s foreign investment. That is, there is no expectation for capital account liberalization.

Monetary Policies

The Money and Credit Council (MCC) approved the following policies to be implemented in 2004:

1. Public banks are authorized to extend up to 45% increase in outstanding of non-public sector facilities in 2004 without limitation of credits sectoral allocations. The share of various sectors out of total increase in the outstanding facilities of non-public sector for commercial banks are as follows:

Sectoral allocation of credits to non-public sector (percent)	
Agriculture and water	25
Manufacturing and mining	32
Housing and construction	28
Exports	11
Domestic trade, services and miscellaneous	4
Total	<u>100</u>

2. The provisional interest rate for short-term deposits was determined at 7 percent, and for term investment deposits was set at 13-17 percent per annum. Banks are allowed to set their rates on two, three, and four-years deposits within the above range.

3. Excepted (minimum) banking loans interest rates for manufacturing, mining and export sectors reduced by one percent compared to 2003 rates. The interest rates for other sectors in public banks are the same as before. Thus, it is also assumed that the loans interest rates of banking system will reduce by 1% at 2004 and remain unchanged in 2005.
4. To reach the targets of the 3rd Plan regarding inflation rate controls, Central Bank of Iran targeted liquidity growth within the range of 20-24 percent.
5. Central Bank of Iran was authorized to issue 5 trillion Rials participation papers (bonds) with 17 percent minimum interest rate.
6. Reserve requirement ratios for public commercial banks, private banks and non-bank credit institutions unified equal to weighted average of reserve requirement ratios at end of 2003 for different financial institutions. Central Bank of Iran is authorized to change this rate up to $\pm 3\%$.

The above conditions are also adopted as policy assumptions for the forecast period.

Fiscal Policy

According to the 2004 government budget law, the following guidelines are drawn:

1. According to budget law, increase in outstanding of directed banking facilities in 2004, is to be up to 3 trillion Rials. Public sector share of this increase is 25% and of cooperative and private sectors 75%. At least 65% percent of the share of cooperative and private sectors shall be distributed among deprived provinces.
2. Government is allowed to sell up to the ceiling of 16.1 billion \$ in 2004. Moreover, the Central Bank is responsible for regulating foreign exchange market and management of BOP.

3. The accounting rate of government foreign exchange sale is based on interbank market rate. Government is allowed to provide and guarantee financial resources up to 9.3 billion \$ from foreign capital markets in form of project finance contracts or partnership.
4. Government is allowed to issue 10 trillion Rials participation papers² to accelerate the implementation of acquisition of non-financial assets. Of this amount, 2 trillion Rials is allocated to road and transportation sector, 2.5 trillion Rials to water resources and 5.5 trillion Rials to other projects. Public corporations are also allowed to rise up participation papers issuance to 3.2 trillion Rials through issuing participation papers for completing projects of acquisition of non-financial assets.
5. Government current and development expenditures are assumed to be according to approved amounts for 2004 and grew by the growth rate of previous year for 2005.

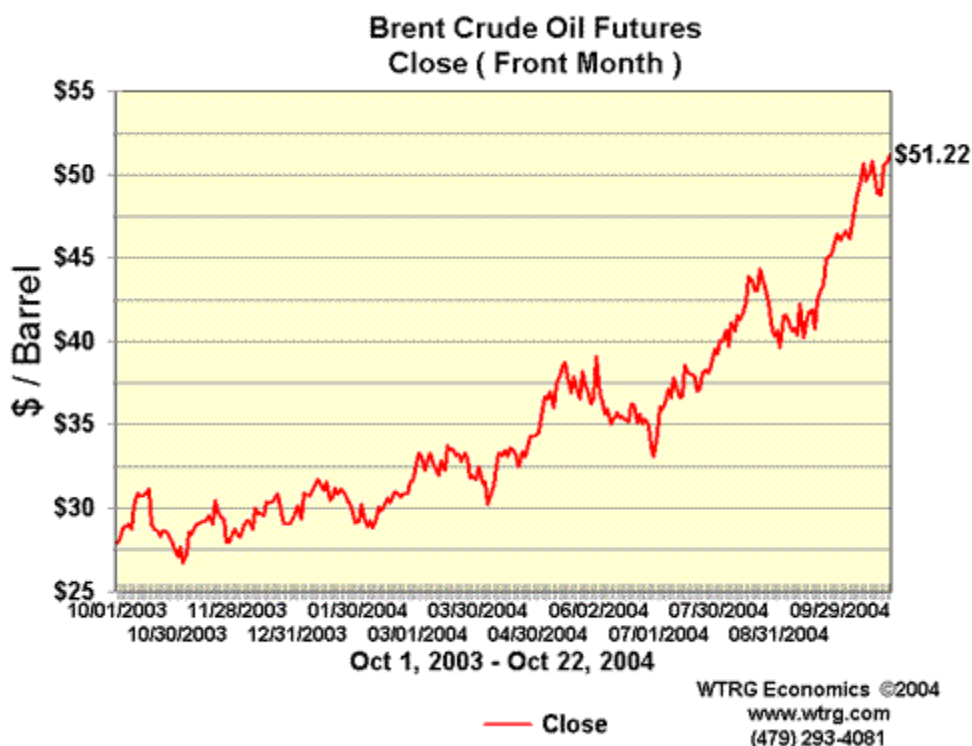
It is also assumed that there will not be any important changes than the above picture of government budget structure in our forecast period.

2. International Environment

Oil prices have been rising and are over \$20.00 per barrel higher than last year prices. What are the chances for prices to return to \$30 per barrel and what are the risks for even higher prices? This lost answer will be the most important variable in the Iran's economy. As the following graph shows the oil prices has an increasing pattern. But as a national model builder, we can not forecast the future of this variable in our national framework and any assumption regarding crude oil price may highly affects the forecasts of Iranian economy. However, we assumed that 30% increase in 2004 and 0.7% increase in 2005 crude oil prices may be regular (non-optimistic and non-pessimistic). These estimates are according to April-August price increase for

² Participation paper is some kind of bond with guaranteed and determined minimum interest rate. This invention is used to finance investment project and the final interest rate will be determined at maturity in some excess of minimum rate.

2004 in comparison with 2003, and on an annual price forecast of 2005 given by international energy outlook³.



It is also assumed that the foreign economic variables of our model obey the assumptions of IMF world economic outlook⁴ in advanced economies prices and productions. In this regard we assume that advanced economies output will grow by 3.5 and 3.1 percent in 2004 and 2005. The consumer price annual percent changes will be 1.7 for both 2004 and 2005. An annual increase of 0.5 percent of Libor is also adopted for 2004 and 2005 according to IMF world economic outlook forecasts. However, these variable less affect on Iran’s economy than the crude oil price.

4. Forecast Summary

The following table shows the forecast of the Macroeconometric Model of Iran Version 6. for some selected variables.

³ <http://www.eia.doe.gov/oiaf/ieo/oil.html>

⁴ IMF world economic outlook, April 2004, International Monetary Fund.

Forecast of the main Iran's macroeconomic variables

%change	2003	2004	2005
	Actual	Forecast	Forecast
Real private consumption	4.4%	10.1%	10.2%
Consumer price index	15.6%	10.7%	10.9%
Market exchange rate, Rials/Dollar	3.8%	8.0%	17.1%
Employment, thousand persons	4.9%	5.6%	5.2%
Real gross domestic product at market prices	6.7%	11.3%	10.5%
Real non-oil gross domestic product at market price	5.9%	12.7%	11.6%
Real investment	10.1%	33.1%	20.8%
Non-organized market interest rate (change)	0.0%	11.9%	2.7%
Liquidity	26.1%	22.0%	20.3%
Import of goods	30.7%	39.7%	13.9%
Import of services	24.0%	13.6%	12.0%
Unemployment	-6.0%	-0.7%	3.0%
Wage index	23.4%	20.7%	16.4%
Whole sale price index	10.1%	5.8%	8.2%
Export of non-oil goods	25.6%	7.0%	7.0%
Real export of goods	19.4%	8.3%	8.0%
Export of oil	17.7%	35.2%	7.0%
Export of services	27.7%	19.7%	17.1%

These figures are based on the solution of Macroeconometric Model of Iran Ver. 6.00.

5. Policy Issues and Uncertainty

Iran's economy has experienced many qualitative changes during the last 3 decades and in this regards model building in an econometric framework based on historical data may have some weaknesses in comparison to other economies. This problem comes from unstable and indisciplinary volatile changes in economic variables caused by structural changes of the economy.

Price of crude oil has a very important role in Iranian economy. Using accurate forecast of this exogenous variable in the national model will create more accurate forecast for other variables engaged. The used forecast values for this variable are not desirable figures, because the international predicted figures themselves suffer from qualitative changes effects in the oil market.

Future structural changes of Iran's economy are not predictable. These changes belong to the category of qualitative data and the amount of their effects on the economy is not simply measurable.

Political changes effects are not negligible in the economy. However, it is predictable that some political changes with immeasurable effects will be occurred in Iran. In this regard the positions of United States and Europe about Iran are important, especially in the case of current debates of terrorism and nuclear weapons.

However, the above reasons will be the main sources of discrepancies between actual and predicted values of the model for Iran's economy.