INTERNATIONAL MONETARY FUND

IMF Country Report No. 18/93

# ISLAMIC REPUBLIC OF IRAN

March 2018

## 2018 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR THE ISLAMIC REPUBLIC OF IRAN

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2018 Article IV consultation with the Islamic Republic of Iran, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its March 22, 2018 consideration of the staff report that concluded the Article IV consultation with the Islamic Republic of Iran.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 22, 2018, following discussions that ended on February 19, 2018, with the officials of the Islamic Republic of Iran on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on March 7, 2018.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Islamic Republic of Iran.

The documents listed below will be separately released.

Selected Issues

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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**International Monetary Fund**
**Washington, D.C.**

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FOR IMMEDIATE RELEASE
March 29, 2018

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

**IMF Executive Board Concludes 2018 Article IV Consultation with the Islamic Republic of Iran**

On March 21, 2018, the Executive Board of the International Monetary Fund (IMF) concluded the 2018 Article IV consultation[1] with the Islamic Republic of Iran.

Following a strong rebound in the aftermath of the 2016 nuclear agreement, real GDP growth is expected to reach 4.3 percent in 2017/18. In the first half of 2017/18, recovery broadened to the non-oil sector, aided by supportive fiscal and monetary policies and a recovery in construction and services activity. The unemployment rate declined to 11.7 percent in the first half of 2017/18, but remained particularly high for youth and women. Inflation averaged 9.9 percent during the first 11 months of 2017/18 aided by moderation in food prices and stable administered prices. The foreign exchange market experienced volatility in early 2018; following the increase in interest rates in February, the spread between the official and the market rate narrowed to under 20 percent.

Real GDP growth is expected to ease to 4 percent in 2018/19, as oil production stabilizes in line with Iran's OPEC cap, and is forecast to average 4½ percent over the medium-term. The current account is expected to remain in surplus as improved oil prices and higher gas exports allow international reserve buffers to rise gradually. On-going uncertainty is expected to keep FDI subdued and hamper the further expansion of Correspondent Bank Relations (CBRs). Inflation is expected to be contained around 12 percent in 2018/19 as liquidity growth is curbed to limit the second-round effects of the recent depreciation in the exchange rate. The pace of job creation lags that needed to absorb the large number of new entrants joining the labor market, implying that unemployment could remain above 11 percent.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

**Executive Board Assessment**[2]

Directors welcomed the macroeconomic progress made by Iran, particularly in broadening the recovery of the non-oil sector following the lifting of sanctions. However, Directors noted that a weak banking sector, structural bottlenecks, and heightened uncertainty pose risks. To create jobs for the highly educated youth, improve living standards, and achieve higher growth rates, they encouraged the authorities to persevere with prudent policies and pursue deep multifaceted reforms despite the challenging domestic and geopolitical environment.

Directors underscored that financial sector reform should be a priority, in particular recapitalization and restructuring of viable banks, and resolution of non-viable ones. They highlighted that state-controlled banks should start preparing and implementing recovery plans as soon as possible even as they await the initiation of the planned Asset Quality Review. Directors welcomed the progress in strengthening the AML/CFT framework. They encouraged timely passage and implementation of the AML and CFT amendments in line with the FATF action plan. This would help restore confidence in the system and facilitate correspondent banking relationships.

Directors emphasized that continued efforts to unify the dual exchange rate, together with a clear communication strategy and tighter monetary conditions, would support the transition to a market-based monetary policy framework. They also highlighted the need to securitize government's debt to the Central Bank of Iran (CBI) and provide the CBI full autonomy. Directors agreed that the new Central Bank Law should enhance the CBI's autonomy and make price stability the core objective of monetary policy.

Directors recognized the authorities' efforts to contain the cash-based fiscal deficit. Going forward, they saw need for broad-based, growth-friendly measures to contain fiscal deficits and debt as well as create space for higher social and investment spending. Directors underscored that adjustment efforts should be gradual and continue to focus on mobilizing tax revenue, removing exemptions, reducing fuel subsidies, and reforming the pension system. They emphasized that targeting cash transfers to the poor will be important to create space and make the adjustment more equitable. Directors also encouraged the authorities to develop a medium-term debt management strategy.

Directors emphasized that deeper reforms are needed to close the infrastructure gap, create more jobs, and further reduce poverty. They highlighted that reform efforts should focus on diversifying the economy, improving the business climate (especially reducing red tape), modernizing regulations, strengthening the bankruptcy framework, and easing market entry. They encouraged the authorities to facilitate greater female labor force participation by reducing

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[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

barriers, subsidizing child care to low income women, and tackling informality. Directors also underscored the importance of improving the quality, timeliness, and availability of data.

## Islamic Republic of Iran: Selected Macroeconomic Indicators, 2015/16–2022/23 1/

Quota: SDR 3,567.10 million

Population: 80 million, 2016/17

Per capita GDP: current US$5,027, PPP current US$17,366, 2016/17

Poverty headcount ratio at $5.50 a day (2011 PPP): 10.5 percent, 2014/15

Main exports: oil, gas, chemical and petrochemical products

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | (Annual percentage change, unless otherwise indicated) | | | | | | | |
| National accounts | | | | | | | | |
| Nominal GDP at market prices (trillions of Iranian rials) | 11,129 | 12,723 | 14,772 | 17,926 | 20,742 | 23,811 | 27,365 | 31,464 |
| Real GDP at factor cost | -1.6 | 12.5 | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Real oil GDP | 7.2 | 61.6 | 5.2 | 4.6 | 3.7 | 3.8 | 4.0 | 4.0 |
| Real non-oil GDP | -3.1 | 3.3 | 4.0 | 3.8 | 4.1 | 4.2 | 4.2 | 4.5 |
| CPI inflation (average) | 11.9 | 9.1 | 9.9 | 12.1 | 11.5 | 11.7 | 11.3 | 10.8 |
| CPI inflation (end of period) | 8.4 | 11.8 | 10.2 | 11.2 | 13.4 | 11.6 | 11.0 | 10.5 |
| GDP deflator at factor cost | 0.4 | 1.6 | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Unemployment rate (percent of labor force) | 11.0 | 12.4 | 11.8 | 11.7 | 11.6 | 11.4 | 11.4 | 11.2 |
| | (Percent of GDP) | | | | | | | |
| Saving investment balance 2/ | | | | | | | | |
| Current account balance | 0.3 | 4.0 | 4.3 | 7.0 | 6.3 | 5.8 | 5.8 | 5.9 |
| Investment | 34.9 | 33.5 | 36.2 | 36.2 | 36.7 | 37.2 | 37.7 | 38.2 |
| Change in stocks | 11.6 | 12.6 | 15.3 | 14.7 | 14.2 | 13.6 | 13.0 | 12.5 |
| Total fixed capital investment | 23.3 | 20.9 | 20.9 | 21.5 | 22.5 | 23.6 | 24.7 | 25.7 |
| Public | 2.5 | 3.3 | 2.3 | 3.7 | 2.5 | 2.5 | 2.5 | 2.6 |
| Private | 20.8 | 17.7 | 18.6 | 17.8 | 20.0 | 21.1 | 22.2 | 23.1 |
| Gross national savings | 35.2 | 37.6 | 40.4 | 43.2 | 43.0 | 42.9 | 43.5 | 44.2 |
| Public | 0.6 | 0.2 | 0.1 | 1.1 | 0.3 | 0.3 | 0.2 | 0.1 |
| Private | 34.6 | 37.3 | 40.4 | 42.0 | 42.6 | 42.6 | 43.3 | 44.1 |
| Central government operations | | | | | | | | |
| Revenue | 16.1 | 17.3 | 15.7 | 18.7 | 19.5 | 19.5 | 19.5 | 19.5 |
| Tax revenue | 7.1 | 8.0 | 7.3 | 7.2 | 7.2 | 7.3 | 7.3 | 7.4 |
| Nontax revenue | 9.0 | 9.3 | 8.3 | 11.4 | 12.3 | 12.2 | 12.2 | 12.1 |
| *Of which*: oil revenue | 6.0 | 5.8 | 5.4 | 9.0 | 9.5 | 9.4 | 9.4 | 9.3 |
| Expenditure | 17.9 | 19.5 | 18.0 | 20.0 | 22.2 | 22.2 | 22.4 | 22.4 |
| Net lending/borrowing (budget) | -1.8 | -2.3 | -2.3 | -1.4 | -2.7 | -2.7 | -2.8 | -2.9 |
| Non-oil net lending/borrowing (percent of non-oil GDP) | -8.6 | -9.2 | -8.7 | -12.9 | -15.3 | -15.0 | -14.9 | -14.8 |
| Gross Public Debt | 42.3 | 49.1 | 40.9 | 53.9 | 49.2 | 45.6 | 42.6 | 40.0 |
| | (Annual percentage change, unless otherwise indicated) | | | | | | | |
| Monetary sector | | | | | | | | |
| Net foreign assets | 14.4 | -3.9 | -0.1 | 36.4 | 50.5 | 21.5 | 25.7 | 22.8 |
| Net domestic assets | 41.5 | 39.3 | 33.2 | 20.0 | 9.7 | 19.0 | 15.4 | 13.8 |
| Credit to the private sector in rials | 16.7 | 24.7 | 21.0 | 19.4 | 15.7 | 15.3 | 15.8 | 14.0 |
| Base money | 16.4 | 17.2 | 20.7 | 20.9 | 18.9 | 18.2 | 17.2 | 15.4 |
| Narrow money (M1) | 13.2 | 19.3 | 19.2 | 18.9 | 16.8 | 17.5 | 16.9 | 15.5 |
| Broad money (M2) | 30.0 | 23.2 | 23.5 | 23.8 | 20.2 | 19.9 | 18.8 | 16.9 |
| | (Billions of US$, unless otherwise indicated) | | | | | | | |
| External sector | | | | | | | | |
| Current account balance | 1.2 | 16.3 | 18.4 | 29.2 | 26.0 | 23.0 | 24.5 | 26.5 |
| Exports of goods and services | 74.4 | 94.4 | 109.5 | 130.3 | 127.5 | 126.1 | 129.7 | 134.0 |
| Imports of goods and services | -74.0 | -79.5 | -91.5 | -103.3 | -103.7 | -105.4 | -107.5 | -110.0 |
| External and publicly guaranteed debt | 10.0 | 9.3 | 8.7 | 9.1 | 9.6 | 10.2 | 10.7 | 11.3 |
| *Of which:* short-term debt | 2.0 | 3.3 | 3.4 | 3.5 | 3.6 | 3.8 | 3.9 | 4.1 |
| Gross official assets/reserves | 128.4 | 120.7 | 111.7 | 124.9 | 143.5 | 158.5 | 181.4 | 204.2 |
| Oil and gas sector | | | | | | | | |
| Total oil and gas exports | 26.9 | 49.8 | 63.7 | 78.3 | 73.6 | 69.2 | 70.3 | 72.3 |
| Crude oil exports (millions of barrels/day) | 1.4 | 2.1 | 2.5 | 2.7 | 2.8 | 2.9 | 3.0 | 3.1 |
| Crude oil production (millions of barrels/day) | 2.9 | 3.7 | 3.8 | 3.8 | 3.9 | 4.1 | 4.3 | 4.4 |
| Memorandum items: | | | | | | | | |
| Average exchange rate, Official (Iranian rials per US$) | 29,645 | 31,457 | … | … | … | … | … | … |
| Average exchange rate, Market (Iranian rials per US$) | 34,359 | 36,328 | … | … | … | … | … | … |

Sources: Iran authorities; and IMF staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

2/ Based on central government operations.

INTERNATIONAL MONETARY FUND

# ISLAMIC REPUBLIC OF IRAN

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION

March 7, 2018

## KEY ISSUES

**Context**. The recovery has broadened to the non-oil sector and the authorities sustained macroeconomic stability in challenging circumstances. Nevertheless, the legacy of sanctions and policies of that period have left incomes at the levels of a decade ago and unemployment high. A weak banking sector, structural bottlenecks and heightened uncertainty constrain Iran's growth potential.

**Outlook and risks**. Growth is likely to remain rangebound near 4 percent as policies tighten to sustain macroeconomic stability and high uncertainty persists. Broad political consensus and public support are needed to kick-start the domestic reform agenda. Risks are tilted to the downside and could cause growth to slow if they materialize.

*Policy discussions focused on the sequencing and faster implementation of reforms to sustain macroeconomic stability and spur job creation:*

**Deep structural reforms are needed to enable the private sector to grow and create the jobs required to address high youth unemployment and raise incomes**. Action to address risks, redefine the role of the state, stamp out corruption, improve the business environment and employ more of Iran's highly educated women would help the economy diversify and lift productivity.

**Comprehensive restructuring and recapitalization of banks is urgently needed**. Financial sector reform should see the banking system substantially restructured, viable banks recapitalized, non-viable ones resolved, and Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) reform completed.

**Broad-based measures are needed to contain fiscal deficits and debt, protect growth and share the reform burden equitably**. The adjustment should be gradual to safeguard growth and rely mostly on domestic revenue mobilization. This combined with targeting of transfers to the poor would ensure the adjustment is more equitable.

**Unifying the dual exchange rate would help stem FX pressures, counter reserve losses, remove costly subsidies and promote competitiveness**. Confidence in the unified rate would be enhanced by tighter monetary conditions and a move to a market-based monetary policy framework complemented by securitization of government debt to the Central Bank of Iran (CBI) and full autonomy for the CBI to pursue low and stable inflation.

| **Approved By**<br>Aasim M. Husain and Rupa Duttagupta | Discussions took place in Tehran during December 2–14, 2017 and February 17–19, 2018. Staff representatives comprised C. Purfield (head), S. Cakir (advance team lead), D. Fayad, M. Pinat (all MCD), C. El Khoury, E. Addo Awadzi (both LEG), and M. Souto (MCM). Mr. Husain (MCD) and Mr. Mojarrad (OED) also participated in some of the discussions. The missions met with Minister of Finance and Economy Karbasian, Central Bank Governor Seif and Vice-President Nobakht (Plan and Budget Organization), as well other senior government officials and private sector representatives. O. Lamy, M. Orihuela-Quintanilla and A. Sadeghi assisted in the preparation of the report. Box 1 was prepared by A. Sadeghi; Box 3 by C. Feher (FAD), V. Malta (SPR) assisted with estimates of the impact of gender-related reforms. |
|---|---|

# CONTENTS

**TABLES**

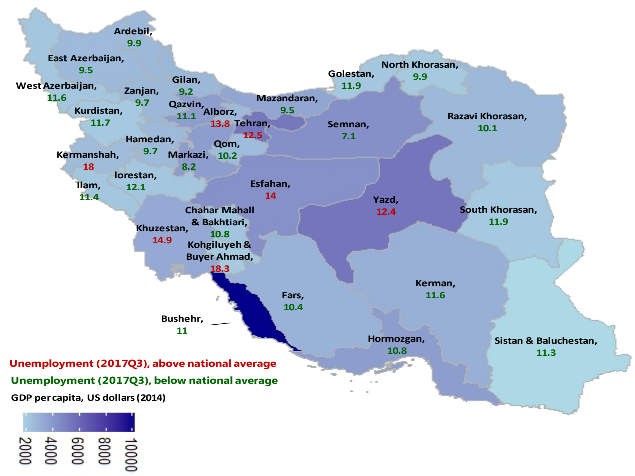


**APPENDICES**

# CONTEXT

1. **The authorities face a challenging domestic and geopolitical environment**. President Rouhani was elected for a second term in May 2017 amid growing pressure to address high unemployment and raise incomes. In late-2017, street protests occurred in several cities. Externally, risks surrounding Iran's foreign relations have increased. The U.S. administration waived the application of nuclear sanctions for 120 days on January 12, 2018 but is seeking substantial changes to the JCPOA.

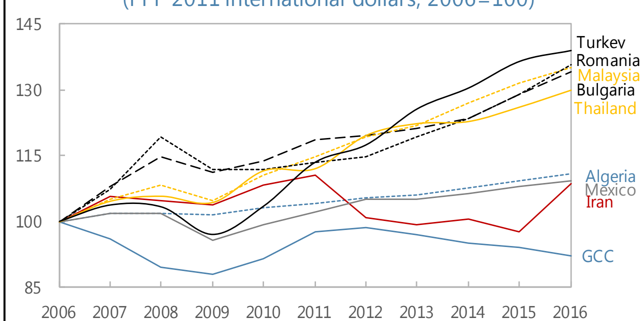
GDP Per Capita and Unemployment Rate 1/
(US dollars, Percent)




Source: Statistical Center of Iran; and IMF Staff Estimates.
1/ GDP per capita excludes oil.

2. **The recovery broadened to the non-oil sector in 2017 following the rebound in oil production and growth in 2016 after the lifting of nuclear-related sanctions**. However, to realize Iran's considerable potential and generate the jobs necessary to tackle unemployment and lift incomes, the authorities need to implement a holistic reform package that entrenches macroeconomic stability, develops the private sector, and ensures its resources benefit all its citizens (Table 1).

GDP Per Capita Growth Index
(PPP 2011 international dollars, 2006=100)




Source: Iranian authorities, and IMF staff calculations.

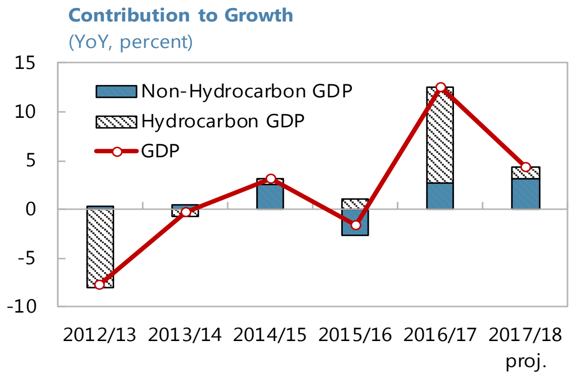
# ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

## A. Recent Developments

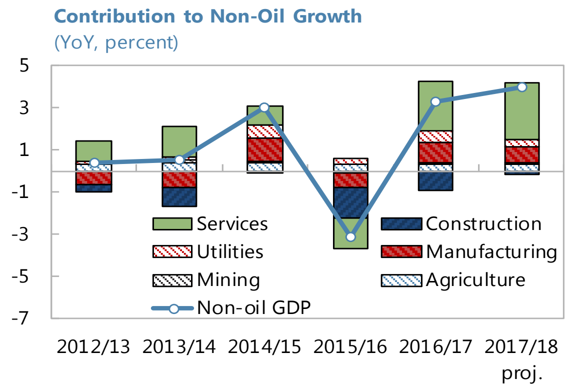
3. **Following the strong rebound in growth in the aftermath of the 2016 nuclear agreement, growth is expected to reach 4.3 percent in 2017/18 as oil production stabilized at Iran's OPEC cap** (Figure 1). The recovery begun to broaden to the non-oil sector in 2017/18 aided by supportive fiscal and monetary policies and the recovery in the construction—where growth returned to positive territory in Q2 2017/18 for the first time in six years—and services sectors. Unemployment declined from 12.7 percent in H1 2016/17 to 11.7 percent in H1 2017/18 but remains high amongst youth and women.

## Figure 1. Islamic Republic of Iran: Macroeconomic Indicators, 2012/13–2017/18

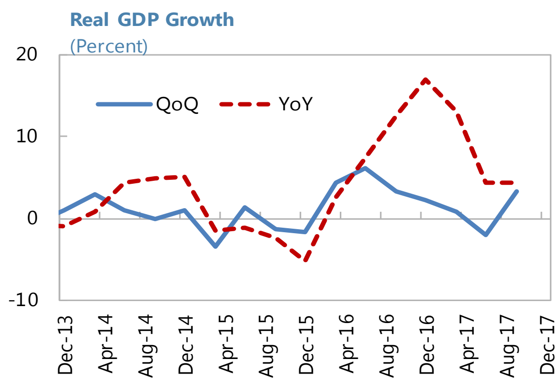
Growth in 2016/17 was mainly driven by the recovery in oil production and exports ...



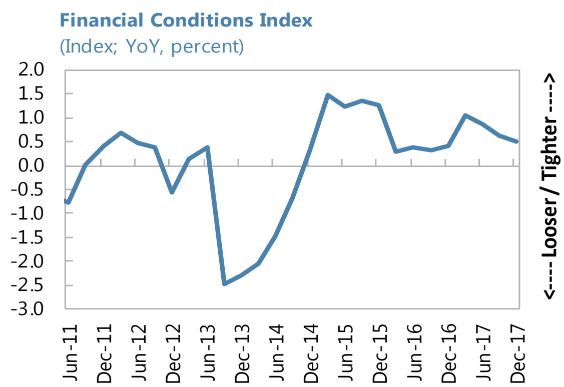

... and a rebound in services and manufacturing.



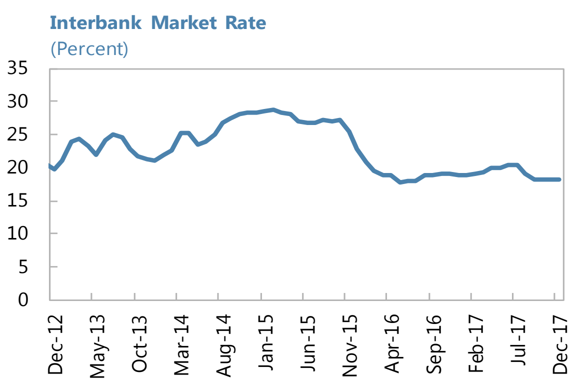

Growth eased in the first half of 2017/18 as oil production stabilized at Iran's OPEC cap and...



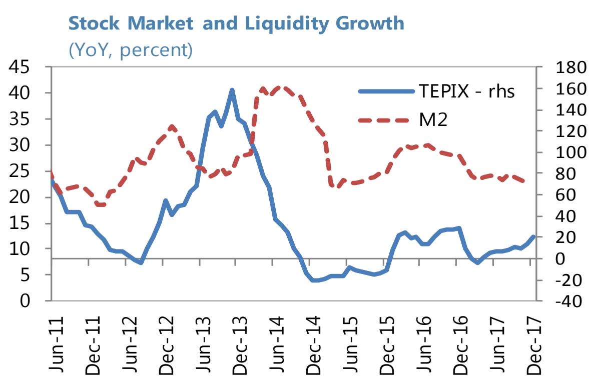

... as financial and monetary conditions remained tight ...




... on the back of still elevated interbank rates,...




... slowdown in the pace of liquidity growth and decline in the stock market.




Source: Iranian authorities, and IMF staff calculations.

4. **CPI inflation moderated** (Figure 2). After finishing 2016/17 at 11.8 percent, average inflation declined to 9.9 percent during the first 11 months of 2017/18 aided by moderation in food prices and stable administered prices. The depreciation of the Rial since November 2017 will keep inflation in double digits during the remainder of 2017/18.

5. **Measures were taken to address liquidity and interest rate pressures**. Liquidity growth remains robust (Figure 3) reflecting CBI support to pay depositors of former Unlicensed Financial Institutions (UFIs) and on-going assistance to distressed banks. To encourage banks to improve their finances, the CBI has required banks to submit liquidity management plans to continue access to the CBI's emergency lending facilities (ELA). Moreover, to generate income relief for banks, ELA was converted to credit lines for several banks with the interest rate reduced from 34 to 16 percent if collateralized, and 18 percent if not. The authorities took measures to alleviate pressures from high real interest rates, enforcing the short-term deposit rate cap (10 percent) set by the Money and Credit Council (MCC). This helped to reduce the interbank rates from 27 percent in 2015 to 18 percent by end-2017. In line with the 2017/18 budget, the government drew on the CBI's unrealized FX revaluation gains (2.5 percent of GDP) to partially recapitalize some state-owned banks (SBs) and clear some of its arrears to banks. Amendments to the banking law to strengthen the CBI's supervisory and resolution powers and define the role of Deposit Insurance Fund (DIF) in bank resolution were submitted to Parliament.

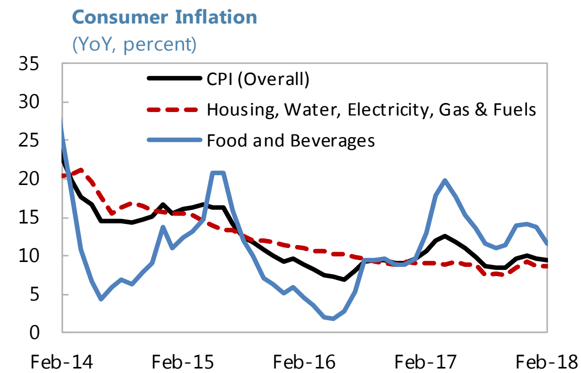
6. **Iran sustained a sizable current account surplus but reserves have fallen**. Reflecting higher oil prices, the current account surplus is estimated to have reached 4.3 percent of GDP in 2017/18. FDI is materializing albeit more slowly than anticipated reflecting heightened uncertainty. Trade credits have risen because of difficulties in transferring export earnings from some trading partners. In the face of high import demand, capital outflows and the problems in accessing export earnings, reserves declined by US$8.7 billion between end-March 2017 and early 2018[1] (Figure 4). Amid heightened uncertainty, aggravated by street protests, the gap between the official and market exchange rates widened to near 30 percent in mid-February. In response, the CBI allowed banks to temporarily issue Rial Certificate of Deposits (CDs) at 20 percent and foreign-exchange indexed CDs at 4 percent and the gap narrowed to about 20 percent.

7. **The fiscal deficit was contained in 2017/18**. The central government (CG) cash-based fiscal deficit is estimated at 2.3 percent of GDP in 2017/18 while the non-oil CG deficit improved to 8.7 percent of non-oil GDP. Shortfalls in oil and tax revenues were off-set by cuts in investment and other spending. Staff's estimate of the non-oil augmented central government (ACG) deficit—including the Targeted Subsidy Organization (TSO) and National Development Fund of Iran (NDFI)—widened to 12.6 percent of non-oil GDP reflecting the non-adjustment of fuel prices. The on-going audit of arrears improved transparency about historical off-budget debts but pushed public debt to near 50 percent of GDP at end-2016/17. The authorities securitized 9 percent of these arrears through bonds bearing marketable profit rates (Figure 5).

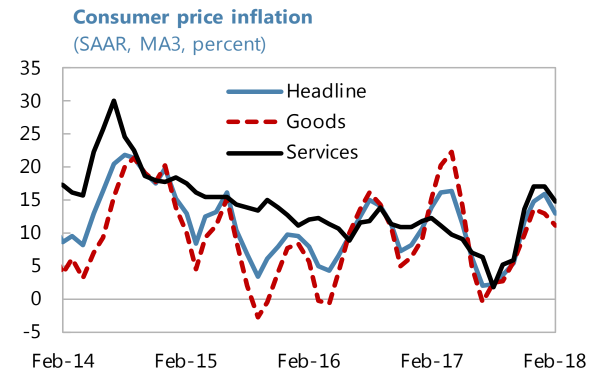
[1] The foreign assets in domestic currency terms as reported in the monetary survey, together with within year preliminary data on the change in official reserves shared with staff, may imply sizeable valuation changes once annual data on the change in gross international reserves become available.

## Figure 2. Islamic Republic of Iran: Price Developments, 2014/15–2017/18

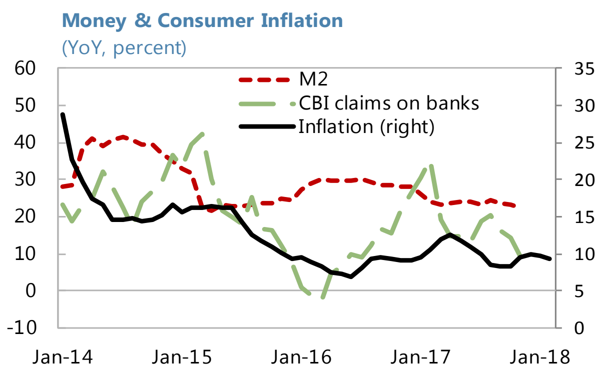
The average inflation rate declined to 9.9 percent during the first 11 months of 2017/18.



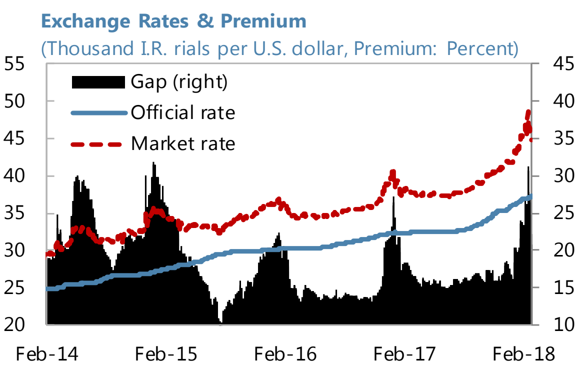

Inflation momentum remains high, reflecting...



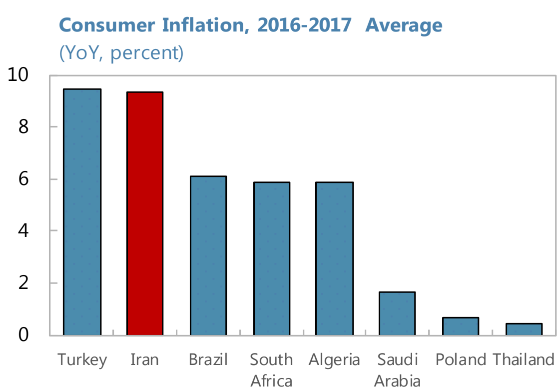

...strong liquidity growth of 23 percent and...



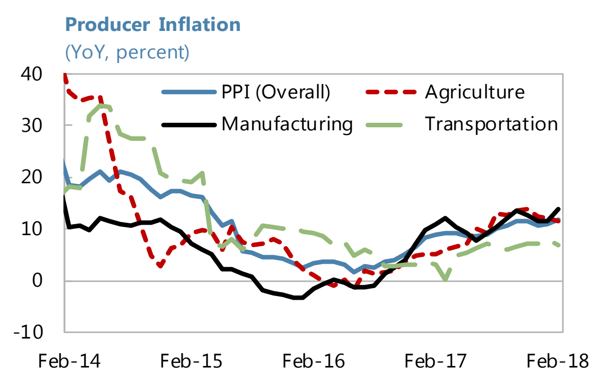

...remergence of depreciation pressures.




The inflation rate remains among the highest of Iran's peers.




Inflationary pressures may intensify as administered prices adjust.

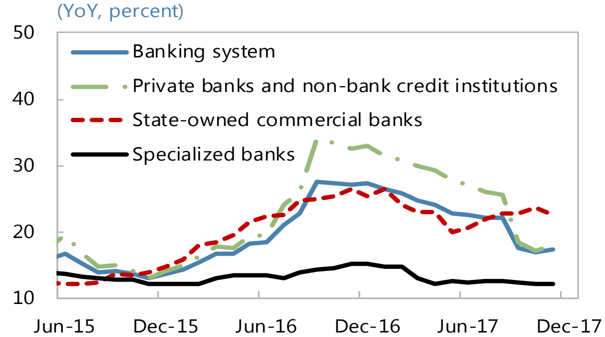



Source: Iranian authorities and IMF staff calculations.

## Figure 3. Islamic Republic of Iran: Money and Credit Developments, 1995/96–2017/18

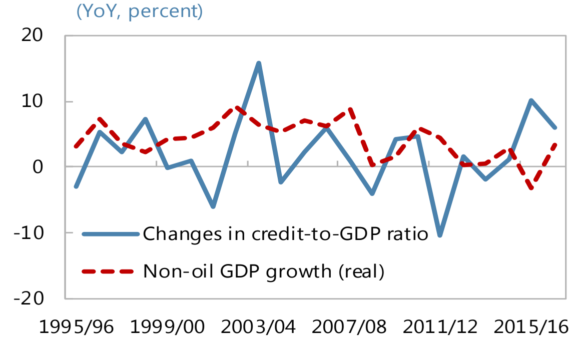
Despite relatively robust credit growth…

**Private Sector Credit Growth**
(YoY, percent)



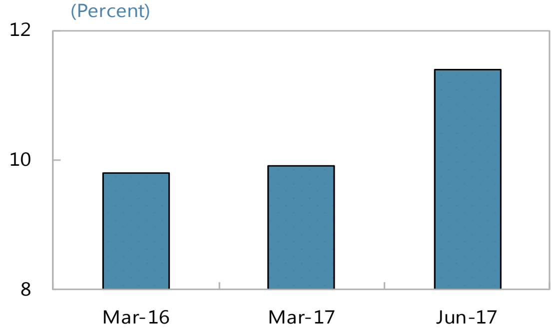

…non-oil activity is not responding to the credit impulse injected in recent years…

**Credit Impulse and Non-Oil GDP Growth**
(YoY, percent)



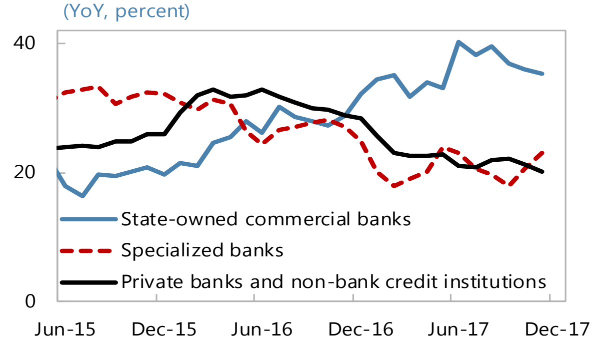

…as banks' balance sheets remain impaired and capital positions weak.

**Non-performing Loans/Gross Loans**
(Percent)



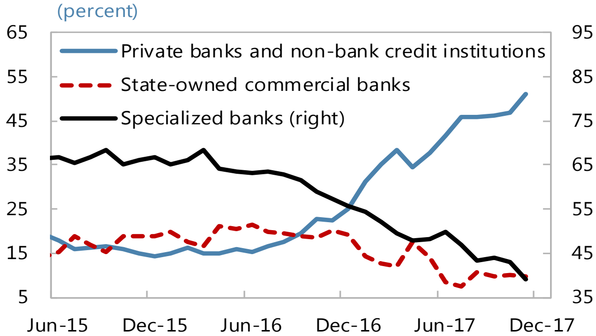

The failure of a non-bank credit institution triggered a deposit outflow from private to public banks…

**Deposits of Non-Public Sector**
(YoY, percent)



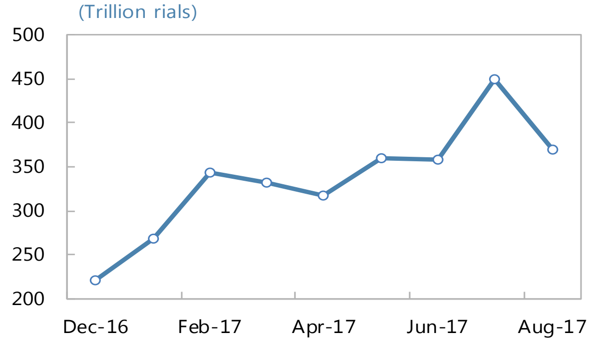

… and private banks' reliance on overdraft facility from the CBI increased in tandem.

**Banks' Share in Total Debt to Central Bank**
(percent)




As a result, the CBI converted the overdraft facility of private banks to a regular funding facility, which caused the overdraft to decline.

**Bank's Overdrafts from CBI**
(Trillion rials)



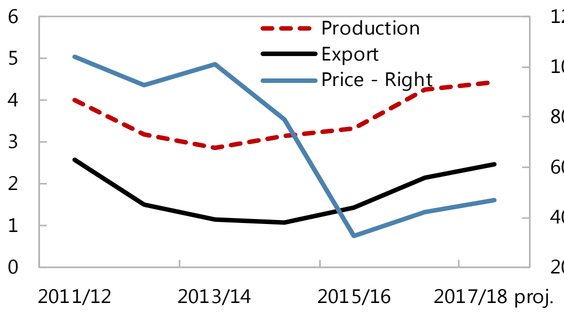

Source: Iranian authorities, and IMF staff calculations.

## Figure 4. Islamic Republic of Iran: External Sector Developments, 2011/12–2017/18

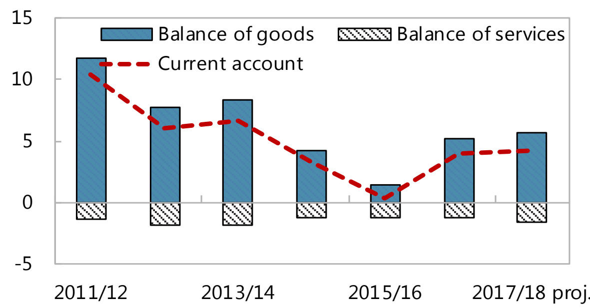
More favorable oil prices and the rise in oil production following the removal of nuclear sanctions...

...sustained the current account surplus in 2017/18.

**Crude Oil Production, Export, & Price**
(Million bpd, price in U.S. dollar)



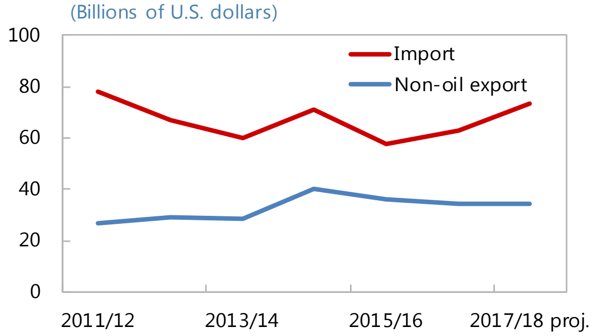

**Current Account**
(Percent of GDP)



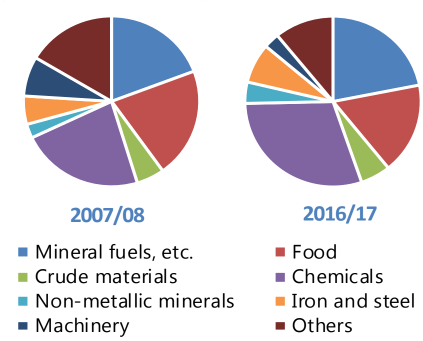

Import growth is strong but non-oil exports remain sluggish...

... but relatively diversified. Petrochemicals and mineral fuels are rising at the expense of machinery.

**Imports and Non-Oil Exports**
(Billions of U.S. dollars)



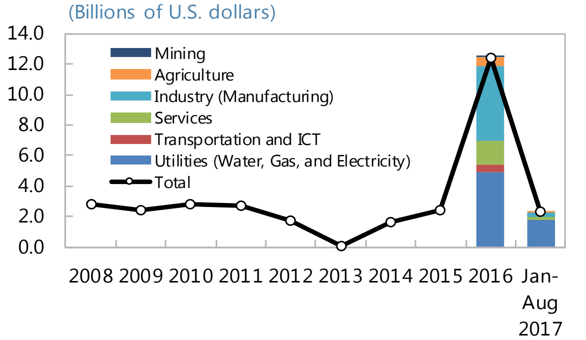

**Non-Oil Export Breakdown by Sector**
(Millions of U.S. dollars)



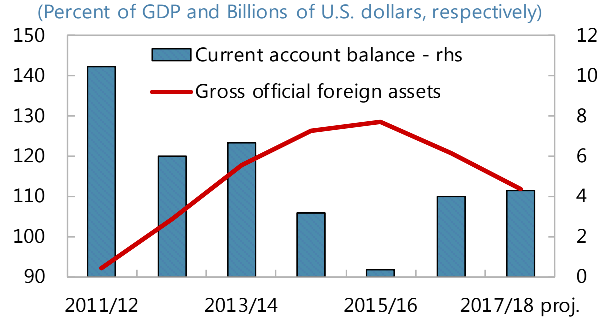

The rebound in FDI approvals in 2016/2017 should materialize gradually in future years ...

...however, difficulties in accessing oil proceeds and delays in exchange rate unification have caused reserves to fall.

**Foreign Direct Investment, Approved Projects**
(Billions of U.S. dollars)




**Current Account Balance & Gross Official Foreign Assets**
(Percent of GDP and Billions of U.S. dollars, respectively)

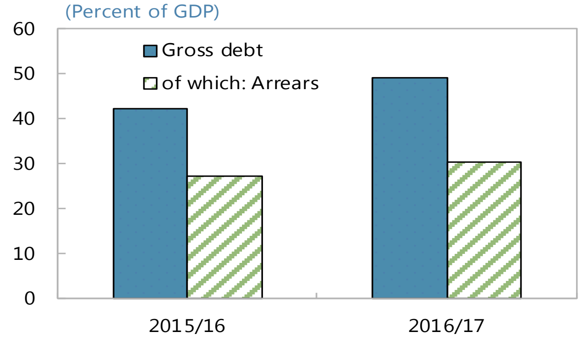



Source: IEA, fDi Markets, Iranian authorities, and IMF staff calculations.

## Figure 5. Islamic Republic of Iran: Fiscal Developments and Prospects, 2015/16–2022/23

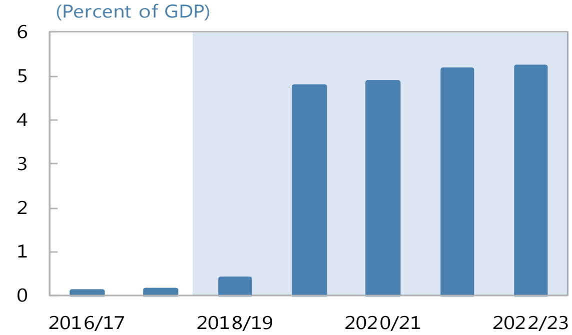
With the recognition of government arrears, debt increased substantially in 2015/16 and further in 2016/17.

**Public Debt**
(Percent of GDP)



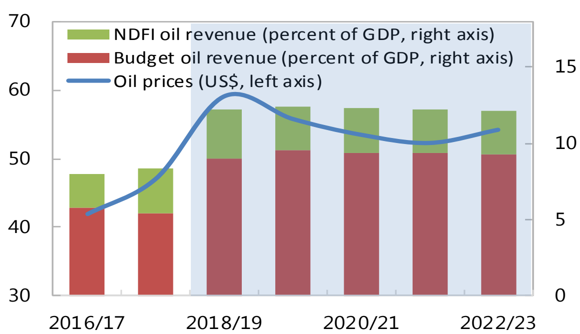

Fiscal consolidation is needed to create room for higher interest costs due to banks recapitalization, and arrears securitization.

**Interest payments**
(Percent of GDP)



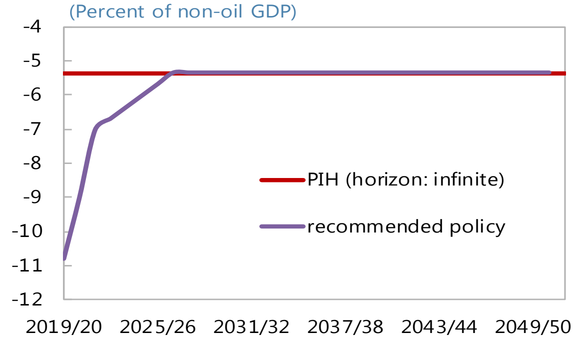

The expected rebound in oil revenue aided by favorable oil prices…

**Parameters Affecting Budget Share in Oil Revenue**



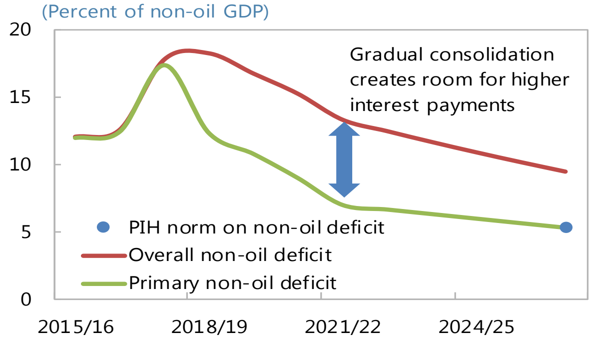

… together with ample oil resources and the need to protect growth suggest there is space for a gradual adjustment in the non-oil deficit towards the PIH norm over 10 years.

**Non-Oil Primary Balance**
(Percent of non-oil GDP)



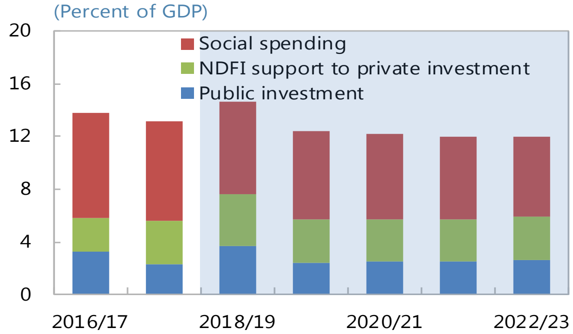

Measures of 4.5 percent of GDP over the next four years would…

**Fiscal Deficit Trend to Adjust to the PIH Norm**
(Percent of non-oil GDP)




…create space to preserve growth-enhancing investment and social spending.

**Public Investment**
(Percent of GDP)




Sources: Iran authorities, and IMF staff estimates and projections.

8. **The 2018/19 CG budget envisages a more accommodative fiscal stance as higher oil revenues fund additional spending to address infrastructure and social needs**. CG spending increases to 20 percent of GDP largely reflecting higher investment spending. Revenue is also estimated to rise owing to higher global oil prices, as well as the increase in the share of oil proceeds ear-marked to fund CG investment spending and the one percentage point increase in the customs tax rate. This should allow the CG deficit to narrow to 1.4 percent of GDP in 2018/19. The underlying fiscal stance measured by the CG non-oil deficit widens to 12.9 percent of non-oil GDP as the increase in spending is largely funded by higher oil revenues. Moreover, the non-oil ACG deficit widens to 17.8 percent of non-oil GDP reflecting higher outlays by the NDFI for subsidized on-lending to the manufacturing sector and PPP investments in unfinished infrastructure projects (backed by NDFI guarantees). Finally, to tackle payment arrears to private contractors, the budget authorized an offsetting operation of 7.4 percent of GDP where government debt to contractors is offset against their debt to banks who in turn have reduced their CBI overdraft by an equal amount. The budget also clarified that the government is authorized to adjust fuel prices and reform the cash transfer system during the Sixth National Development Plan (NDP) which ends 2020/21.

9. **The authorities have made progress in strengthening the AML/CFT legislative and institutional framework**. The United Nations (UN) Convention Against Transnational Organized Crime have been approved by parliament. Amendments to the AML and CFT laws to bring them fully in line with international standards were approved by Cabinet and submitted to parliament. The requirements to monitor remittances and the transportation of cash have also been upgraded. The National Risk Assessment (NRA) was initiated, the CBI is bolstering its supervision and the Financial Intelligence Unit (FIU) is enhancing the quality of its financial intelligence. The CBI has requested an IMF assessment of the AML/CFT framework, due to commence late-2018 and finalize in late 2019, and Iran gained observer status in the Eurasian AML/CFT group.

## B. Outlook and Risks

10. **Real GDP growth is projected at 4.0 percent in 2018/19 and to remain in that range in the medium-term** (Tables 2–12). Oil production is expected to remain flat through 2018, in line with OPEC commitments. The rise in gas and condensate exports following recent investments compensates for declining oil production from older fields allowing the oil sector to sustain growth at 4 percent (Box 1). Non-oil sector growth improves gradually towards 4½ percent over the medium-term reflecting completion of bank recapitalization in 2019/20. On-going uncertainty keeps FDI subdued and hampers further expansion of Correspondent Bank Relations (CBRs). The current account is expected to remain in surplus as improved oil prices and higher gas exports allow international reserve buffers to rise gradually.

11. **CPI inflation remains in low double digits in the medium-term**. Average inflation rises to 12 percent in 2018/19 reflecting recent depreciation pressures. The forecast reflects full unification of the exchange rate in 2019/20. Liquidity growth is curbed to limit second-round effects of exchange rate pass-through on inflation and the gradual increase in fuel prices. Credit to the private

sector strengthens after banks' recapitalization, in turn supporting the gradual strengthening of non-oil economic growth.

12. **The fiscal deficit is set to rise driven by higher interest outlays and rising pension system deficits but debt declines**. Assuming the NDFI's share of oil proceeds is lowered to 20 percent and the gradual implementation of fuel subsidy reform under the NDP, the CG fiscal deficit is projected to average 3 percent of GDP in the medium-term reflecting higher interest outlays associated with the bonds for arrears securitization and bank recapitalization. High nominal GDP growth will reduce the debt-to-GDP ratio to 40 percent of GDP by 2022/23 (Appendix II).

13. **Risks are tilted to the downside** (Box 2). A rise in social or external tensions could delay the reform process. Delays or failure to decisively address problem banks, implement fiscal measures or unify the exchange rate risks a return to high inflation and further pressures on the exchange rate. With little improvement in banks' balance sheets, credit to the private sector would continue to be devoted to the evergreening of NPLs and ultimately reduce private sector growth. On the other hand, faster implementation of reforms in a manner that underpins confidence and shares the burden equitably could see growth surprise on the upside. A more difficult external environment or lower oil prices could increase pressure on the external and fiscal accounts. Failure to secure FATF approval of the measures taken under the action plan or to effectively implement AML/CFT international standards could reverse the improvement in CBRs and stall prospective FDI inflows. Thus, it is paramount the authorities implement a comprehensive reform plan to safeguard stability and build FX and fiscal buffers in order to preserve space for policy maneuver if needed, while taking measures to reduce unemployment, inequality and to protect the poor.

14. **The authorities concurred with staff's assessment noting that the growth trajectory is likely to be higher reflecting the impact of planned financial sector and business climate reforms**. While acknowledging the risks and underscoring how external uncertainty is hampering investment, they expect most JCPOA signatories will adhere to the agreement.

# POLICY DISCUSSIONS

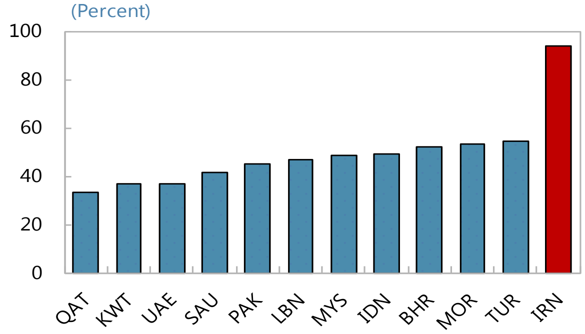
## A. Advancing Reforms in the Financial Sector

15. **In the past year, the CBI merged or closed several UFIs that threatened financial stability and contributed to excessive interest rate pressures**. The legal framework was revised to make the CBI the sole authority to license and regulate financial institutions. UFI assets and liabilities were transferred to existing Credit Institutions (CIs). However, a deposit run in two UFIs prior to the transfer triggered a shift of deposits to public commercial banks necessitating CBI ELA to stem liquidity pressures (Figure 6). While 98 percent of depositors in those UFIs have now been paid, deposits over $25,000 are frozen pending a court decision on the CBI's asset review of these entities. It is essential to ensure that the CIs' balance sheets are not weakened from the clean-up of UFIs so they remain sound and viable and that their ownership and management meet fit and proper

## Figure 6. Islamic Republic of Iran: Financial Indicators, 2009/10–2016/17

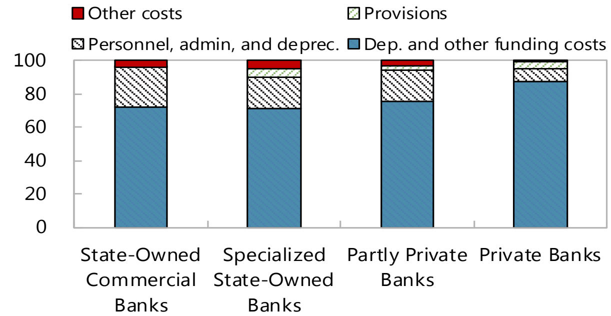
The cost-to-income ratio for banks in Iran is amongst the highest in the world.

**Cost-to-income ratio, April 2016**
(Percent)



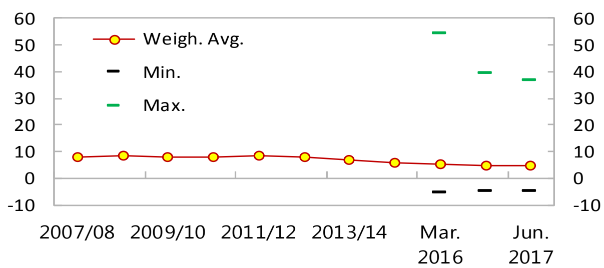

The remuneration of deposits and investment accounts consumes more than 70 percent of costs.

**Banks' cost structure, April 2016**
(In percent of total costs)




Banks' capital ratios had fallen, until their capital adequacy ratios were boosted with CBI's revaluation gains.

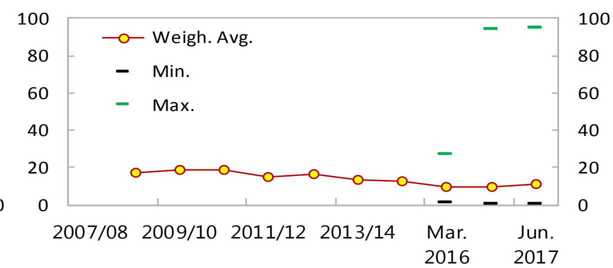
**Banking Sector Capital Adequacy Ratio 1/**
(Percent)




Note: 1/ CAR = base capital/risk-weighted assets.

NPLs remain high and may not fully reflect the true credit quality of banks' loans portfolios…

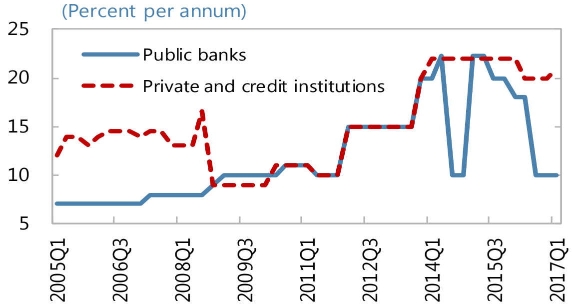
**Banking Sector NPL Ratio 1/**
(Percent)




Note: 1/ NPL ratio = gross NPL/gross loans.

… specially for private banks and credit institutions, which have been competing aggresively for deposits.

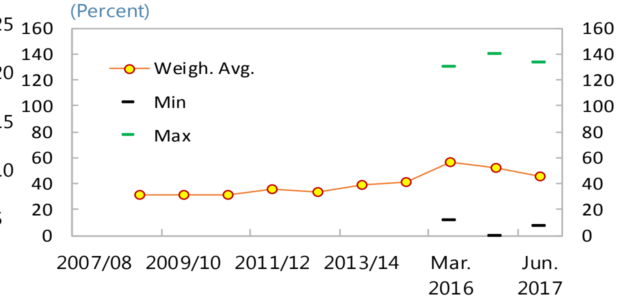
**Short-term deposit rates 1/**
(Percent per annum)




Note: 1/ Rates are maximum rates offered by banks.

At the same time, provisions to NPLs continue to decrease.

**Provision to NPL Ratio 1/**
(Percent)



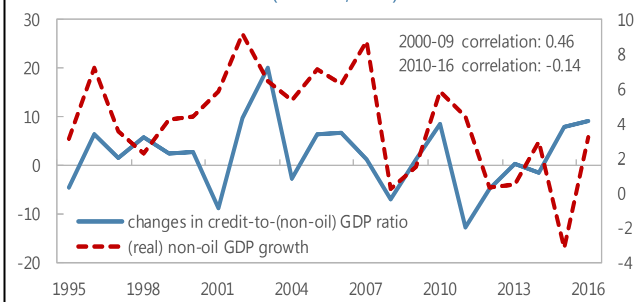

Note: 1/ Provision to NPL ratio = Total provision/Total NPL

Source: Iranian authorities, S&P Global Market Inteligence, and IMF staff calculations.

standards. Moreover, the owners and unsecured debt holders of the UFIs should have their claims/rights fully written-off before any depositor face losses.

16. **Notwithstanding the use of CBI FX revaluation gains and the securitization of some government arrears to banks in the past year, the average Capital Adequacy Ratio (CAR) had fallen to 4.9 percent by end-June 2017 from 5.2 percent a year earlier and the nonperforming loans (NPLs) ratio had risen to 11.4 percent**. The provisioning rate on these NPLs fell to 43.6 percent (from 48.5 percent in March 2016). The banking system continues to operate at a loss as the margin between mandated lending and deposit rates is insufficient to cover high operating costs and increasing provision expenses related to nonperforming assets. The correlation between the credit impulse and non-oil activity is diminishing as banks' NPLs grow.

**Credit Impulse and Non-Oil GDP Growth**
(Percent, YoY)




Source: Iranian authorities, and IMF staff calculations.

17. **The CBI plans to undertake an independent Asset Quality Review (AQR), including related-party lending assessment to identify the financial system's recapitalization needs**. An AQR will help identify the true extent of non-performing assets, the value of associated collateral, provisions adequacy and credit risk management weaknesses. Staff urged the CBI to move expeditiously with the AQR to contain financial stability risks and be prepared to take additional actions following its conclusion, including requiring banks to raise capital, resolve NPLs, improve credit risk management, tackle related-party lending and demonstrate their commercial viability on a forward-looking basis. Non-viable banks should be rapidly and orderly resolved under a least-cost principle.

18. **The restructuring of state-owned banks (SBs) should proceed now—since the AQR will take time—to ensure that CBI and government support provided is linked to measures to promote financial soundness**. Recovery plans should be prepared by SBs and other government-controlled banks while the AQR proceeds. The government must tackle elevated operating costs, refrain from directed credit, cover interest subsidies, adjust regulated prices so firms can start to meet their obligations to banks, and ensure that the SBs' governance, internal procedures, and credit risk management support a profitable business model. The issuance of recapitalization bonds—to cover government's arrears to banks and the capital required to meet prudential requirements—would make SBs solvent and provide them a cash-flow from interest and should be linked to the implementation of the recovery plans. Private banks accessing CBI ELA should also be required to prepare and implement recovery plans.

19. **Stronger supervisory and resolution powers would aid bank restructuring**. Early passage of the new CBI Law and amendments to banking law to grant it the requisite supervisory and resolution powers is critical, and should be supported by strengthening of resources and

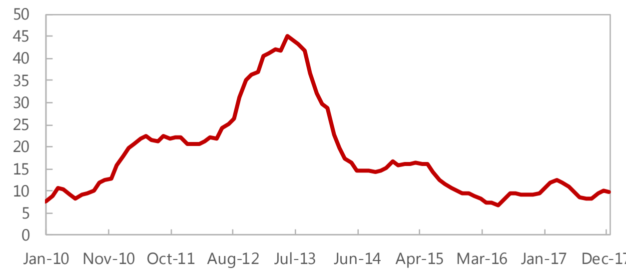
capacity for risk-based supervision. The CBI should then move quickly to use those powers to place unviable banks in resolution and restructure assets and liabilities. The DIF should be adequately funded and have access to funding facilities if it is to have the capacity to repay depositors in a timely manner. The proposal to tighten provisioning and loss recognition standards is a welcome step towards Basel II. The impact of the tighter standards on banks' capital positions must be quantified and provided for under the recapitalization plan to ensure banks are adequately capitalized.

20. **The authorities acknowledged the complexity and scope of banks' problems and agreed on the need for action**. They noted that NPLs and other frozen assets comprised 28 percent of banks' total assets but that the exact recapitalization need will only be finalized once the AQR is completed. In a fiscally constrained environment, they acknowledged need to forge consensus on how to restructure and fund the recapitalization.

## B. Modernizing the Monetary Policy Framework

21. **The CBI kept inflation close to single digits since end-2015 by curbing liquidity growth while managing carefully its support to distressed banks**. Still, the CBI is obliged to provide liquidity to all banks, including insolvent ones, and to accommodate credit support to specific sectors and the funding needs of the budget and SOEs. Moreover, the absence of a regular funding facility for banks, together with banks' unrestricted access to ELA without collateral, undermines control over monetary aggregates.

**Consumer Inflation**
(Percent, YoY)




Source: Iranian authorities.

22. **The government arrears netting operation can be improved to preserve the CBI's balance sheet and enhance its ability to maintain price stability**. If the government securitizes its debt to the CBI with bonds bearing a market interest rate, the CBI could use these bonds in open market operations to manage banking system liquidity and thereby enhance monetary policy effectiveness. To protect the CBI's balance sheet from further erosion and preserve its ability to manage liquidity and control inflation, the authorities should avoid any further use of CBI revaluation gains to recapitalize banks.

23. **Bank recapitalization should be accompanied by an overhaul of the central bank's lending facilities**. To smooth the transition to a market-based monetary policy framework, the CBI should ensure interest rates support its single digit inflation target.[2] An emergency lending facility, restricted to viable banks and providing temporary liquidity against high-quality collateral at the

[2] See IMF Country Report 17/63.

CBI's discretion with pre-established limits for all banks, would preserve the CBI's capacity to absorb losses that may arise from future sterilization operations.

24. **Greater CBI independence, successful financial sector reform, and fiscal discipline is necessary to sustain low and stable inflation**. The new Central Bank Law should enshrine price stability as the core objective of monetary policy, replace government representatives with independent experts, streamline the CBI's governing bodies and prohibit CBI financing of the government. Clear communication and better coordination between monetary, fiscal and capital market policies would facilitate the transition.

25. **The level of the official exchange rate and the gap between the official and market exchange rates are eroding reserves, creating distortions and undermining competitiveness**. Uncertainty and incomplete access to reserves have also put pressure on the market exchange rate. To address this, the authorities have increased import tariffs, moved more goods off the priority list and recently raised interest rates. Nevertheless, the gap between the official and market rate constituted a subsidy to importers of priority list goods of 1.4 percent of GDP in 2017/18 and continues to stimulate imports. Staff's calculations show the official exchange rate was overvalued by 13–16 percent and the market exchange rate was broadly in line with fundamentals at end-2016/17 (Appendix I).

26. **Faster progress toward exchange rate unification would help counter FX pressures**. If pressures reemerge, the CBI should extend the rate increase and allow lending rates to adjust commensurately to protect banks' net interest income. This combined with the re-start of the interbank FX market could prepare the ground for unification and transition to a more flexible exchange rate regime in the context of a carefully crafted communication plan. Unification would afford the CBI greater space to use its reserves to smooth market pressures; eliminate the economic distortions and potential rent-seeking associated with the subsidy; allow fair and equal access to FX for all; and promote non-oil export competitiveness.

27. **The authorities still plan to unify the exchange rate by end-March 2019 but issues surrounding the transfer of export earnings and CBRs complicate the timing**. They will continue to gradually remove all but pharmaceutical goods from the priority list and would consider sustaining the interest rate increase and closing the gap between the official and market rate more quickly should FX pressures persist. The authorities acknowledged the need for a new monetary framework and see the new central bank bill as key to this transition. They broadly agreed with the assessment that the market exchange rate was in line with macro-fundamentals at end-2016/17.

## C. Safeguarding Fiscal Sustainability

28. **Reflecting expenditure constraint, the authorities contained the cash-based fiscal deficit notwithstanding the impact of sanctions and lower oil prices**. Progress has been made through the on-going audit to regularize historical arrears, while the introduction of performance based budgeting in one-third of ministries and the publication of detailed budget data improved

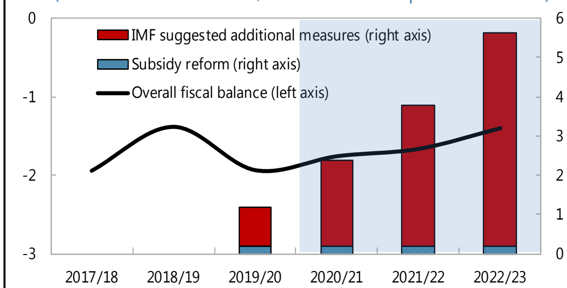
transparency. The authorities have also strengthened tax administration and tax collections have exceeded oil revenues as the main source of budget revenue since 2015/16.

29. **Looking ahead, fiscal policy will need to gradually tighten to contain emerging debt pressures**. Notwithstanding the implementation of fuel and subsidy reform during the NDP, the projected non-oil fiscal deficit of the ACG would average 19 percent of non-oil GDP in the medium-term, well above the level that ensures adequate savings for future generations at a time when the budget faces large contingent liabilities from growing pension system deficits (Box 3). Staff estimate that the issuance of bonds for bank recapitalization will push debt to almost 54 percent of GDP in 2018/19 which, with the securitization of arrears, will see the budgeted interest bill rise to 4.8 percent of GDP in 2019/20. Fiscal policy needs to consolidate to reduce the governments' borrowing requirement and contain debt given the increased risk of shocks (Appendix II) in the context of a nascent domestic debt market and no external finance.

30. **A medium-term general government fiscal framework (MTFF) targeting a gradual adjustment over 10 years would contain debt and minimize the growth impact of adjustment**. Iran's oil and NDFI assets imply that it has some fiscal space to allow for a gradual adjustment over a decade to the estimated PIH norm of 5.4 percent of non-oil GDP by 2029. Gradually lowering the non-oil deficit to about 13.4 percent of non-oil GDP by 2022/23 would create fiscal space, reduce the ACG and CG deficits, and contain gross financing needs. This would allow the debt burden to fall well below the authorities' 40 percent of GDP debt ceiling by 2022/23 and would give some headroom relative to the debt target to address shocks. To attain this path, additional fiscal measures of 5.4 percent of non-oil GDP are needed over the next four years.

**Fiscal Measures**

(Percent of non-oil GDP, fiscal balance in percent of GDP )




Source: IMF staff estimates

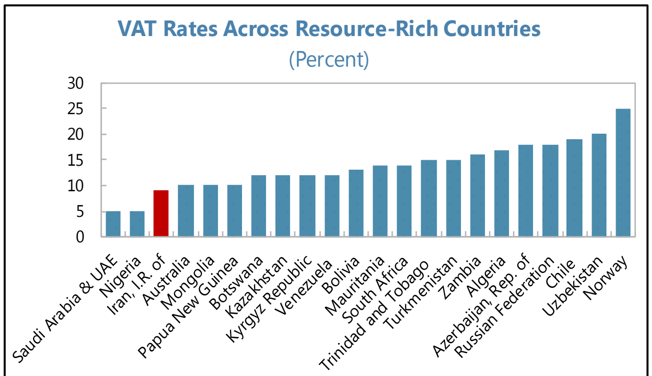
**Staff's Assessment of Fiscal Space, 2014/15-2022/23**

| | | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | (percent of non-oil GDP, unless otherwise indicated) | | | | | | | | |
| Non-oil Augmented CG balance with the authorities' identified measures (current policy) 1/ | -10.8 | -11.4 | -12.1 | -12.6 | -17.8 | -19.3 | -19.0 | -18.9 | -18.8 |
| Overall CG balance (% of GDP) | -1.1 | -1.8 | -2.3 | -1.9 | -1.4 | -2.7 | -2.7 | -2.8 | -2.9 |
| Overall Augmented CG balance (% of GDP) | -0.7 | -3.0 | -2.7 | -2.3 | -2.1 | -3.0 | -3.1 | -3.3 | -3.4 |
| Non-oil CG primary balance | -7.7 | -8.5 | -9.1 | -8.6 | -12.5 | -9.3 | -9.0 | -8.6 | -8.5 |
| Non-oil Augmented CG primary balance | -10.7 | -11.3 | -12.0 | -12.5 | -17.4 | -13.3 | -13.0 | -12.6 | -12.5 |
| Debt-to-GDP ratio | 11.8 | 42.3 | 49.1 | 40.9 | 53.9 | 49.2 | 45.6 | 42.6 | 40.0 |
| Non-oil Augmented CG balance with additional measures 1/ | -10.8 | -11.4 | -12.1 | -12.6 | -17.8 | -18.3 | -16.8 | -15.3 | -13.4 |
| Overall CG balance (% of GDP) | -1.1 | -1.8 | -2.3 | -1.9 | -1.4 | -1.9 | -1.8 | -1.7 | -1.4 |
| Overall Augmented CG balance (% of GDP) | -0.7 | -3.0 | -2.7 | -2.3 | -2.1 | -2.2 | -2.1 | -2.1 | -1.9 |
| Debt-to-GDP ratio | 11.8 | 42.3 | 49.1 | 40.9 | 53.9 | 48.3 | 43.9 | 39.9 | 36.1 |

Source: Iran authorities, and IMF staff projections.

1/ Staff estimates of permanent cumulative measures to be taken every year.

31. **The adjustment effort should rely mainly on domestic revenue mobilization given the low tax-to-GDP ratio (8 percent in 2016/17) and the need to protect social and investment spending**. Eliminating tax exemptions, especially to companies owned by foundations and other exempt entities, and improving tax compliance should take priority over rate increases and would spread the burden of adjustment more equitably. Introducing a VAT registration threshold with a simplified tax regime for small businesses would improve VAT compliance. Enhancing tax administration by organizing INTA by taxpayer groups, the introduction of e-tax processes and a shift to risk-based auditing would strengthen administration and combat evasion.



Sources: International Bureau of Fiscal Documentation, IBFD, 2013 (www.ibfd.org).

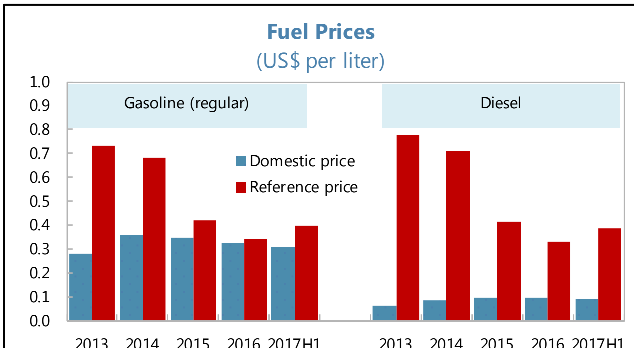
**Options to Create Fiscal Space 1/**
(Percent of non-oil GDP)

| | |
|---|---|
| Reducing NDFI's spending 2/ | 3.4 |
| Increase revenue base by removing exemptions and taking administrative measures to reduce tax evasion | 1.9 |
| Pension reform | 0.1 |
| Cumulative impact | 5.4 |

1/ Cumulative effect 2019/20 - 2022/23

2/ Oil proceeds are currently shared across the National Iranian Oil Company (14.5 percent), the central government budget (62.8 percent), and the NDFI (22.7 percent). NDFI spending is assumed to decline in tandem with the reduction in its share in oil revenues.

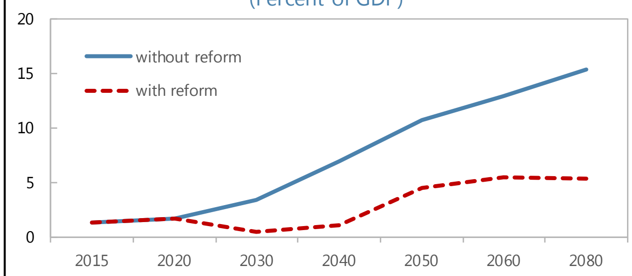
32. **Staff supports the planned gradual reduction of general fuel subsidies and the better targeting of cash transfers to the poor as this creates space for higher social safety net spending to compensate vulnerable households**. Fuel subsidies cost 1.6 percent of GDP in 2017/18. Adopting an automatic price adjustment mechanism would support a gradual increase in pump prices and phasing-out of fuel subsidies. Better targeting of cash transfers by removing the richest 20 percent of households from the beneficiary list could create space to raise the cash transfer to the poorest households by 1 percent of GDP. It would be important to ensure that targeting be based on a thorough review of individuals' assets and disposable income.



Source: WDI and IMF staff calculations

33. **Iran's pension system faces a growing deficit**. Unification of pension schemes, a clear definition of general government pension obligations, and rationalizing asset management would increase transparency about pension finances. Gradually increasing the retirement age to 65, reducing accrual rates to 2 percent per year and expanding the pension benefit calculation period, gradually, to 20 years, would lower the pension deficit to 0.5 percent of GDP by 2030.

**Pension Deficit**
(Percent of GDP)




Sources: IMF staff calculations.

34. **Public financial management reforms are essential to improve the efficiency and effectiveness of public spending**. Expanding the rollout of performance-based budgeting could identify cost savings. The transition to accrual-based accounting in the medium-term needs to be complemented by expanding the coverage of fiscal accounts to the sub-national governments, social security schemes, TSO and the NDFI. This would ensure all spending commitments and PPP-related risks are adequately captured and provided for.

35. **Rising debt calls for a debt management strategy and annual borrowing program**.[3] To ensure the orderly development of the primary bond market, a new public debt law should give the Ministry of Economy and Finance (MOEF) the sole authority to borrow and issue guarantees on behalf of the CG, set rules to determine whether local governments can borrow, and strengthen MOEF oversight of State-Owned Enterprises (SOEs) and subnational debt. An issuance calendar would also facilitate market development and monetary policy coordination.

36. **The authorities underscored their commitment to fiscal discipline**. The conservative oil price assumption of $55 per barrel in the 2018/19 budget limits risks of deficit overruns. They acknowledged the rise in social and spending pressures and aim to eliminate absolute poverty by developing a universal social safety net that merges all social support programs and eliminates untargeted subsidies. They have prepared a draft bill on debt management, are developing a debt management strategy and a parametric pension reform. They noted that addressing tax exemptions will require political consensus.

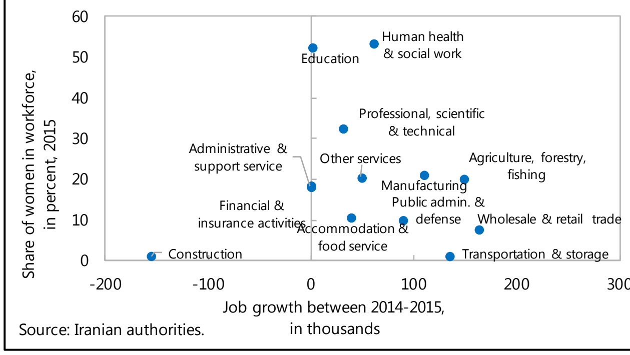
## D. Enhancing Growth and Job Creation Potential

37. **The business environment improved in 2017 reflecting macroeconomic stability**. Iran's rank on the 2017–18 Global Competitiveness Index (GCI) rose seven notches to sixty-ninth. Between January–November 2017, exports to the Euro Area doubled y/y and are up nine-fold since their sanctions low. Some 1.3 million jobs were created in the last two years. The AML/CFT legal framework was also strengthened.

[3] Selected Issues Paper (SIP) Chapter I.

38. **Nonetheless, Iran face challenges of high youth unemployment and falling productivity stemming from its continued reliance on oil and the public sector to drive growth** (Figure 7). Labor force participation is below 40 percent largely due to the very low rate of female participation and the high degree of informality and underreporting of employment. Unemployment is high and rising for youth and job creation was insufficient to absorb new entrants and the rise in labor force participation. Most jobs were created in lower skilled services and agriculture that do not match Iran's skilled youth and employ few women. Productivity has been in decline, growth remains too capital intensive and the private sector has significant room to grow to create jobs. Non-oil exports are small (8½ percent of GDP) and dominated by petrochemicals which benefit from free natural gas.

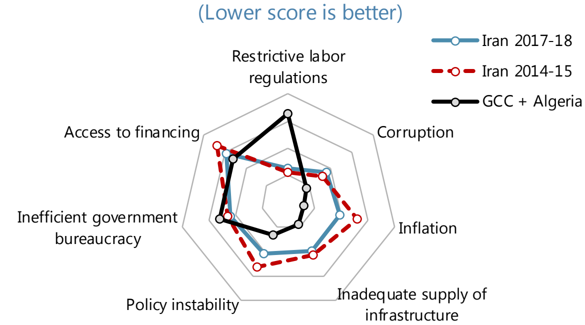
**Job Creation and Gender, 2015**




Source: Iranian authorities.

39. **Further improvements in the business environment would spur faster development of the private non-oil sector**. Across most surveys, access to finance remains the main obstacle to business, followed by bureaucracy and policy instability. Less red-tape, modern regulations, a reformed bankruptcy framework, liberalized prices and fewer barriers to entry could help the private sector operate on a more level playing field with SOEs.

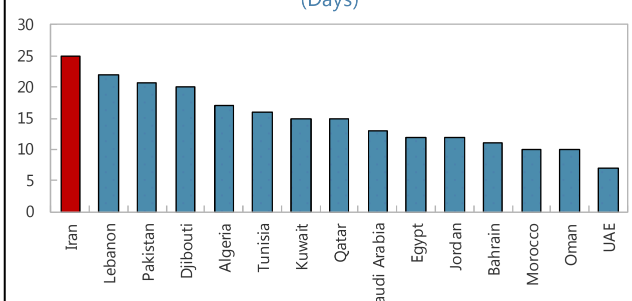
**Most Problematic Factors for Doing Business**
(Lower score is better)




Source: World Bank.

40. **Reducing trade barriers would stimulate exports**. Lack of bilateral and multilateral trade agreements reduce market access for Iranian firms.[4] The tariffs applied to Iran's exports by its trading partners averaged 8.9 percent in 2014 (compared to a global average of 2.9 percent). Domestic import tariffs averaged 20.9 percent in 2017/18 and restrictions on service trade (the fourth highest in the world) work to protect inefficient enterprises. It takes 25 days to clear exports. Proposed Customs Law amendments tackle these constraints by introducing e-processes, supply chain management and restricting the release of goods from bonded warehouses to licensed brokers to counter smuggling.

**Time to Export, 2014**
(Days)



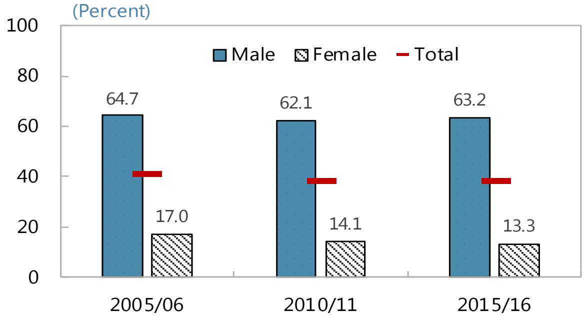

Source: World Bank.

[4] SIP Chapter II

## Figure 7. Islamic Republic of Iran: Structural Indicators, 2005/06–2027/28

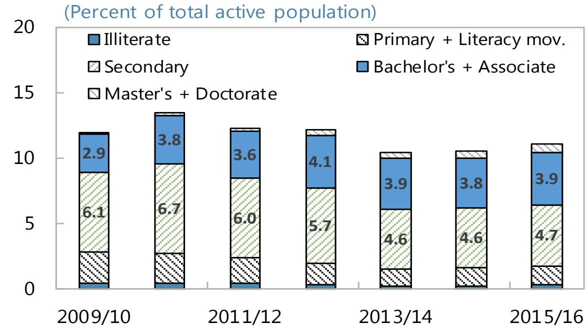
The overall participation rate is low reflecting low female labor force participation…

**Labor Force Participation Rate by Gender**
(Percent)



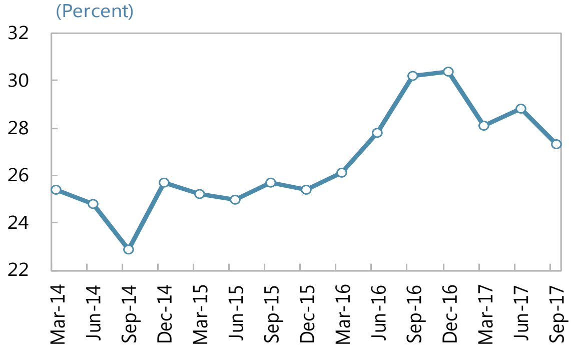

… and rising unemployment, particularly among the most educated…

**Unemployment Rate by Level of Education**
(Percent of total active population)



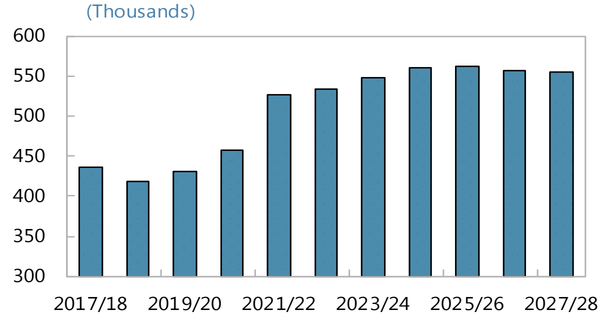

… and youth unemployment remains high, despite recent improvements.

**Youth Unemployment Rate**
(Percent)



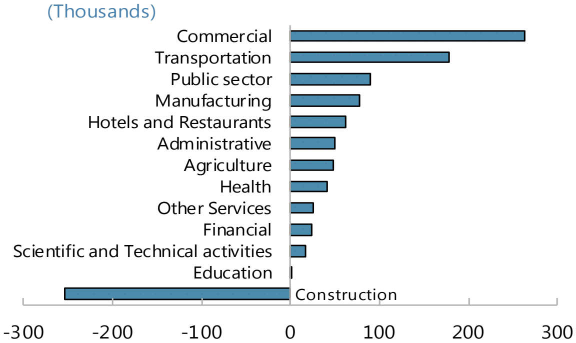

The working-age population is expected to rise by around 500,000 people a year in the next 10 years

**Expected Increase of Working-Age Population**
(Thousands)



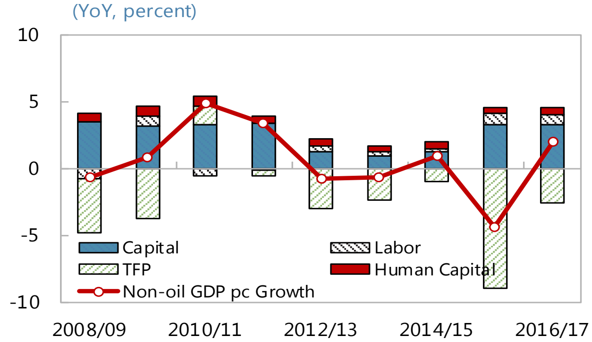

Recent job creation in the commercial and transportation sectors has only partially offset job destruction in construction…

**Job Growth by Sector, 2013/14-2015/16**
(Thousands)




… and non-oil growth continues to be driven by capital accumulation with TFP in long-term decline.

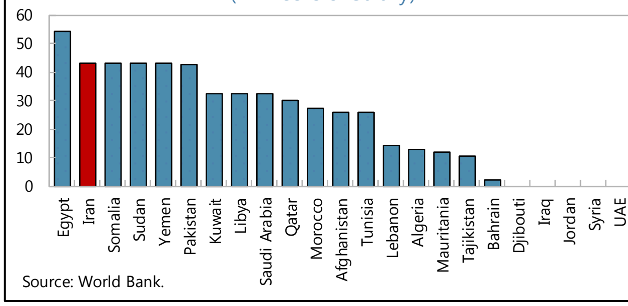
**Contribution to Non-Oil GDP Per Capita Growth**
(YoY, percent)




Source: Iranian authorities, WDI, and IMF staff calculations.

41. **As the economy recovers, restrictive labor regulations are emerging as a concern**. Government approval is required to dismiss workers and may deter more permanent hiring as employers rely increasingly on fixed-term contracts. Legal restrictions against women (e.g., with respect to foreign travel by married women), and the tax code (e.g., the income tax deduction) limit female labor force participation (FLFP) although the official rate is likely understated due to social reasons and the underreporting of part-time work. Measures to overcome obstacles to employing women in the formal sector, expand access to child care facilities, and reduce the gender wage gap over time would increase FLFP. Staff estimates suggest closing the gender wage gap by half could boost GDP by 26 percent. Moreover, the rise in tax revenues would more than offset the fiscal cost of a child-care subsidy to lower income mothers.[5] Additionally, to improve incentives for employees to work and stay in the labor force, a pension reform could reconsider retirement incentives and eliminate the minimum service time criteria to provide greater income security to workers with short employment histories.

**Severance Pay for Redundancy Dismissal for a Worker With 10 Years of Tenure, 2016**
(In Weeks of Salary)




Source: World Bank.

42. **Bolstering the anti-corruption framework would deter financial crimes, enhance accountability, improve the business climate and help attract foreign investment**. Areas of priority are to enhance transparency of corporate beneficial ownership, establishing an independent anti-corruption agency, continuing to actively pursue corruption cases, and enhancing the system of declaration of assets of senior public officials and measures to identify domestic politically exposed persons in line with international standards.[6]

43. **The authorities acknowledged the need for wide ranging reforms to increase non-oil growth and job creation**. They saw the Customs Law amendments in parliament as necessary to combat smuggling and lower trade costs. They noted that their WTO membership process is stalled but are hopeful that with international support it could restart. To increase youth employment, they plan to roll-out nationally a pilot internship program for university graduates and offer a two-year waiver of employer social security contributions for firms retaining interns. They noted this would assist women in finding work given half of tertiary-level graduates are female. They have removed gender caps in recruitment rounds at most ministries and have evaluated the contribution of household work to GDP but stressed that greater efforts are needed to bring women into formal sector employment.

[5] SIP Chapter III

[6] SIP Chapter IV

## E. Other Issues

44. **More timely and comprehensive data would enhance transparency, inform policy design and support the reform program**. Publishing data per a pre-announced schedule would aid policy design. Developing general government and public-sector debt statistics is key to improving fiscal statistics. The errors and omissions in the balance of payments are a concern. The authorities acknowledged the deficiencies and noted that they plan to implement the recommendations of the 2017 Multisector Statistics TA mission.

45. **The exchange rate regime gives rise to several multiple currency practices (MCPs) and an exchange restriction subject to Fund approval under Article VIII**, Sections 2(a) and 3. A MCP and exchange restriction arise from the establishment of an official exchange rate for use in some exchange transactions, which differs by more than two percent from the rate used by foreign exchange bureaus. Two other MCPs arise from the differences of more than two percent between the current official and bureau market rates, and the preferential rates for certain imports for which foreign exchange payment commitments were made through letters of credits or bank drafts prior to March 21, 2002 and July 24, 2012.

# STAFF APPRAISAL

46. **The recovery in headline growth following the lifting of nuclear-related sanctions has begun to broaden to the non-oil sector**. Holistic, carefully sequenced, reform is required to preserve and build on these gains so that growth leads to higher job creation and improved living standards.

47. **The authorities need to move expeditiously to restore banks to a sound financial footing so they can finance an expansion in private sector economic activity**. A banking system that is substantially restructured, with viable banks recapitalized and non-viable ones resolved, along with stronger supervisory and resolution powers and improvements in the effectiveness of supervision would help safeguard financial stability and sustain the recovery. Staff welcomes the planned AQR as this would crystalize banks' recapitalization needs and inform the financial sector reform plan. The restructuring of SBs should proceed quickly alongside the AQR to ensure their on-going recapitalization is accompanied by measures to make them commercially viable. Private banks should also prepare and implement recovery plans. Securitizing the government's debt to the CBI would provide it a tool to conduct open market operations and enhance its ability to contain inflation.

48. **A comprehensive package of fiscal measures must accompany the financial sector reform if deficits and debt are to remain contained**. The adjustment can be spread over 10 years to minimize the impact on growth. A package that sees a higher share of oil revenue dedicated to cover interest costs arising from bank recapitalization bonds, along with measures to expand tax revenue and reform the pension system would gradually lower deficits and debt while creating space for higher social and investment spending. Eliminating tax exemptions, especially to

companies owned by foundations and other exempt entities and improving taxpayer compliance should take priority over tax rate increases. A formula-based, gradual phase-out of untargeted domestic fuel price subsidies combined with targeted income support to compensate the vulnerable would make the reform more sustainable and equitable. Developing a debt management strategy and making the MOEF the sole authority to borrow and issue government guarantees would contain debt and reduce borrowing costs.

49. **Staff assesses the external position to be weaker than warranted by fundamentals and desirable policy settings**. Unifying the exchange rate and allowing more exchange rate flexibility would reduce economic distortions, promote fairness and export competitiveness, and create greater space to use reserves to smooth market pressures. Recognizing, however, the potentially greater market volatility in the run-up to the unification, confidence in the exchange rate would be enhanced by a clear communication strategy and tightening of the monetary policy stance. This would support the transition to a market-based monetary policy framework, complemented by full autonomy for the CBI to pursue low and stable inflation. A new Central Bank Law that enhances the CBI's autonomy and makes price stability the core objective of monetary policy should be complemented by steps to reduce quasi-fiscal activities arising from directed credit initiatives and administered price controls.

50. **Strengthening the AML/CFT legislative and institutional framework in line with the FATF action plan and its effective implementation remain essential**. The UN Convention Against Transnational Organized Crime was approved by parliament. Staff urges timely passage of the AML and CFT amendments to bring them fully in line with international standards and ratification of the UN Convention for the suppression of the financing of terrorism. Beyond the action plan, enhancing the effectiveness of the AML/CFT system, including by completing the NRA, improving transparency of corporate beneficial ownership, enhancing the system of asset declaration for senior public officials and measures to identify domestic politically exposed persons and moving to risk-based AML/CFT supervision of financial institutions is necessary to counter corruption, tax evasion, and terrorism financing, and facilitate improved CBRs and re-integration into the global financial system.

51. **Faster implementation of business climate reforms would allow the private sector to develop, lifting growth and job creation**. Reducing red tape, modernizing regulations, strengthening the bankruptcy framework and easing market entry will help private firms grow and create jobs. An effective anti-corruption framework in line with international standards would also bolster accountability, improve the business climate, and help attract foreign investment. A review of labor regulation could improve incentives for firms to hire and address informality. Development of non-oil exports will require lowering the costs to trade, better infrastructure, and pursuing non-preferential trade agreements.

52. **FLFP should be further facilitated**. Iran's highly educated women are an untapped source of growth and productivity. Reducing legal and social barriers, pay gaps, subsidizing child care to low income women, and tackling informality would create job opportunities for women and could substantially boost economic growth.

53. **Staff encourage the authorities to improve the quality, timeliness and availability of data, including by participating in E-GDDS**.

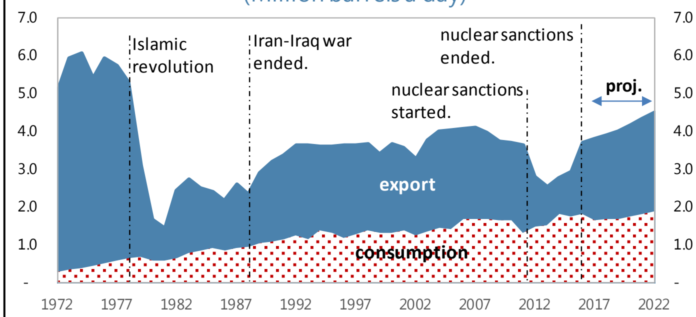
54. **Staff recommend Executive Board approval of the retention of the MCP and exchange restriction arising from the greater than the two percent deviation between the official and bureau exchange rates, since they are maintained for balance of payments reasons, are non-discriminatory, and are temporary considering the authorities' commitment to unify the exchange rate by March 20, 2019**. Staff also recommend Executive Board approval of the retention of the two MCPs referred to above (¶45) through March 20, 2019. These measures are not maintained for balance of payment reasons and do not impede its adjustment, and are non-discriminatory among members.

55. **It is recommended that the next Article IV consultation takes place on the standard 12-month cycle**.

## Box 1. Energy Sector in Iran

**Increasing oil and gas production requires significant investment**. Absent new investment, oil production is set to decline by about 240,000 bpd annually as oil fields age. In November 2016, Iran signed a 5-year $4.8 billion deal with China and Total to develop South Pars. The government hopes to attract $100 billion in foreign investment in the oil and gas sector and has introduced a new contract to allow partial foreign ownership in projects.

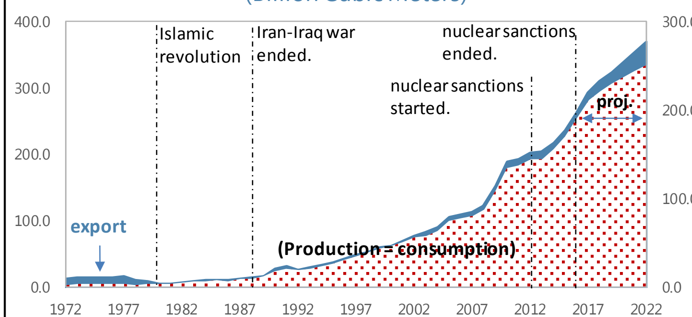
**Crude Oil, Iran, 1972-2022**
(Million barrels a day)




Source: Central Bank of Iran, OPEC, BP, EIA, and IMF staff calculations.

**There is potential to expand natural gas and condensate exports**. Iran holds the world's largest gas reserves but only 5 percent of production is exported. Natural gas is generating almost 90 percent of Iran's power. Larger gas exports will become feasible as production increases. One major challenge, however, is lack of LNG facilities and limited capacity of gas pipelines. The authorities expect gas exports to increase to about 10 percent of total gas production by 2022. Condensate production is 650,000 bpd and is expected to increase by 100,000 bpd annually to 2022.

**Natural Gas, Iran, 1972-2022 1/**
(Billion Cubic Meters)




Source: Central Bank of Iran, OPEC, BP, EIA, and IMF staff calculations.
Note: 1/ Excludes gas flared or recycled.

## Box 2. Risk Assessment Matrix 1/

| Source of Risks | Relative Likelihood | Time Horizon | Potential Impact | Policy Response |
|---|---|---|---|---|
| **Spillover Risks** | | | | |
| Intensification of the risks of fragmentation/security dislocation in part of the Middle East, Africa, Asia, and Europe | High | Short to Medium Term | High<br>Regional conflicts could weigh negatively on Iran's trade development and regional integration. | Speed up structural reforms. Continue efforts to focus on domestic reforms to increase Iran's attractiveness to foreign investors. Increase fiscal revenues by increasing the share of central government budget in oil revenues. Build fiscal and external buffers. |
| Tighter global financial conditions. Against the backdrop of continued monetary policy normalization and increasingly stretched valuations across asset classes, an abrupt change in global risk appetite could lead to sudden, sharp increases in interest rates and associated tightening of financial conditions. | High | Short to Medium Term | Medium<br>Iran faces challenges in fully connecting to the global financial system and its external debt remains low. | Speed up financial sector reform. Continued improvements in Iran's AML/CFT framework and the health of its banking system remain essential to facilitate fuller reintegration into the global financial system. |
| Structurally weak growth in key advanced economies. | High | Medium Term | High<br>Weak growth in euro area and Japan would negatively impact Iran's oil exports and growth. | Continue domestic reforms that diversify the economy, strengthen domestic productive capacity and enhance resilience to shocks. |
| Significant China slowdown and its spillovers. | Low/Medium | Short to Medium Term | High<br>China has become one of Iran's key trade partners in the recent past. China accounts for 45 percent of Iran's total exports. | Continued efforts to diversify Iran's trade and to attract foreign investors. Speed up structural reform to foster broader based growth. |
| Lower energy prices driven by weakening OPEC/Russia cartel cohesion and/or recovery of oil production in the African continent. | Low | Short to Medium Term | High<br>Negative impact on oil revenue, thus reducing scope for increasing growth-enhancing spending. | Improve fiscal planning by articulating fiscal priorities within a medium-term framework and build fiscal buffers. Continue to reduce oil dependency by increasing domestic tax revenue. |
| **Domestic Risks** | | | | |
| Uncertainties related to the implementation of the JCPOA. | High | Short to Medium Term | High<br>Growth and exports would be negatively affected by the re-imposition of sanctions or counter-measures that would lower direct investment and capital inflows, and disconnect Iran from the global financial system. | Continue reforms to strengthen domestic productive capacity, build external and domestic buffers and improve the AML/CFT framework. |
| Financial strains from inadequate progress on banking sector recapitalization and restructuring. | High | Short to Medium Term | High<br>Continued banking system stress would see liquidity growth and inflation accelerate, real interest rates remain high, and growth slow. | Build broad-based consensus on a comprehensive restructuring and recapitalization strategy and how it is to be financed. |
| Weakening of political or social support for reform. | High | Short to Medium Term | High<br>Difficulties in advancing reforms could hamper growth and job prospects, especially for the youth and women. | Improve transparency and outreach to public and key stakeholders to build support for reforms. Strengthen administrative capacity through technical assistance. |
| FATF introducing counter-measures against Iran. | Medium | Short to Medium term | High<br>Iran could lose access SWIFT, existing CBRs with European banks could be terminated. | Improve the AML/CFT framework, tighten policies to avoid pressure on the exchange rate and inflation. |
| Limited progress in strengthening the monetary and fiscal policy frameworks. | Medium | Short to Medium Term | Medium<br>Without fiscal and monetary policy reform there is a risk of higher inflation, real exchange rate appreciation, and eroding competitiveness. | Reduce non-oil fiscal deficit to support disinflation, while mobilizing tax revenue to create space for growth-enhancing spending. Develop buffers to protect the economy against the consequences of adverse shocks. Develop a medium-term fiscal framework to anchor annual fiscal deficits. |

Source: IMF staff.

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within one year and three years, respectively.

## Box 3. The Pension System in Iran

**Iran's pension system is facing financial pressures**. High rates of economic inactivity and unemployment imply only 29 percent of the working age population contribute to any pension scheme. A demographic transition will take place over the next 20 years and worsen the demographic support ratio and increase financial pressures.

**The three largest pension schemes (90 percent of the system) are insolvent**. Accrued-to-date benefit obligations exceed reserves. Two schemes are illiquid and require budget transfers of 1.6 percent of GDP per year. The largest scheme, the Social Security Organization (SSO) is liquid but is borrowing from banks to meet its obligations and will deplete reserves by 2027.

**Pension schemes' financial difficulties reflect unsustainable eligibility and benefit rules.** The low effective retirement age (60 percent of pensioners are under 60 years and only 25 percent of those over 60 receive a contributory pension) are influenced by the policy to use early retirement to control unemployment. Benefit calculations put replacement rates close to 100 percent of final salaries.

**The regulatory and institutional pension framework created uncertainty concerning the government's explicit liabilities**. SSO's financial statements are not included in fiscal data or the budget. Assets (often in SOEs and real sector) are managed as businesses, without regard to the schemes' finances.

## Table 1. Islamic Republic of Iran: Status of Staff Recommendations from the 2016 Article IV Consultation

| Recommendations | Status |
|---|---|
| Fiscal Policy | |
| Improve tax collections and public financial management systems. | Tax revenues increased in 2016/17 through administrative measures and authorities have taken steps moving towards accrual accounting and improvement in the quality of financial statements. |
| Better target cash transfers | The 2018/19 budget clarified that the government can adjust in fuel prices and reform subsidies and the cash transfer system over the course of the Sixth National Development Plan. |
| Introduce a medium-term fiscal framework that targets a gradual adjustment in the non-oil fiscal deficit. | The CG non-oil fiscal deficit increased to 9.2 percent of GDP in 2016/17. A medium-term fiscal framework has not been introduced. |
| Direct a higher portion of oil revenues to budget and replenish Oil Stabilization Fund to build fiscal buffers | The share of oil revenue to NDFI was effectively reduced to 22.7 percent in 2018/19 budget to allow the CG budget's share of oil proceeds to rise. |
| Monetary Policy | |
| Clearly define a lender of last resort framework, provide tools to CBI to manage liquidity | Authorities requested technical assistance to develop a market based monetary policy framework, including establishment of a lender of last resort framework. |
| Unify the exchange rate shift to a managed float | While the authorities committed to unify the exchange rate by February 2018, difficulties in transferring oil proceed due to lack of correspondent bank relations remain unsolved. |
| Financial Sector Reform | |
| Strengthening the AML/CFT framework | ~~T~~The United Nations Convention Against Transnational Organized Crime have been approved by parliament. Amendments to the AML and CFT laws were approved by cabinet and submitted to parliament. The requirements to monitor remittances and the transportation of cash have also been upgraded. The National Risk Assessment was initiated with the World Bank, the CBI is bolstering its supervision and the Financial Intelligence Unit (FIU) is enhancing the quality of its financial intelligence. |
| Continue securitization of government arrears | The on-going audit of government arrears has revealed additional debts. The debt stock is now estimated to have reached 50 percent of GDP by end-2016/17. The authorities securitized 9 percent of arrears in 2016/17. |
| Adopt new banking and central bank laws | Amendments to the existing banking law to strengthen the CBI's supervisory, disciplinary and resolution powers and to create a Deposit Insurance Fund were submitted to the parliament. Parliament has since proposed its own amendments to the existing banking law and central bank laws aimed at further strengthening the CBI's supervisory and resolution powers and its independence. Formal consideration of these proposals by Parliament have yet to begin. |
| Recapitalize state owned banks linked to measure to improve their commercial viability | The government used part of CBI's FX revaluation gains to recapitalize some public banks. |
| Place distressed banks under administration or intensified supervision | Distressed banks continue to have access to CBI liquidity, but are required to submit liquidity management or recovery plans. UFIs were merged, acquired, or closed. |
| Conduct an asset quality review | An asset quality review has not been initiated yet. |
| Reforms to Promote Jobs and Growth | |
| Improve business environment | Iran improved its global ranking by seven notches in one year to the 69th place in the Global Competitiveness Index due to improved inflation and exchange rate stability in 2016 and 2017. Amendments to the Custom Law submitted to Parliament could combat corruption, smuggling, and lower trade costs if approved. |
| Improve labor market regulations with specific measures to facilitate youth and female employment | A pilot internship program for university graduates have been completed and should be rolled-out nationally and completed by a two-year waiver of employer social security contributions for firms retaining interns in 2018/19. Gender caps in recruitment rounds at most ministries have been removed. |

Source: IMF staff.

## Table 2. Islamic Republic of Iran: Selected Macroeconomic Indicators, 2015/16–2022/23 1/

Quota: SDR 3,567.10 million
Population: 80 million, 2016/17
Per capita GDP: current US$5,027, PPP current US$17,366, 2016/17
Poverty headcount ratio at $5.50 a day (2011 PPP): 10.5 percent, 2014/15
Main exports: oil, gas, chemical and petrochemical products

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | (Annual percentage change, unless otherwise indicated) | | | | | | | |
| National accounts | | | | | | | | |
| Nominal GDP at market prices (trillions of Iranian rials) | 11,129 | 12,723 | 14,772 | 17,926 | 20,742 | 23,811 | 27,365 | 31,464 |
| Real GDP at factor cost | -1.6 | 12.5 | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Real oil GDP | 7.2 | 61.6 | 5.2 | 4.6 | 3.7 | 3.8 | 4.0 | 4.0 |
| Real non-oil GDP | -3.1 | 3.3 | 4.0 | 3.8 | 4.1 | 4.2 | 4.2 | 4.5 |
| CPI inflation (average) | 11.9 | 9.1 | 9.9 | 12.1 | 11.5 | 11.7 | 11.3 | 10.8 |
| CPI inflation (end of period) | 8.4 | 11.8 | 10.2 | 11.2 | 13.4 | 11.6 | 11.0 | 10.5 |
| GDP deflator at factor cost | 0.4 | 1.6 | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Unemployment rate (percent of labor force) | 11.0 | 12.4 | 11.8 | 11.7 | 11.6 | 11.4 | 11.4 | 11.2 |
| | (Percent of GDP) | | | | | | | |
| Saving investment balance 2/ | | | | | | | | |
| Current account balance | 0.3 | 4.0 | 4.3 | 7.0 | 6.3 | 5.8 | 5.8 | 5.9 |
| Investment | 34.9 | 33.5 | 36.2 | 36.2 | 36.7 | 37.2 | 37.7 | 38.2 |
| Change in stocks | 11.6 | 12.6 | 15.3 | 14.7 | 14.2 | 13.6 | 13.0 | 12.5 |
| Total fixed capital investment | 23.3 | 20.9 | 20.9 | 21.5 | 22.5 | 23.6 | 24.7 | 25.7 |
| Public | 2.5 | 3.3 | 2.3 | 3.7 | 2.5 | 2.5 | 2.5 | 2.6 |
| Private | 20.8 | 17.7 | 18.6 | 17.8 | 20.0 | 21.1 | 22.2 | 23.1 |
| Gross national savings | 35.2 | 37.6 | 40.4 | 43.2 | 43.0 | 42.9 | 43.5 | 44.2 |
| Public | 0.6 | 0.2 | 0.1 | 1.1 | 0.3 | 0.3 | 0.2 | 0.1 |
| Private | 34.6 | 37.3 | 40.4 | 42.0 | 42.6 | 42.6 | 43.3 | 44.1 |
| Central government operations | | | | | | | | |
| Revenue | 16.1 | 17.3 | 15.7 | 18.7 | 19.5 | 19.5 | 19.5 | 19.5 |
| Tax revenue | 7.1 | 8.0 | 7.3 | 7.2 | 7.2 | 7.3 | 7.3 | 7.4 |
| Nontax revenue | 9.0 | 9.3 | 8.3 | 11.4 | 12.3 | 12.2 | 12.2 | 12.1 |
| *Of which*: oil revenue | 6.0 | 5.8 | 5.4 | 9.0 | 9.5 | 9.4 | 9.4 | 9.3 |
| Expenditure | 17.9 | 19.5 | 18.0 | 20.0 | 22.2 | 22.2 | 22.4 | 22.4 |
| Net lending/borrowing (budget) | -1.8 | -2.3 | -2.3 | -1.4 | -2.7 | -2.7 | -2.8 | -2.9 |
| Non-oil net lending/borrowing (percent of non-oil GDP) | -8.6 | -9.2 | -8.7 | -12.9 | -15.3 | -15.0 | -14.9 | -14.8 |
| Gross Public Debt | 42.3 | 49.1 | 40.9 | 53.9 | 49.2 | 45.6 | 42.6 | 40.0 |
| | (Annual percentage change, unless otherwise indicated) | | | | | | | |
| Monetary sector | | | | | | | | |
| Net foreign assets | 14.4 | -3.9 | -0.1 | 36.4 | 50.5 | 21.5 | 25.7 | 22.8 |
| Net domestic assets | 41.5 | 39.3 | 33.2 | 20.0 | 9.7 | 19.0 | 15.4 | 13.8 |
| Credit to the private sector in rials | 16.7 | 24.7 | 21.0 | 19.4 | 15.7 | 15.3 | 15.8 | 14.0 |
| Base money | 16.4 | 17.2 | 20.7 | 20.9 | 18.9 | 18.2 | 17.2 | 15.4 |
| Narrow money (M1) | 13.2 | 19.3 | 19.2 | 18.9 | 16.8 | 17.5 | 16.9 | 15.5 |
| Broad money (M2) | 30.0 | 23.2 | 23.5 | 23.8 | 20.2 | 19.9 | 18.8 | 16.9 |
| | (Billions of US$, unless otherwise indicated) | | | | | | | |
| External sector | | | | | | | | |
| Current account balance | 1.2 | 16.3 | 18.4 | 29.2 | 26.0 | 23.0 | 24.5 | 26.5 |
| Exports of goods and services | 74.4 | 94.4 | 109.5 | 130.3 | 127.5 | 126.1 | 129.7 | 134.0 |
| Imports of goods and services | -74.0 | -79.5 | -91.5 | -103.3 | -103.7 | -105.4 | -107.5 | -110.0 |
| External and publicly guaranteed debt | 10.0 | 9.3 | 8.7 | 9.1 | 9.6 | 10.2 | 10.7 | 11.3 |
| *Of which:* short-term debt | 2.0 | 3.3 | 3.4 | 3.5 | 3.6 | 3.8 | 3.9 | 4.1 |
| Gross official assets/reserves | 128.4 | 120.7 | 111.7 | 124.9 | 143.5 | 158.5 | 181.4 | 204.2 |
| Oil and gas sector | | | | | | | | |
| Total oil and gas exports | 26.9 | 49.8 | 63.7 | 78.3 | 73.6 | 69.2 | 70.3 | 72.3 |
| Crude oil exports (millions of barrels/day) | 1.4 | 2.1 | 2.5 | 2.7 | 2.8 | 2.9 | 3.0 | 3.1 |
| Crude oil production (millions of barrels/day) | 2.9 | 3.7 | 3.8 | 3.8 | 3.9 | 4.1 | 4.3 | 4.4 |
| Memorandum items: | | | | | | | | |
| Average exchange rate, Official (Iranian rials per US$) | 29,645 | 31,457 | … | … | … | … | … | … |
| Average exchange rate, Market (Iranian rials per US$) | 34,359 | 36,328 | … | … | … | … | … | … |

Sources: Iran authorities; and IMF staff estimates and projections.
1/ The Iranian fiscal year ends March 20.
2/ Based on central government operations.

## Table 3. Islamic Republic of Iran: Augmented Central Government Operations, 2015/16–2022/23 1/

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | | | | (Billions of rials) | | | | |
| Revenue | 2,278,364 | 2,786,025 | 3,085,659 | 4,269,300 | 5,022,989 | 5,739,540 | 6,572,730 | 7,517,593 |
| Tax revenue | 791,980 | 1,014,600 | 1,085,118 | 1,295,799 | 1,497,477 | 1,735,565 | 2,007,633 | 2,319,378 |
| Budget | 791,980 | 1,014,600 | 1,085,118 | 1,295,799 | 1,497,477 | 1,735,565 | 2,007,633 | 2,319,378 |
| Nontax revenue | 1,486,384 | 1,771,425 | 2,000,542 | 2,973,502 | 3,525,512 | 4,003,975 | 4,565,096 | 5,198,215 |
| Budget (excluding oil revenue) | 331,855 | 445,200 | 424,067 | 436,723 | 575,575 | 666,656 | 770,825 | 890,237 |
| TSO (excluding transfer from budget) | 334,016 | 313,565 | 339,763 | 339,763 | 373,740 | 411,113 | 452,225 | 497,447 |
| Oil revenue | 820,513 | 1,012,660 | 1,236,712 | 2,197,016 | 2,576,198 | 2,926,206 | 3,342,046 | 3,810,531 |
| | | | | | | | | |
| Expenditure | 2,606,852 | 3,125,832 | 3,424,122 | 4,637,821 | 5,646,714 | 6,479,118 | 7,465,106 | 8,585,595 |
| Expense | 2,050,610 | 2,385,229 | 2,602,358 | 3,276,071 | 4,470,364 | 5,109,711 | 5,889,730 | 6,726,216 |
| Budget (excluding transfer to TSO) | 1,615,111 | 1,958,478 | 2,109,232 | 2,782,945 | 3,978,407 | 4,618,924 | 5,400,114 | 6,228,566 |
| TSO | 435,499 | 426,751 | 493,126 | 493,126 | 491,956 | 490,786 | 489,616 | 497,650 |
| Net acquisition of nonfinancial assets | 556,242 | 740,603 | 821,763 | 1,361,750 | 1,176,350 | 1,369,407 | 1,575,376 | 1,859,379 |
| Budget | 273,766 | 417,000 | 335,799 | 657,478 | 512,335 | 596,456 | 678,641 | 821,202 |
| NDFI (onlending) | 282,477 | 323,603 | 485,965 | 704,272 | 664,015 | 772,951 | 896,735 | 1,038,177 |
| | | | | | | | | |
| Overall balance | -328,488 | -339,807 | -338,462 | -368,520 | -623,725 | -739,577 | -892,376 | -1,068,002 |
| | | | | | | | | |
| Net acquisition of financial assets | -354,002 | -230,142 | -174,091 | 4,904,103 | -143,083 | -107,471 | -126,377 | -158,232 |
| Budget | -221,685 | -180,399 | -122,060 | 5,025,073 | -81,687 | -19,012 | -11,407 | -11,407 |
| NDFI | -132,318 | -49,743 | -52,031 | -120,970 | -61,395 | -88,459 | -114,970 | -146,825 |
| Net acquisition of financial liabilities | -25,514 | 109,665 | 164,372 | 5,272,623 | 480,642 | 632,106 | 765,999 | 909,770 |
| Budget | -25,514 | 109,665 | 164,372 | 5,272,623 | 480,642 | 632,106 | 765,999 | 909,770 |
| | | | | | | | | |
| | | | (percent of GDP, unless otherwise indicated) | | | | | |
| Revenue | 20.5 | 21.9 | 20.9 | 23.8 | 24.2 | 24.1 | 24.0 | 23.9 |
| Tax revenue | 7.1 | 8.0 | 7.3 | 7.2 | 7.2 | 7.3 | 7.3 | 7.4 |
| Budget | 7.1 | 8.0 | 7.3 | 7.2 | 7.2 | 7.3 | 7.3 | 7.4 |
| Nontax revenue | 13.4 | 13.9 | 13.5 | 16.6 | 17.0 | 16.8 | 16.7 | 16.5 |
| Budget (excluding oil revenue) | 3.0 | 3.5 | 2.9 | 2.4 | 2.8 | 2.8 | 2.8 | 2.8 |
| TSO (excluding transfer from budget) | 3.0 | 2.5 | 2.3 | 1.9 | 1.8 | 1.7 | 1.7 | 1.6 |
| Oil revenue | 7.4 | 8.0 | 8.4 | 12.3 | 12.4 | 12.3 | 12.2 | 12.1 |
| | | | | | | | | |
| Expenditure | 23.4 | 24.6 | 23.2 | 25.9 | 27.2 | 27.2 | 27.3 | 27.3 |
| Expense | 18.4 | 18.7 | 17.6 | 18.3 | 21.6 | 21.5 | 21.5 | 21.4 |
| Budget (excluding transfer to TSO) | 14.5 | 15.4 | 14.3 | 15.5 | 19.2 | 19.4 | 19.7 | 19.8 |
| TSO | 3.9 | 3.4 | 3.3 | 2.8 | 2.4 | 2.1 | 1.8 | 1.6 |
| Net acquisition of nonfinancial assets | 5.0 | 5.8 | 5.6 | 7.6 | 5.7 | 5.8 | 5.8 | 5.9 |
| Budget | 2.5 | 3.3 | 2.3 | 3.7 | 2.5 | 2.5 | 2.5 | 2.6 |
| NDFI (onlending) | 2.5 | 2.5 | 3.3 | 3.9 | 3.2 | 3.2 | 3.3 | 3.3 |
| | | | | | | | | |
| Overall balance | -3.0 | -2.7 | -2.3 | -2.1 | -3.0 | -3.1 | -3.3 | -3.4 |
| | | | | | | | | |
| Net acquisition of financial assets | -3.2 | -1.8 | -1.2 | 27.4 | -0.7 | -0.5 | -0.5 | -0.5 |
| Budget | -2.0 | -1.4 | -0.8 | 28.0 | -0.4 | -0.1 | 0.0 | 0.0 |
| NDFI | -1.2 | -0.4 | -0.4 | -0.7 | -0.3 | -0.4 | -0.4 | -0.5 |
| | | | | | | | | |
| Net acquisition of financial liabilities | -0.2 | 0.9 | 1.1 | 29.4 | 2.3 | 2.7 | 2.8 | 2.9 |
| Budget | -0.2 | 0.9 | 1.1 | 29.4 | 2.3 | 2.7 | 2.8 | 2.9 |
| | | | | | | | | |
| Memorandum item: | | | | | | | | |
| Non-oil balance (percent of nonoil GDP) | -11.4 | -12.1 | -12.6 | -17.8 | -19.3 | -19.0 | -18.9 | -18.8 |
| Non-oil primary balance (percent of nonoil GDP) | -11.3 | -12.0 | -12.5 | -17.4 | -13.3 | -13.0 | -12.6 | -12.5 |
| Nominal GDP (billions of rials) | 11,129,033 | 12,722,849 | 14,772,314 | 17,926,285 | 20,742,327 | 23,810,613 | 27,364,559 | 31,463,666 |

Sources: Iran authorities, and IMF staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

**Table 4. Islamic Republic of Iran: Central Government Operations, 2015/16–2022/23 1/ 2/**
(In percent of GDP)

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| Revenue | 16.1 | 17.3 | 15.7 | 18.7 | 19.5 | 19.5 | 19.5 | 19.5 |
| Tax revenue | 7.1 | 8.0 | 7.3 | 7.2 | 7.2 | 7.3 | 7.3 | 7.4 |
| Taxes on income, profits and capital gains | 3.6 | 3.7 | 3.3 | 3.1 | 3.1 | 3.1 | 3.2 | 3.2 |
| Taxes on property | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Taxes on goods and services | 2.2 | 2.7 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| *Of which*: value added tax | 1.8 | 1.8 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Taxes on international trade and transactions | 1.0 | 1.4 | 1.5 | 1.7 | 1.7 | 1.7 | 1.7 | 1.7 |
| Other revenue, of which | 9.0 | 9.3 | 8.3 | 11.4 | 12.3 | 12.2 | 12.2 | 12.1 |
| Property Income | 7.3 | 7.4 | 6.4 | 10.0 | 10.5 | 10.4 | 10.4 | 10.3 |
| *Of which*: rents (oil revenue) | 6.0 | 5.8 | 5.4 | 9.0 | 9.5 | 9.4 | 9.4 | 9.3 |
| Other | 1.7 | 1.9 | 1.9 | 1.4 | 1.8 | 1.8 | 1.8 | 1.8 |
| Expenditure | 17.9 | 19.5 | 18.0 | 20.0 | 22.2 | 22.2 | 22.4 | 22.4 |
| Expense | 15.4 | 16.3 | 15.7 | 16.4 | 19.8 | 19.7 | 19.9 | 19.8 |
| *Of which*: Interest payments | 0.1 | 0.1 | 0.2 | 0.4 | 4.8 | 4.9 | 5.1 | 5.2 |
| Net acquisition of nonfinancial assets | 2.5 | 3.3 | 2.3 | 3.7 | 2.5 | 2.5 | 2.5 | 2.6 |
| Gross operating balance | 0.7 | 1.0 | -0.1 | 2.3 | -0.2 | -0.2 | -0.4 | -0.3 |
| Net lending/borrowing (including TSO) | -1.8 | -2.3 | -1.9 | -1.4 | -2.7 | -2.7 | -2.8 | -2.9 |
| Net lending/borrowing (budget, excluding TSO) | -1.8 | -2.3 | -2.3 | -1.4 | -2.7 | -2.7 | -2.8 | -2.9 |
| Balance of Targeted Subsidy Organization | 0.0 | 0.0 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Financial assets | -2.0 | -1.4 | -0.8 | 28.0 | -0.4 | -0.1 | 0.0 | 0.0 |
| Financial liabilities | -0.2 | 0.9 | 1.1 | 29.4 | 2.3 | 2.7 | 2.8 | 2.9 |
| Memorandum items: | | | (Percent of non-oil GDP) | | | | | |
| Tax revenue | 7.9 | 9.1 | 8.7 | 9.0 | 9.0 | 9.0 | 9.0 | 8.9 |
| Income tax | 4.0 | 4.2 | 3.9 | 3.9 | 3.9 | 3.9 | 3.9 | 3.9 |
| VAT | 2.0 | 2.0 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 | 2.1 |
| Non-oil net lending/borrowing | -8.6 | -9.2 | -8.7 | -12.9 | -15.3 | -15.0 | -14.9 | -14.8 |
| Change in nonoil net lending (+ = tightening) | -0.8 | -0.6 | 0.5 | -4.2 | -2.3 | 0.3 | 0.1 | 0.1 |
| Non-oil primary balance | -8.5 | -9.1 | -8.6 | -12.5 | -9.3 | -9.0 | -8.6 | -8.5 |

Sources: Iranian authorities; and Fund staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

2/ The statement of government operations covers budgetary central government and balance of the Targeted Subsidy Organization but excludes the NDFI.

**Table 5. Islamic Republic of Iran: Central Government Operations, 2015/16–2022/23 1/ 2/**
(In billions of rials, unless otherwise indicated)

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| Revenue | 1,794,189 | 2,198,600 | 2,311,962 | 3,346,236 | 4,046,630 | 4,643,934 | 5,338,740 | 6,128,793 |
| Tax revenue | 791,980 | 1,014,600 | 1,085,118 | 1,295,799 | 1,497,477 | 1,735,565 | 2,007,633 | 2,319,378 |
| Taxes on income, profits and capital gains | 405,537 | 467,100 | 482,547 | 556,601 | 642,861 | 748,327 | 868,168 | 1,005,104 |
| Taxes on property | 24,153 | 26,700 | 29,815 | 34,391 | 39,720 | 46,237 | 53,642 | 62,102 |
| Taxes on goods and services | 246,747 | 337,900 | 345,621 | 405,874 | 469,002 | 543,942 | 629,500 | 727,492 |
| *Of which*: value added tax | 197,416 | 224,900 | 257,370 | 298,592 | 344,867 | 401,444 | 465,734 | 539,194 |
| Taxes on international trade and transactions | 115,542 | 182,900 | 227,135 | 298,934 | 345,893 | 397,059 | 456,323 | 524,679 |
| Other revenue | 1,002,209 | 1,184,000 | 1,226,845 | 2,050,437 | 2,549,154 | 2,908,369 | 3,331,106 | 3,809,415 |
| Property income | 817,743 | 936,529 | 950,501 | 1,792,977 | 2,181,002 | 2,479,819 | 2,833,926 | 3,233,815 |
| *Of which*: rents (oil revenue) | 670,354 | 738,800 | 802,778 | 1,613,714 | 1,973,578 | 2,241,713 | 2,560,281 | 2,919,179 |
| Other | 184,466 | 247,471 | 276,344 | 257,460 | 368,152 | 428,550 | 497,180 | 575,600 |
| Expenditure | 1,990,403 | 2,487,200 | 2,656,431 | 3,593,786 | 4,608,960 | 5,295,053 | 6,116,146 | 7,049,970 |
| Expense | 1,716,637 | 2,070,200 | 2,320,632 | 2,936,308 | 4,096,624 | 4,698,597 | 5,437,505 | 6,228,769 |
| *Of which*: Interest payments | 11,845 | 14,284 | 22,632 | 70,000 | 988,197 | 1,158,208 | 1,407,879 | 1,645,315 |
| Net acquisition of nonfinancial assets | 273,766 | 417,000 | 335,799 | 657,478 | 512,335 | 596,456 | 678,641 | 821,202 |
| Gross operating balance | 77,552 | 128,400 | -8,670 | 409,928 | -49,994 | -54,663 | -98,765 | -99,976 |
| Net lending/borrowing (including TSO) | -196,171 | -290,064 | -286,432 | -247,550 | -562,329 | -651,119 | -777,406 | -921,177 |
| Net lending/borrowing (budget, excluding TSO) | -196,214 | -288,600 | -344,469 | -247,550 | -562,329 | -651,119 | -777,406 | -921,177 |
| Balance of Targeted Subsidy Organization | 43 | -1,464 | 58,037 | 0 | 0 | 0 | 0 | 0 |
| Financial assets | -221,685 | -180,399 | -122,060 | 5,025,073 | -81,687 | -19,012 | -11,407 | -11,407 |
| Financial liabilities | -25,514 | 109,665 | 164,372 | 5,272,623 | 480,642 | 632,106 | 765,999 | 909,770 |
| Memorandum items: | | | | | | | | |
| Non-oil net lending/borrowing | -866,525 | -1,028,864 | -1,089,210 | -1,861,264 | -2,535,908 | -2,892,832 | -3,337,687 | -3,840,356 |

Sources: Iranian authorities; and Fund staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

2/ The statement of government operations covers budgetary central government and balance of the Targeted Subsidy Organization but excludes the NDFI.

## Table 6. Islamic Republic of Iran: Government Oil Revenue and Funds, 2015/16–2022/23 1/

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | | | (Billions of rials, unless otherwise indicated) | | | | | |
| Oil revenue | 750,795 | 1,452,210 | 1,446,447 | 2,569,609 | 3,013,097 | 3,422,463 | 3,908,826 | 4,456,762 |
| Crude oil exports, total | 702,341 | 1,369,299 | 1,446,447 | 2,569,609 | 3,013,097 | 3,422,463 | 3,908,826 | 4,456,762 |
| Oil exports (millions of barrels per day) | 1.45 | 2.15 | 2.46 | 2.66 | 2.75 | 2.86 | 2.97 | 3.09 |
| Average oil exports price (US$ per barrel) | 32.6 | 42.0 | 47.1 | 59.1 | 55.8 | 53.5 | 52.3 | 54.2 |
| Exchange rate (rial per US$) | 29,645 | 31,457 | ... | ... | ... | ... | ... | ... |
| Allocation of oil revenue | | | | | | | | |
| Total | 929,379 | 1,211,208 | 1,446,447 | 2,569,609 | 3,013,097 | 3,422,463 | 3,908,826 | 4,456,762 |
| Budget 2/ | 670,354 | 738,800 | 802,778 | 1,613,714 | 1,973,578 | 2,241,713 | 2,560,281 | 2,919,179 |
| Revenue according to budget share | 491,771 | 896,891 | 802,778 | 1,613,714 | 1,973,578 | 2,241,713 | 2,560,281 | 2,919,179 |
| Oil revenue advances and repayments 2/ | 178,583 | -158,091 | 0 | 0 | 0 | 0 | 0 | 0 |
| National Development Fund (NDFI) | 150,159 | 273,860 | 433,934 | 583,301 | 602,619 | 684,493 | 781,765 | 891,352 |
| NIOC | 108,865 | 198,548 | 209,735 | 372,593 | 436,899 | 496,257 | 566,780 | 646,230 |
| Shares of annual oil revenue proceeds | | | | | | | | |
| Budget | 65.5 | 65.5 | 55.5 | 62.8 | 65.5 | 65.5 | 65.5 | 65.5 |
| NDFI | 20.0 | 20.0 | 30.0 | 22.7 | 20.0 | 20.0 | 20.0 | 20.0 |
| NIOC | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 |
| | | | (Billions of US$, unless otherwise indicated) | | | | | |
| NDFI | | | | | | | | |
| Flows | | | | | | | | |
| Oil revenue | 5.1 | 8.7 | 12.7 | 13.6 | 12.0 | 11.4 | 12.0 | 12.6 |
| Expenditure (disbursed) 3/ | 9.5 | 10.3 | 14.2 | 16.5 | 13.2 | 12.9 | 13.8 | 14.7 |
| Balance | -4.5 | -1.6 | -1.5 | -2.8 | -1.2 | -1.5 | -1.8 | -2.1 |
| Assets | | | | | | | | |
| Disbursments, cumulative | 12.6 | 22.9 | 37.1 | 53.6 | 66.8 | 79.7 | 93.5 | 108.2 |
| Assets | 48.8 | 57.5 | 70.2 | 83.8 | 95.8 | 107.3 | 119.3 | 131.9 |
| Balance at the CBI 4/ | 36.2 | 34.6 | 33.1 | 30.3 | 29.0 | 27.5 | 25.8 | 23.7 |
| Memorandum items | | | | | | | | |
| NDFI expenditure (percent of nonoil GDP) | 2.8 | 2.9 | 3.9 | 4.9 | 4.0 | 4.0 | 4.0 | 4.0 |
| NDFI deposits (percent of GDP) | 9.6 | 8.6 | 7.7 | 7.2 | 7.0 | 6.9 | 6.1 | 5.3 |
| Central government deposits at the CBI 5/ | 52.8 | 45.0 | 42.8 | 32.1 | 33.8 | 29.3 | 27.4 | 25.1 |

Source: Iran authorities, and IMF staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

2/ Budget allocation includes, in 2015/16, advances of rials 180,000 billions, and repayment of advances of 280,000 in 2016/17. This does not impact the annual budget share.

3/ The NDFI extends 50 percent of its resources to finance the private sector (including companies whose state ownership is below 20 percent) and 20 percent to promote foreign investment. The remaining 32 percent is invested in capital markets abroad. The NDFI deposits its funds in domestic banks, who are responsible for approving the loans. It can also be used for foreign direct investment in Iran, if those foreign companies provide 30 percent of the investment needs.

4/ Including currency adjustments and government bonus payback.

5/ NDFI deposits are kept at the central bank as foreign exchange deposits of the government.

**Table 7. Islamic Republic of Iran: Targeted Subsidy Organization Accounts, 2015/16–2022/23 1/**

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | | | | (Billions of rials) | | | | |
| Revenue | 435,542 | 425,287 | 551,163 | 493,126 | 491,956 | 490,786 | 489,616 | 497,650 |
| Price Adjustments | 334,016 | 313,565 | 339,763 | 339,763 | 373,740 | 411,113 | 452,225 | 497,447 |
| Budget Appropriations | 101,526 | 111,722 | 211,400 | 153,363 | 118,217 | 79,673 | 37,391 | 203 |
| Expense | 435,499 | 426,751 | 493,126 | 493,126 | 491,956 | 490,786 | 489,616 | 497,650 |
| Cash Transfers | 412,906 | 410,249 | 414,456 | 414,456 | 413,286 | 412,116 | 410,946 | 418,980 |
| Social Security/health | 8,725 | 5,000 | 44,375 | 44,375 | 44,375 | 44,375 | 44,375 | 44,375 |
| Enterprises (Cash and noncash) | 5,770 | 6,439 | 7,483 | 7,483 | 7,483 | 7,483 | 7,483 | 7,483 |
| Other | 8,098 | 5,063 | 26,812 | 26,812 | 26,812 | 26,812 | 26,812 | 26,812 |
| Operating balance | 43 | -1,464 | 58,037 | 0 | 0 | 0 | 0 | 0 |
| Debt | 59,800 | 59,800 | 59,800 | 59,800 | 59,800 | 59,800 | 59,800 | 59,800 |
| CBI | 57,000 | 57,000 | 57,000 | 57,000 | 57,000 | 57,000 | 57,000 | 57,000 |
| Treasury | 2,800 | 2,800 | 2,800 | 2,800 | 2,800 | 2,800 | 2,800 | 2,800 |
| | | | | (Percent of GDP) | | | | |
| Revenue | 3.9 | 3.3 | 3.7 | 2.8 | 2.4 | 2.1 | 1.8 | 1.6 |
| Price Adjustments | 3.0 | 2.5 | 2.3 | 1.9 | 1.8 | 1.7 | 1.7 | 1.6 |
| Budget Appropriations | 0.9 | 0.9 | 1.4 | 0.9 | 0.6 | 0.3 | 0.1 | 0.0 |
| Expense | 3.9 | 3.4 | 3.3 | 2.8 | 2.4 | 2.1 | 1.8 | 1.6 |
| Cash Transfers | 3.7 | 3.2 | 2.8 | 2.3 | 2.0 | 1.7 | 1.5 | 1.3 |
| Social Security/health | 0.1 | 0.0 | 0.3 | 0.2 | 0.2 | 0.2 | 0.2 | 0.1 |
| Enterprises (Cash and noncash) | 0.1 | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other | 0.1 | 0.0 | 0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Operating balance | 0.0 | 0.0 | 0.4 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |

Sources: Iran authorities and IMF staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

## Table 8. Islamic Republic of Iran: Balance of Payments, 2015/16–2021/22 1/

(In percent of GDP)

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| Current account balance | 0.3 | 4.0 | 4.3 | 7.0 | 6.3 | 5.8 | 5.8 | 5.9 |
| Trade balance | 1.4 | 5.2 | 5.7 | 8.1 | 7.5 | 7.1 | 7.1 | 7.2 |
| Exports | 16.8 | 20.8 | 22.7 | 27.9 | 27.6 | 28.4 | 27.6 | 26.9 |
| Oil and gas | 7.2 | 12.3 | 14.7 | 18.7 | 17.8 | 17.4 | 16.7 | 16.2 |
| Crude oil | 4.6 | 8.1 | 9.8 | 13.7 | 13.6 | 14.0 | 13.5 | 13.1 |
| Petroleum products and natural gas | 2.6 | 4.2 | 4.9 | 5.0 | 4.3 | 3.4 | 3.2 | 3.1 |
| Non-oil and gas | 9.6 | 8.5 | 8.0 | 9.2 | 9.8 | 11.0 | 10.9 | 10.7 |
| Imports | -15.4 | -15.6 | -17.0 | -19.8 | -20.1 | -21.2 | -20.5 | -19.8 |
| Services and Income (net) | -1.2 | -1.3 | -1.6 | -1.3 | -1.4 | -1.6 | -1.5 | -1.4 |
| Credits | 3.5 | 3.1 | 3.2 | 4.0 | 3.9 | 4.0 | 3.9 | 3.8 |
| Debits | -4.7 | -4.4 | -4.8 | -5.2 | -5.3 | -5.6 | -5.4 | -5.2 |
| Transfers (net) | 0.1 | 0.1 | 0.1 | 0.2 | 0.2 | 0.2 | 0.2 | 0.2 |
| Capital and financial account balance | 0.6 | -4.1 | -6.4 | -3.8 | -1.8 | -2.0 | -0.4 | -0.8 |
| Foreign direct investment and portfolio equity | 0.1 | 0.5 | 0.2 | 0.2 | 0.2 | 0.2 | 1.4 | 1.3 |
| Medium- and long-term debt | 0.1 | -0.5 | -0.2 | 0.1 | 0.1 | 0.1 | 0.1 | 0.1 |
| Trade credit | 1.4 | -3.5 | -6.3 | -3.4 | -2.1 | -2.4 | -2.0 | -2.4 |
| Other capital 2/ | -1.0 | -0.7 | -0.1 | -0.7 | 0.0 | 0.1 | 0.1 | 0.1 |
| Errors and omissions | -0.4 | -1.8 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Overall balance | 0.6 | -1.9 | -2.1 | 3.2 | 4.5 | 3.8 | 5.4 | 5.1 |
| Change in gross official assets/reserves (– = increase) | -0.6 | 1.9 | 2.1 | -3.2 | -4.5 | -3.8 | -5.4 | -5.1 |
| Memorandum items: | | | | | | | | |
| Net official reserves | 32.1 | 27.4 | 22.6 | 26.3 | 30.5 | 35.4 | 38.9 | 41.8 |
| Gross official assets/reserves | 34.2 | 29.9 | 25.9 | 29.8 | 34.7 | 39.8 | 43.1 | 45.7 |
| Gross foreign liabilities of the Central Bank of Iran | 2.1 | 2.5 | 3.2 | 3.5 | 4.3 | 4.4 | 4.2 | 3.9 |
| External debt | 2.7 | 2.3 | 2.0 | 2.2 | 2.3 | 2.6 | 2.5 | 2.5 |

Sources: Iranian authorities; and Fund staff estimates and projections.

1/ The Iranian fiscal year ends March 20.
2/ Includes Asian Clearence Union (ACU) and commercial banks.

## Table 9. Islamic Republic of Iran: Balance of Payments, 2015/16–2022/23 1/
(In millions of US$, unless otherwise indicated)

| | 2015/16 | 2016/17 | Projections 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|---|---|---|---|---|
| Current account balance | 1,237 | 16,283 | 18,395 | 29,238 | 26,013 | 22,976 | 24,507 | 26,514 |
| (in percent of GDP at market prices) | 0.3 | 4.0 | 4.3 | 7.0 | 6.3 | 5.8 | 5.8 | 5.9 |
| Trade balance | 5,354 | 20,843 | 24,596 | 33,850 | 30,977 | 28,390 | 29,862 | 31,947 |
| Exports | 62,995 | 83,978 | 98,062 | 116,714 | 114,206 | 112,957 | 116,145 | 120,204 |
| Oil and gas | 26,949 | 49,781 | 63,662 | 78,331 | 73,554 | 69,184 | 70,272 | 72,305 |
| Crude oil | 17,259 | 32,910 | 42,292 | 57,240 | 55,989 | 55,732 | 56,679 | 58,463 |
| Petroleum products and natural gas | 9,690 | 16,871 | 21,370 | 21,090 | 17,565 | 13,452 | 13,592 | 13,842 |
| Non-oil and gas | 36,047 | 34,198 | 34,400 | 38,383 | 40,652 | 43,772 | 45,873 | 47,899 |
| Imports | -57,641 | -63,135 | -73,466 | -82,864 | -83,229 | -84,567 | -86,283 | -88,257 |
| Services and Income (net) | -4,544 | -5,118 | -6,809 | -5,274 | -5,686 | -6,201 | -6,213 | -6,368 |
| Credits | 13,031 | 12,596 | 13,928 | 16,563 | 16,214 | 16,044 | 16,494 | 16,868 |
| Debits | -17,575 | -17,714 | -20,737 | -21,837 | -21,900 | -22,244 | -22,707 | -23,235 |
| Transfers (net) | 427 | 558 | 608 | 662 | 722 | 787 | 858 | 935 |
| Capital and financial account balance | 2,346 | -16,658 | -27,435 | -16,000 | -7,402 | -8,024 | -1,600 | -3,757 |
| Foreign direct investment and portfolio equity | 407 | 2,177 | 1,000 | 970 | 956 | 922 | 5,953 | 5,953 |
| Medium- and long-term debt | 253 | -2,095 | -860 | 300 | 400 | 400 | 400 | 400 |
| Bilateral project financing | 901 | 32 | 307 | 300 | 400 | 400 | 400 | 400 |
| Disbursements | 901 | 242 | 500 | 500 | 500 | 500 | 500 | 500 |
| Repayments | 0 | -210 | -193 | -200 | -100 | -100 | -100 | -100 |
| Repayments of rescheduled debt | 438 | 1,694 | 1,167 | 0 | 0 | 0 | 0 | 0 |
| Other official financing and portfolio investment | -210 | -433 | 0 | 0 | 0 | 0 | 0 | 0 |
| Oil prefinancing | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Trade credit | 5,308 | -14,102 | -27,243 | -14,138 | -8,826 | -9,613 | -8,421 | -10,778 |
| Other capital 2/ | -3,622 | -2,637 | -332 | -3,132 | 68 | 268 | 468 | 668 |
| Errors and omissions | -1,350 | -7,292 | 0 | 0 | 0 | 0 | 0 | 0 |
| Overall balance | 2,233 | -7,666 | -9,039 | 13,238 | 18,611 | 14,953 | 22,907 | 22,757 |
| Change in gross official assets/reserves (– = increase) | -2,233 | 7,666 | 9,039 | -13,238 | -18,611 | -14,953 | -22,907 | -22,757 |
| Memorandum items: | | | | | | | | |
| Net official reserves | 120,379 | 110,758 | 97,729 | 110,269 | 125,948 | 140,900 | 163,807 | 186,564 |
| Gross official assets/reserves | 128,399 | 120,733 | 111,694 | 124,932 | 143,543 | 158,495 | 181,402 | 204,159 |
| (in months of the following year's imports) | 19.4 | 15.8 | 13.0 | 14.5 | 14.5 | 14.5 | 14.5 | 14.5 |
| Gross foreign liabilities of the Central Bank of Iran | 8,020 | 9,975 | 13,965 | 14,663 | 17,595 | 17,595 | 17,595 | 17,595 |
| External debt service (percent of exports) | 0.0 | 2.1 | 1.3 | 0.8 | 0.8 | 0.8 | 0.8 | 0.8 |
| External debt (percent of GDP) | 2.7 | 2.3 | 2.0 | 2.2 | 2.3 | 2.6 | 2.5 | 2.5 |

Sources: Iranian authorities; and Fund staff estimates and projections.

1/ The Iranian fiscal year ends March 20.
2/ Includes Asian Clearence Union (ACU) and commercial banks

**Table 10. Islamic Republic of Iran: Labor and Population Data, 2015/16–2022/23 1/**

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | (Millions of people, unless otherwise indicated)) | | | | | | | |
| Population | 79.5 | 80.5 | 81.4 | 82.4 | 83.3 | 84.1 | 85.0 | 85.8 |
| Working age population | 64.6 | 65.4 | 65.9 | 66.5 | 67.0 | 67.5 | 68.1 | 68.8 |
| Labor force | 24.7 | 25.8 | 26.2 | 26.5 | 26.9 | 27.3 | 27.7 | 28.1 |
| Employment | 22.0 | 22.6 | 23.1 | 23.4 | 23.8 | 24.2 | 24.6 | 25.0 |
| Unemployment | 2.7 | 3.2 | 3.1 | 3.1 | 3.1 | 3.1 | 3.1 | 3.2 |
| Nominal GDP per capita (US$) | 4,723 | 5,027 | 5,305 | 5,086 | 4,961 | 4,732 | 4,949 | 5,202 |
| | (Percent) | | | | | | | |
| Participation rate | 38.2 | 39.4 | 39.7 | 39.9 | 40.2 | 40.4 | 40.7 | 40.9 |
| Male | 63.2 | 64.1 | 64.9 | ... | ... | ... | ... | ... |
| Female | 13.3 | 14.9 | 16.5 | ... | ... | ... | ... | ... |
| Unemployment rate | 11.0 | 12.4 | 11.8 | 11.7 | 11.6 | 11.4 | 11.4 | 11.2 |
| Male | 9.3 | 10.5 | 10.1 | ... | ... | ... | ... | ... |
| Female | 19.4 | 20.7 | 20.4 | ... | ... | ... | ... | ... |
| Youth | 26.1 | 29.1 | 28.1 | ... | ... | ... | ... | ... |
| | (Annual percentage change) | | | | | | | |
| Nominal GDP per capita | -2.4 | 12.9 | 14.7 | 20.0 | 14.4 | 13.6 | 13.8 | 13.9 |
| Real GDP per capita | -2.8 | 11.1 | 3.0 | 2.8 | 2.8 | 3.0 | 3.2 | 3.4 |
| Population | 1.3 | 1.2 | 1.2 | 1.2 | 1.1 | 1.1 | 1.0 | 1.0 |
| Labor force | 3.6 | 4.5 | 1.4 | 1.4 | 1.4 | 1.4 | 1.6 | 1.6 |
| Employment | 3.1 | 2.8 | 2.1 | 1.5 | 1.6 | 1.6 | 1.6 | 1.7 |
| Unemployment | 7.5 | 18.0 | -3.6 | 0.9 | 0.2 | -0.3 | 1.1 | 0.2 |

Sources: Iran authorities, and IMF staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

## Table 11. Islamic Republic of Iran: Central Bank Balance Sheet, 2015/16–2022/23 1/

| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|---|---|---|---|---|
| | | | Projections | | | | | |
| | (Billions of rials, unless otherwise indicated) | | | | | | | |
| Net foreign assets (NFA) | 3,259,700 | 3,053,700 | 2,973,187 | 4,047,501 | 6,258,632 | 7,755,838 | 9,970,637 | 12,453,911 |
| Foreign assets | 3,502,400 | 3,377,100 | 3,484,779 | 4,680,902 | 7,265,468 | 8,853,476 | 11,162,186 | 13,742,981 |
| Foreign liabilities 2/ | 242,700 | 323,400 | 511,593 | 633,401 | 1,006,836 | 1,097,638 | 1,191,549 | 1,289,070 |
| | | | | | | | | |
| Net domestic assets (NDA) | -1,673,600 | -1,190,400 | -1,648,985 | -1,855,278 | -3,260,738 | -2,753,291 | -3,090,372 | -3,389,180 |
| Net domestic credit | -276,300 | 147,600 | 372,052 | 564,178 | 297,524 | 302,017 | 342,990 | 482,049 |
| Central government, net | -1,388,800 | -1,318,400 | -1,240,548 | -29,052 | -332,248 | -369,778 | -377,131 | -347,431 |
| Claims | 175,400 | 98,600 | 223,600 | 1,343,600 | 1,363,600 | 1,383,600 | 1,403,600 | 1,423,600 |
| Deposits | 1,564,200 | 1,417,000 | 1,464,148 | 1,372,652 | 1,695,848 | 1,753,378 | 1,780,731 | 1,771,031 |
| Claims on banks | 836,300 | 1,163,300 | 1,279,630 | 243,612 | 280,153 | 322,176 | 370,503 | 426,078 |
| Claims on nonfinancial public enterprises (NFPEs) | 276,200 | 302,700 | 332,970 | 349,619 | 349,619 | 349,619 | 349,619 | 403,402 |
| Other items net, excluding central bank participation papers (CPPs) | -1,397,300 | -1,338,000 | -2,021,038 | -2,419,457 | -3,558,262 | -3,055,308 | -3,433,362 | -3,871,228 |
| | | | | | | | | |
| Base money | 1,575,100 | 1,845,800 | 2,228,001 | 2,692,766 | 3,200,976 | 3,783,907 | 4,433,949 | 5,116,043 |
| Currency | 457,000 | 485,000 | 509,250 | 534,713 | 561,448 | 589,521 | 618,997 | 649,946 |
| Currency in circulation | 371,900 | 393,300 | 407,400 | 449,159 | 466,002 | 489,302 | 513,767 | 539,456 |
| Cash in vaults | 85,100 | 91,700 | 101,850 | 85,554 | 95,446 | 100,218 | 105,229 | 110,491 |
| Reserves | 1,076,000 | 1,313,100 | 1,671,051 | 2,110,354 | 2,591,828 | 3,146,686 | 3,767,252 | 4,418,397 |
| Required reserves | 1,019,000 | 1,253,900 | 1,567,578 | 1,946,666 | 2,347,750 | 2,821,042 | 3,357,968 | 3,933,277 |
| Excess reserves | 57,000 | 59,200 | 103,473 | 163,688 | 244,078 | 325,644 | 409,285 | 485,120 |
| Deposits of NFPE and municipalities | 42,100 | 47,700 | 47,700 | 47,700 | 47,700 | 47,700 | 47,700 | 47,700 |
| | | | | | | | | |
| Other liabilities | 10,400 | 17,500 | -903,800 | -500,544 | -203,083 | 1,218,641 | 2,446,316 | 3,948,688 |
| | | | | | | | | |
| Memorandum items: | | | | | | | | |
| End-period change (in percent of base money) | | | | | | | | |
| Base money | 16.4 | 17.2 | 20.7 | 20.9 | 18.9 | 18.2 | 17.2 | 15.4 |
| NFA | 29.0 | -13.1 | -4.4 | 48.2 | 82.1 | 46.8 | 58.5 | 56.0 |
| NDA (net of other liabilities) | -12.5 | 30.2 | 25.1 | -27.4 | -63.2 | -28.6 | -41.4 | -40.6 |

Sources: Central Bank of Iran; and Fund staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

2/ Includes liabilities in foreign currency to residents.

## Table 12. Islamic Republic of Iran: Monetary Survey, 2015/16–2022/23 1/

| | | | Projections | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
| | (Billions of rials, unless otherwise indicated) | | | | | | | |
| Net foreign assets (NFA) | 3,787,600 | 3,641,700 | 3,637,593 | 4,960,522 | 7,468,058 | 9,074,337 | 11,401,943 | 14,002,361 |
| Foreign assets | 5,807,900 | 5,806,500 | 6,229,862 | 8,047,332 | 11,724,782 | 13,714,954 | 16,439,598 | 19,452,320 |
| Foreign liabilities 2/ | 2,020,300 | 2,164,800 | 2,592,269 | 3,086,810 | 4,256,724 | 4,640,617 | 5,037,655 | 5,449,959 |
| Net domestic assets (NDA) | 6,396,200 | 8,909,700 | 11,866,787 | 14,235,291 | 15,609,857 | 18,581,855 | 21,445,831 | 24,407,506 |
| Net domestic credit | 7,170,500 | 9,542,000 | 11,616,787 | 13,535,291 | 15,409,857 | 17,581,855 | 20,445,831 | 23,407,506 |
| Net credit to government 3/ | -494,900 | 24,800 | 131,338 | -129,832 | -343,681 | -527,781 | -475,389 | -457,378 |
| Claims on nonfinancial public enterprises (NFPEs) | 303,200 | 340,000 | 379,046 | 406,664 | 418,201 | 431,807 | 447,235 | 517,548 |
| Claims on the private sector | 7,362,200 | 9,177,200 | 11,106,403 | 13,258,459 | 15,335,337 | 17,677,829 | 20,473,985 | 23,347,336 |
| Other items, net, excluding CPPs | -774,300 | -632,300 | 250,000 | 700,000 | 200,000 | 1,000,000 | 1,000,000 | 1,000,000 |
| Broad money (M3) | 10,183,200 | 12,551,400 | 15,504,380 | 19,195,813 | 23,077,915 | 27,656,192 | 32,847,773 | 38,409,867 |
| M2 | 10,172,800 | 12,533,900 | 15,484,606 | 19,172,497 | 23,047,030 | 27,622,521 | 32,811,221 | 38,370,324 |
| Cash | 371,900 | 393,300 | 407,400 | 449,159 | 466,002 | 489,302 | 513,767 | 539,456 |
| Deposits | 9,800,900 | 12,140,600 | 15,077,206 | 18,723,339 | 22,581,028 | 27,133,219 | 32,297,454 | 37,830,868 |
| Demand deposits | 995,100 | 1,237,000 | 1,536,209 | 1,860,904 | 2,233,027 | 2,683,191 | 3,193,880 | 3,741,077 |
| Time deposits | 8,805,800 | 10,903,600 | 13,540,996 | 16,862,435 | 20,348,001 | 24,450,027 | 29,103,574 | 34,089,792 |
| CPPs held by nonbanks | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Foreign currency deposits | 10,400 | 17,500 | 19,774 | 23,316 | 30,886 | 33,671 | 36,552 | 39,544 |
| Memorandum items: | | | | | | | | |
| Net credit to government (without valuation effect) 3/ | -494,900 | 24,800 | 131,338 | -129,832 | -343,681 | -527,781 | -475,389 | -457,378 |
| Base money | 1,575,100 | 1,845,800 | 2,228,001 | 2,692,766 | 3,200,976 | 3,783,907 | 4,433,949 | 5,116,043 |
| M1 | 1,367,000 | 1,630,300 | 1,943,609 | 2,310,062 | 2,699,029 | 3,172,493 | 3,707,647 | 4,280,532 |
| Multiplier (M2/base money) | 6.5 | 6.8 | 7.0 | 7.1 | 7.2 | 7.3 | 7.4 | 7.5 |
| Velocity of M2 | 1.1 | 1.0 | 1.0 | 0.9 | 0.9 | 0.9 | 0.8 | 0.8 |
| GDP | 11,129,033 | 12,722,849 | 14,772,314 | 17,926,285 | 20,742,327 | 23,810,613 | 27,364,559 | 31,463,666 |
| | (Annual change, in percent) | | | | | | | |
| NFA | 14.4 | -3.9 | -0.1 | 36.4 | 50.5 | 21.5 | 25.7 | 22.8 |
| NDA | 41.5 | 39.3 | 33.2 | 20.0 | 9.7 | 19.0 | 15.4 | 13.8 |
| Base money | 16.4 | 17.2 | 20.7 | 20.9 | 18.9 | 18.2 | 17.2 | 15.4 |
| M1 | 13.2 | 19.3 | 19.2 | 18.9 | 16.8 | 17.5 | 16.9 | 15.5 |
| M2 | 30.0 | 23.2 | 23.5 | 23.8 | 20.2 | 19.9 | 18.8 | 16.9 |
| Credit to private sector in rials | 16.7 | 24.7 | 21.0 | 19.4 | 15.7 | 15.3 | 15.8 | 14.0 |

Sources: Central Bank of Iran; and Fund staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

2/ Includes liabilities in foreign currency to residents.

3/ Includes foreign exchange deposits of the NDFI.

# Appendix I. External Sector Assessment

*Iran's external position is characterized by low external debt, a sizable reserves cushion, and a current account surplus. Still, the CBI has been losing reserves since the beginning of 2016/17 and the authorities face difficulties in transferring their oil proceeds from their trading partners. The official rate was 15.5 percent stronger than the market rate in 2016/17 and it subsidized a significant share of imports and undermined exports competitiveness. Staff assesses the external position to be weaker than warranted by fundamentals and desirable policy settings. The unification of the exchange rate is expected to result in the exchange rate settling at the market rate, which in turn, would likely make the unified rate more closely in line with fundamentals.*

## A. Overview of Iran's External Sector

1. **The current account position has remained in surplus, supported by oil exports, following the lifting of nuclear sanctions** (Table 1). Imports picked up reflecting pent-up demand and an overvalued official exchange rate. The current account surplus is expected to stabilize near 5.5 percent of GDP in tandem with the rise in oil and gas exports. The financial account is poised to improve moderately, reflecting improving access to oil export receipts as CBRs improve over time, FDI commitments materialize gradually, and errors and omissions normalize.

2. **External buffers have weakened considering continued constraints in CBRs that hamper access to international reserves**. The lack of correspondent banking relationships hampers the repatriation of export proceeds, mainly oil, from some key trading partners, which translates into large trade credit accumulation and delays in the repatriation of export proceeds. To address the latter, Iran has reached agreements with some countries to convert its dollar reserves and export earnings into other currencies and is increasingly denominating its oil sales contracts in euros. The uncertain outlook for oil prices, the impact of remaining sanctions, and heightened risk of snap-back of nuclear sanctions pose risks to Iran's external position.

## B. Exchange Rate Assessment

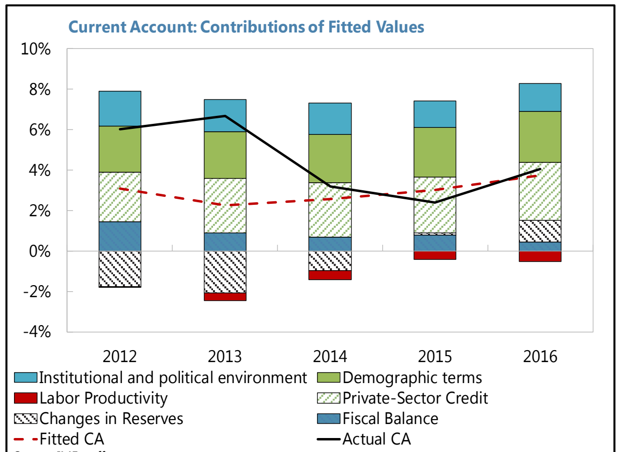
3. **The exchange rate assessment at end 2016/17 pointed to an overvaluation in the official exchange rate of about 13–16 percent**. The market rate was 15.5 percent more depreciated than the official rate in 2016/17 and analysis suggest that it was broadly in line with fundamentals at end 2016/17. The unification of the exchange rate at the market rate would likely make the REER in line with fundamentals.

## Table 1. Islamic Republic of Iran: External Sector Vulnerabilities

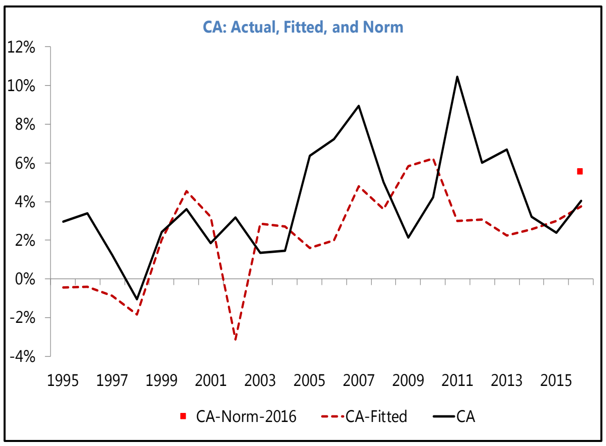
| | |
|---|---|
| **Overall assessment**: Iran's external position in 2017 is weaker than warranted by fundamentals and desirable policy settings. If the JCPOA remains in place, progress is made on AML/CFT issues, CBRs improve, and fiscal adjustment is as planned, the current account and access to foreign reserves should gradually improve, strengthening the external position. Lower oil prices and external uncertainty pose risks, including to exchange rate stability. | **Background**. Despite a current account surplus, Iran has lost foreign exchange reserves in 2016/17 due to difficulties in repatriation of oil receipts. The CBI has also been intervening in the foreign exchange market to fend-off depreciation pressures. The overvaluation in the official exchange rate stimulated imports and weakened the current account relative to the estimated norm.<br><br>**Potential policy responses**. Fiscal consolidation and a tighter monetary policy stance will help to protect macroeconomic stability and strengthen the external position. The (official) real exchange appears overvalued whereas market exchange rate is broadly in line with fundamentals; exchange rate unification could correct the estimated overvaluation. The rise in uncertainties over Iran's external environment cloud the assessment. |
| **Current account**: increasing gradually | **Background**. Current account surpluses have increased from 0.3 percent in 2015/16 to 4 percent in 2016/17 due to the removal of nuclear sanctions. In 2017/18, the pick-up in imports and stagnation of non-oil exports offset the increase in oil exports and allowed the current account surplus to increase slightly.<br><br>**Assessment**. The current account remains in surplus. Unifying the exchange rate at the market rate would help contain imports and stimulate non-oil exports and reduce Iran's dependency on oil revenue over time. |
| **Real exchange rate**: overvaluation amid large uncertainties | **Background**. Iran has a dual exchange rate system: an official appreciated rate for imports of select priority goods, and a market rate for other imports. Oil proceeds are converted at the official rate for fiscal revenues. Uncertainty over Iran's external environment has led to bouts of volatility in the parallel rate.<br><br>**Assessment**. Staff's analysis suggest that the market exchange rate is broadly in line with fundamentals whereas the official exchange rate appears overvalued. |
| **Capital and financial account**: rising outflows | **Background**. Iran's economy was cut off from international financial markets due to international sanctions. External debt is less than 2 percent of GDP. FDI and portfolio inflows are insignificant. Nevertheless, errors and omissions turned negative in 2016/17 and difficulties in collection of export receivables led to a significant rise in export credits.<br><br>**Assessment**. The authorities need to tighten macroeconomic policies and improve CBRs to reduce outflows and thereby strengthen the external position |
| **FX assets/reserves**: large but not fully accessible | **Background**. Iran's foreign exchange assets/reserves stood at $120.7 billion at end-2016/17, equivalent to almost 16 months of imports. Some of the stock of reserve remains inaccessible due to limited CBRs. Large trade credit accumulation has emerged because of Iran's difficulty in receiving payments.<br><br>**Assessment**. The level of gross foreign exchange assets appears comfortable but rise in external uncertainties and difficulties in accessing reserves require tightening of policies to strengthen external position. |
| **Foreign assets and liabilities position**: no detailed information available | **Background**. Gross external debt is low at below 2 percent of GDP. Foreign assets of the banking system, including the CBI, are equivalent to about 50 percent of GDP. However, a non-negligible share of foreign assets is encumbered and therefore not available for payment purposes, even after sanctions relief.<br><br>**Assessment**. Iran appears to have a large positive IIP, but the lack of information on corporate and households net foreign asset holdings adds uncertainty to this assessment. |

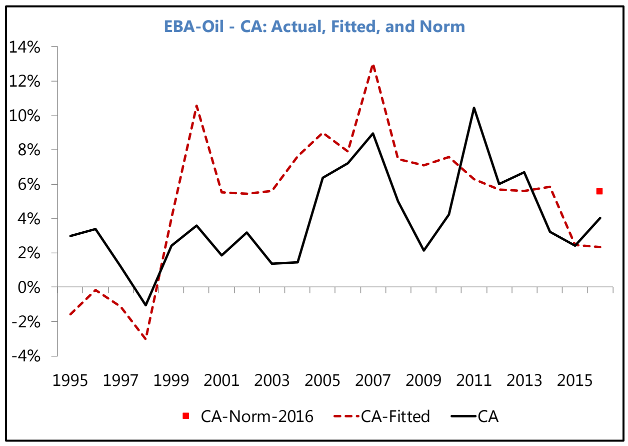
Source: IMF staff.

- **Current account approach**: the REER was overvalued by 12.9 percent. The current account balance (CA) in 2016/17 of 4 percent of GDP was below the norm of 5.8 percent of GDP. The main drivers of the CA norm in Iran were private credit, demographic trends, institutional and political environment, change in reserves, and a large policy gap. A widening fiscal deficit and foreign reserves loss left the CA surplus weaker than the norm. Over the medium-term, planned fiscal consolidation to reach the PIH norm by 2028, the improvement of CBRs and exchange rate unification should help close the current account gap. Prudent fiscal and monetary policies would contain inflation and support competitiveness. Reforms to improve the business climate and labor market would address Iran's productivity gap.

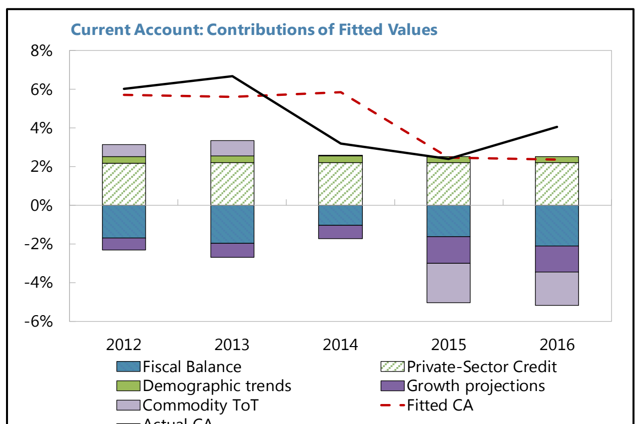


Source: IMF staff.




- **EBA-Oil current account approach**: the current account assessment for commodity exporters confirms the overvaluation of the official REER by 12.4 percent at end 2016/17. The methodology emphasizes the characteristics of oil dependent economies where the government tends to play a larger-than-typical role and the current account may be particularly sensitive to fiscal policy. A widening fiscal deficit and foreign reserves loss has left the CA surplus weaker than the



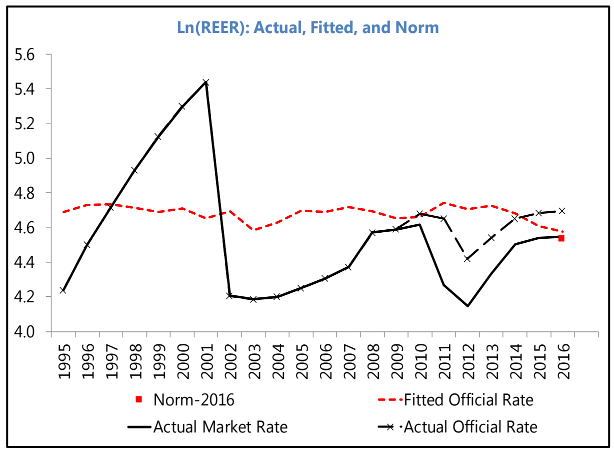
Source: IMF staff.

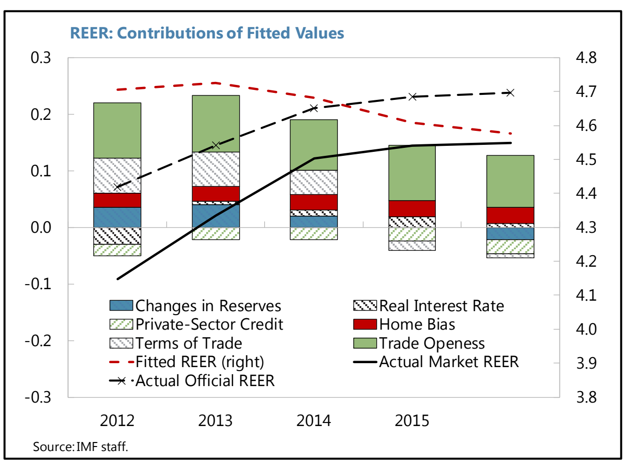
norm in 2016/17 and explains the current account gap. The desirable level of cyclically adjusted fiscal balance reflects the fiscal adjustment need to create fiscal space to address banking reform costs and the increase in reserves in the medium term required to build external buffers. As such, the fiscal deficit was a structural contributor to the CA underperformance and in recent years also the terms-of-trade shock. However, the methodology does not capture the structural reforms required to improve the productivity and competitiveness of the Iranian economy and the deviation of fiscal policy from the long-term PIH norm.

**CA Model**

| | EBA-Lite | EBA-Oil |
|---|---|---|
| CA-Actual | 4.0% | 4.0% |
| Cyclical Contributions (from model) | -0.8% | -1.8% |
| Cyclically adjusted CA | 4.8% | 5.8% |
| **CA-Norm** | **5.5%** | **5.5%** |
| Cyclically adjusted CA Norm | 6.3% | 7.3% |
| CA-Gap | -1.5% | -1.5% |
| o/w Policy gap | -1.8% | -3.1% |
| Elasticity | -0.12 | -0.12 |
| **REER Gap** | **12.9%** | **12.4%** |

- **Real effective exchange rate approach**. The official REER was overvalued by 16 percent and the market REER by 1 percent at end-2016/17. The overvaluation was mostly driven by the financial home bias and lack of trade openness. Exchange rate unification and transition to a more flexible exchange rate would allow the economy to better manage terms of trade shocks, and greater trade openness would improve growth prospects.




**REER Model**

| | Official REER | Market REER |
|---|---|---|
| ln(REER)-Actual | 4.70 | 4.55 |
| ln(REER)-Norm | 4.53 | 4.53 |
| **REER-Gap** | **16.1%** | **1.4%** |
| ln(REER)-Fitted | 4.58 | 4.58 |
| Residual | 0.12 | -0.03 |
| Policy gap | 0.04 | 0.04 |

4. **The premium between the parallel rate and the official rate averaged about 16.4 percent in calendar year 2017, and widened further since start-2018 amid heightened uncertainty, but higher interest rate helped narrow the gap**. The authorities have moved additional categories of goods imports from the priority list of imports that are valued at the official exchange rate to the market rate. As of September 2017, 78 percent of goods categories (52 percent at end-2016/17) and 44.5 percent of imports by value (44 percent at end-2016/17) were at market rate. Since September 2017, tourism-related goods, rice, airline fuels and airplanes have also been removed from the priority list.

5. **In conclusion, the exchange rate assessment suggests Iran's external position in 2016/17** was weaker than warranted by fundamentals and desirable policy settings.

## C. External Sustainability

6. **Iran's external position suggests no significant sustainability risk**. External debt is low and forecast to remain stable at around 2 percent of GDP. Gross official reserves are ample but the authorities continue to encounter difficulties in accessing some of their reserves due to limited CBRs. Data on the international investment position are not available reflecting shortcomings in compilation of private sector external assets (see Statistical Annex).

**Iran: Reserve adequacy measures**

| | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|---|---|---|
| Gross official reserves (billions of U.S. dollars) | 126.2 | 128.4 | 120.7 | 111.7 | 124.9 | 143.5 | 158.5 | 181.4 | 204.2 |
| Month of current imports of good and services | 17.1 | 20.8 | 18.2 | 14.6 | 14.5 | 16.6 | 18.0 | 20.2 | 22.3 |
| Percent of short-term debt at remaining maturity plus current account balance | 883.5 | 3475.5 | 561.6 | 482.1 | 379.0 | 482.4 | 590.2 | 635.8 | 665.1 |
| Percent of the IMF composite measure (fixed) 1/ | 324.0 | 296.6 | 239.8 | 201.8 | 209.5 | 259.2 | 267.0 | 283.4 | 298.1 |
| Percent of the IMF composite measure (flexible) 1/ | 638.2 | 574.6 | 464.9 | 392.6 | 407.9 | 503.1 | 518.6 | 550.9 | 579.7 |

1/ The IMF composite measures are calculated as a weighted sum of short-term debt, other portfolio liabilities, broad money, and exports in percent of GDP. Official reserves are recommended to be in the range of 100-150 percent

# Appendix II. Public DSA

*The on-going arrears audit has revealed government arrears of about 30 percent of GDP and brought the debt-to-GDP ratio to near 50 percent in 2016/17. The anticipated recapitalization of the banking system is expected to further raise the debt-to-GDP ratio to 54 percent of GDP in 2018/19. Debt gradually converges to authorities' Sixth National Development Plan debt ceiling of 40 percent GDP in the medium-term aided by the increase in oil prices. Iran's debt dynamics remain susceptible to growth and interest rate shocks.*

1. **The recapitalization of the banking system in 2018/19 is expected to increase the public debt burden to about 54 percent of GDP**, but Iran's debt dynamics would improve in the medium term. The interest associated with prospective banking sector recapitalization bonds is expected to push the CG interest bill to 4.8 percent of GDP by 2019/20. Iran's gross financing need rises from 4.5 percent of GDP in 2017/18 to about 15 percent in 2019/20. However, because the stock of government payment arrears is being securitized gradually through 2023/24 and higher oil prices boost revenues, the deficit is contained, which combined with the impact of inflation, helps the debt burden to decline to 40 percent of GDP by 2022/23.

2. **Fiscal vulnerabilities have increased.** In a scenario where real GDP growth declines by 5.5 percentage points from the baseline in 2018 and 2019, a one standard deviation shock, the debt-to-GDP ratio peaks at 84.4 percent of GDP before stabilizing at 82 percent of GDP over the medium-term. The gross financing need of the government would rise to 22.5 percent of GDP in 2019/20. Alternatively, a scenario based on historical averages that sees a deterioration of the primary balance of about 1.3 percent of GDP in 2018/19 combined with an increase in effective interest payments by 1.2 percentage points relative to baseline,[1] would see the debt-to-GDP ratio peak above 70 percent of GDP in 2019/20 before declining. Under a severe global downturn scenario, which combines a real GDP shock, higher effective interest rates, and deterioration in the primary balance in the medium term, debt and financing needs would reach 88 and 24 percent of GDP, respectively, in 2019/2020, and will increase in the medium term. The recognition of additional arrears and a higher cost of bank recapitalization would push the debt and financing needs even higher in the medium-term under a severe shock scenario.

3. **Measures are also needed to bring the non-oil fiscal balance in line with long-term intergenerational equity**. The 2017/18 augmented non-oil primary deficit of 12.6 percent of non-oil GDP is substantially above the Permanent Income Hypothesis (PIH) norm (5.4 percent of non-oil GDP) that ensures exhaustible oil revenue is sufficiently transformed into financial assets for future generations. Measures of about 7 percent of non-oil GDP would need to be identified over the next decade to bring the non-oil primary deficit to 5.4 percent of non-oil GDP by 2027/28.

[1] The primary balance shock assumes a reduction relative to baseline by half of the historical standard deviation, the interest rate shock assumes that for every 1 percent of GDP deterioration in primary balance, the interest rate increases by 25 basis points (see Figure 3).

## Table 1. Islamic Republic of Iran: Public Sector Debt Sustainability Analysis (DSA)—Baseline Scenario

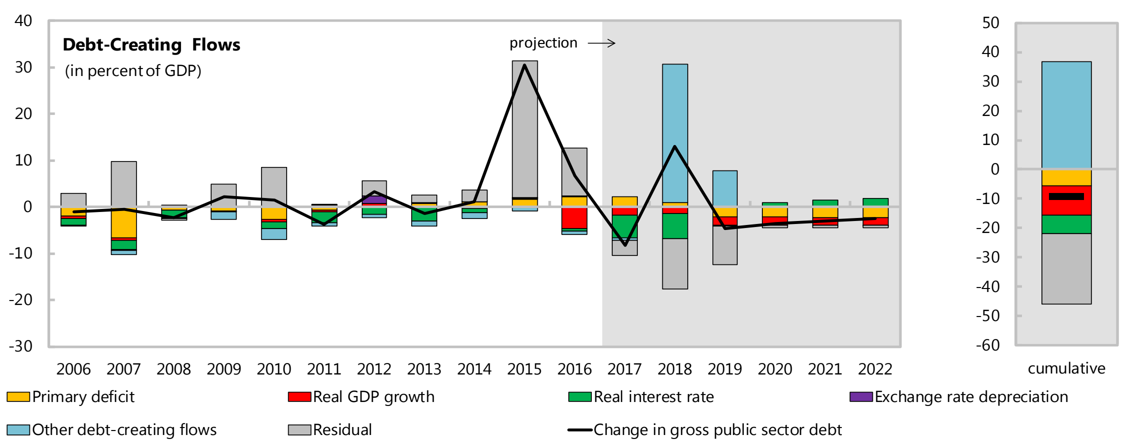
(In percent of GDP unless otherwise indicated)

### Debt, Economic and Market Indicators [1]

| | Actual | | | Projections | | | | | | As of February 08, 2018 | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006-2014 [2] | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Sovereign Spreads | | |
| Nominal gross public debt | 11.1 | 42.3 | 49.1 | 40.8 | 53.9 | 49.2 | 45.6 | 42.6 | 40.0 | EMBIG (bp) 3/ | | n.a. |
| Public gross financing needs | -1.2 | 1.8 | 4.7 | 4.5 | 13.5 | 14.7 | 6.8 | 5.7 | 5.7 | 5Y CDS (bp) | | n.a. |
| Real GDP growth (in percent) | 1.8 | -1.6 | 12.5 | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 | Ratings | Foreign | Local |
| Inflation (GDP deflator, in percent) | 19.1 | 0.4 | 1.6 | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 | Moody's | n.a. | n.a. |
| Nominal GDP growth (in percent) | 21.1 | -1.2 | 14.3 | 16.1 | 21.4 | 15.7 | 14.8 | 14.9 | 15.0 | S&Ps | n.a. | n.a. |
| Effective interest rate (in percent) [4] | 1.5 | 0.9 | 0.3 | 0.4 | 1.3 | 11.3 | 12.7 | 14.4 | 15.6 | Fitch | n.a. | n.a. |

### Contribution to Changes in Public Debt

| | Actual | | | Projections | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2006-2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | cumulative | debt-stabilizing |
| Change in gross public sector debt | -0.1 | 30.5 | 6.8 | -8.3 | 13.0 | -4.6 | -3.6 | -3.0 | -2.5 | -9.1 | primary |
| Identified debt-creating flows | -3.8 | 1.0 | -3.6 | -5.0 | 24.0 | 3.7 | -3.1 | -2.6 | -2.1 | 15.0 | balance [10] |
| Primary deficit | -1.2 | 1.7 | 2.2 | 2.2 | 1.0 | -2.1 | -2.1 | -2.3 | -2.3 | -5.6 | 0.2 |
| Primary (noninterest) revenue and grants | 19.3 | 16.1 | 17.3 | 15.7 | 18.7 | 19.5 | 19.5 | 19.5 | 19.5 | 112.3 | |
| Primary (noninterest) expenditure | 18.0 | 17.8 | 19.4 | 17.8 | 19.7 | 17.5 | 17.4 | 17.2 | 17.2 | 106.7 | |
| Automatic debt dynamics [5] | -1.6 | 0.3 | -5.1 | -6.7 | -6.7 | -2.0 | -0.9 | -0.2 | 0.2 | -16.3 | |
| Interest rate/growth differential [6] | -1.8 | 0.2 | -5.2 | -6.7 | -6.7 | -2.0 | -0.9 | -0.2 | 0.2 | -16.3 | |
| Of which: real interest rate | -1.7 | 0.1 | -0.6 | -4.8 | -5.4 | -0.2 | 0.9 | 1.5 | 1.9 | -6.2 | |
| Of which: real GDP growth | -0.2 | 0.2 | -4.6 | -1.8 | -1.3 | -1.9 | -1.8 | -1.7 | -1.6 | -10.1 | |
| Exchange rate depreciation [7] | 0.3 | 0.1 | 0.1 | … | … | … | … | … | … | … | |
| Other identified debt-creating flows | -1.0 | -0.9 | -0.7 | -0.5 | 29.7 | 7.8 | -0.1 | 0.0 | 0.0 | 36.9 | |
| Privatization (negative) | -1.0 | -0.9 | -0.7 | -0.5 | 29.7 | -0.2 | -0.1 | 0.0 | 0.0 | 28.9 | |
| Contingent liabilities [8] | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 8.0 | 0.0 | 0.0 | 0.0 | 8.0 | |
| Please specify (2) (e.g., ESM and Euroarea loans) | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | |
| Residual, including asset changes [9] | 3.7 | 29.5 | 10.4 | -3.3 | -10.9 | -8.4 | -0.5 | -0.5 | -0.4 | -24.0 | |




Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

4/ Defined as interest payments divided by debt stock (excluding guarantees) at the end of previous year. It increases rapidly in the projection period, as Iran is projected to continue to securitize its debt with interest-bearing instrument.

5/ Derived as $[(r - \pi(1+g) - g + ae(1+r)]/(1+g+\pi+g\pi))$ times previous period debt ratio, with $r$ = interest rate; $\pi$ = growth rate of GDP deflator; $g$ = real GDP growth rate; $a$ = share of foreign-currency denominated debt; and $e$ = nominal exchange rate depreciation (measured by increase in local currency value of U.S. dollar).

6/ The real interest rate contribution is derived from the numerator in footnote 5 as $r - \pi(1+g)$ and the real growth contribution as $-g$.

7/ The exchange rate contribution is derived from the numerator in footnote 5 as $ae(1+r)$.

8/ Contingent liabilities account for banking recapitalization and securitization of government debt to CBI.

9/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period. The large residual in 2015 corresponds to the recognition of government arrears.

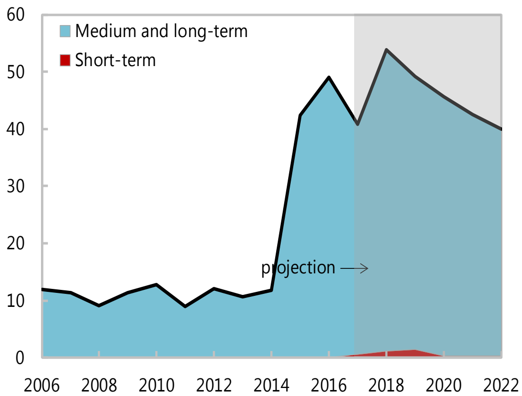
10/ Assumes that key variables (real GDP growth, real interest rate, and other identified debt-creating flows) remain at the level of the last projection year.

## Figure 1. Islamic Republic of Iran: Public DSA—Composition of Public Debt and Alternative Scenarios

### Composition of Public Debt

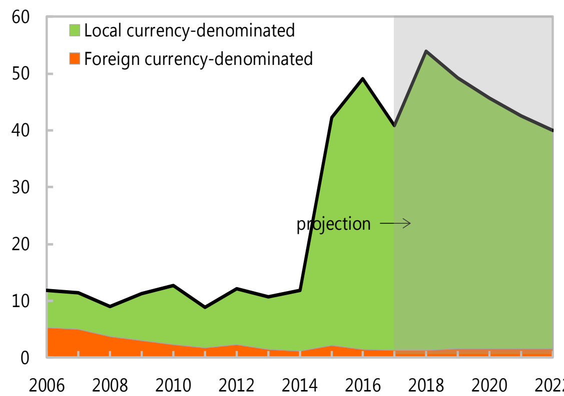
**By Maturity**

(in percent of GDP)




**By Currency**

(in percent of GDP)

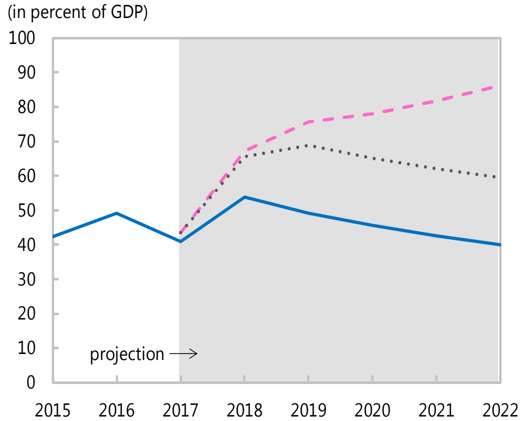



### Alternative Scenarios

Baseline Historical Constant Primary Balance

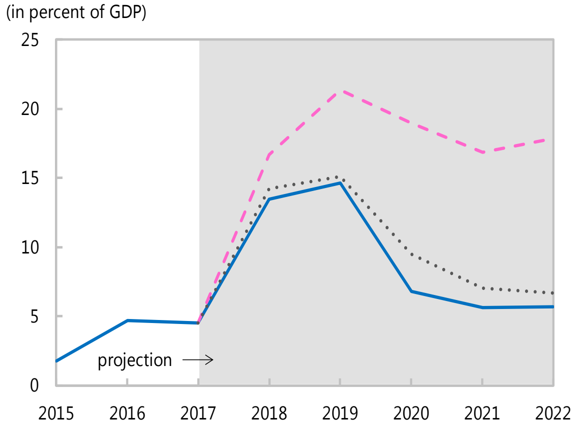
**Gross Nominal Public Debt**

(in percent of GDP)




**Public Gross Financing Needs**

(in percent of GDP)




### Underlying Assumptions

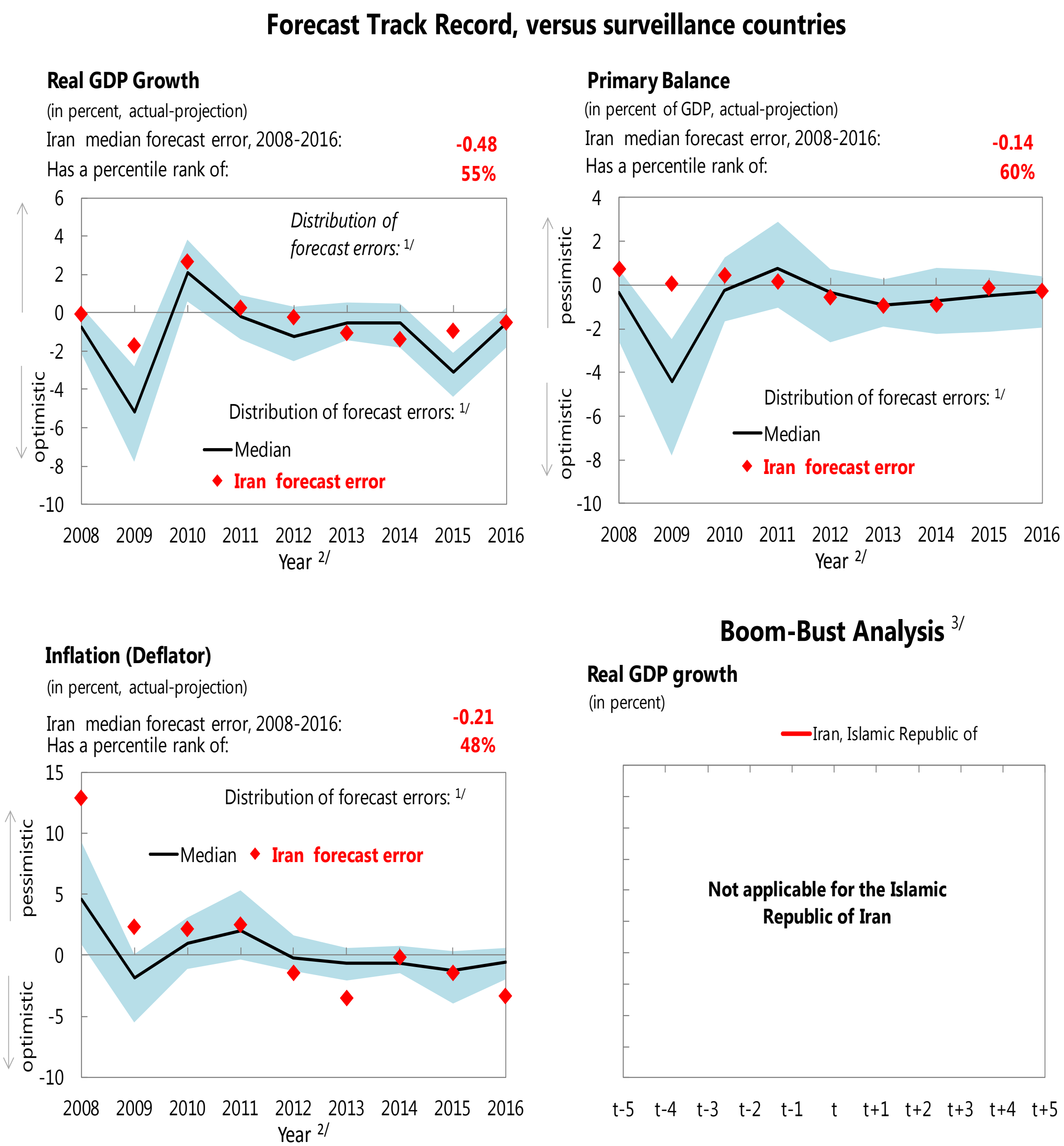
(in percent)

| Baseline Scenario | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|
| Real GDP growth | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Primary Balance | -2.2 | -1.0 | 2.1 | 2.1 | 2.3 | 2.3 |
| Effective interest rate | 0.4 | 1.3 | 11.3 | 12.7 | 14.4 | 15.6 |
| **Constant Primary Balance Scenario** | | | | | | |
| Real GDP growth | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Primary Balance | -2.2 | -2.2 | -2.2 | -2.2 | -2.2 | -2.2 |
| Effective interest rate | 0.4 | 2.5 | 12.6 | 14.9 | 16.9 | 17.9 |

| Historical Scenario | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|
| Real GDP growth | 4.3 | 2.2 | 2.2 | 2.2 | 2.2 | 2.2 |
| Inflation | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Primary Balance | -2.2 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 |
| Effective interest rate | 0.4 | 2.5 | 6.0 | 7.0 | 8.0 | 8.4 |

Source: IMF staff.

**Figure 2. Islamic Republic of Iran: Public DSA—Realism of Baseline Assumptions**




Source : IMF staff.

1/ Plotted distribution includes surveillance countries, percentile rank refers to all countries

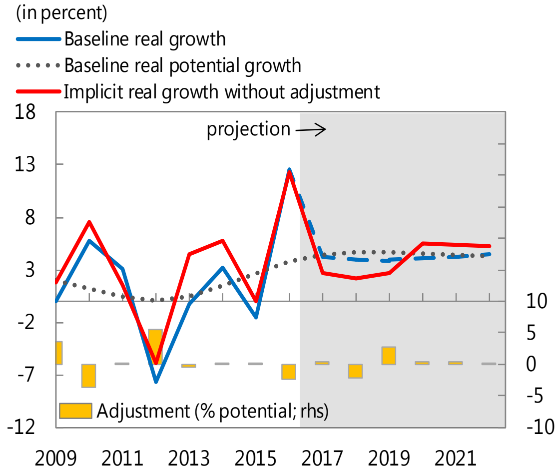
2/ Projections made in the spring WEO vintage of the preceding year

3/ Iran, Islamic Republic of has had a cumulative increase in private sector credit of 17 percent of GDP, 2013-2016. For Iran, Islamic Republic of, t corresponds
2017; for the distribution, t corresponds to the first year of the crisis.

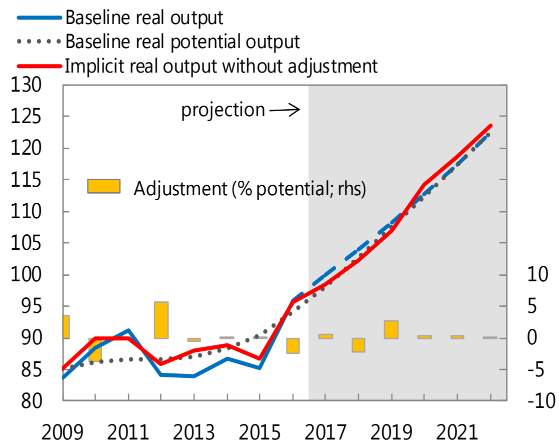
## Figure 2. Islamic Republic of Iran: Public DSA—Realism of Baseline Assumptions (concluded)

### Growth and Level of Output in Absence of Fiscal Adjustment

**Real GDP Growth**
(in percent)

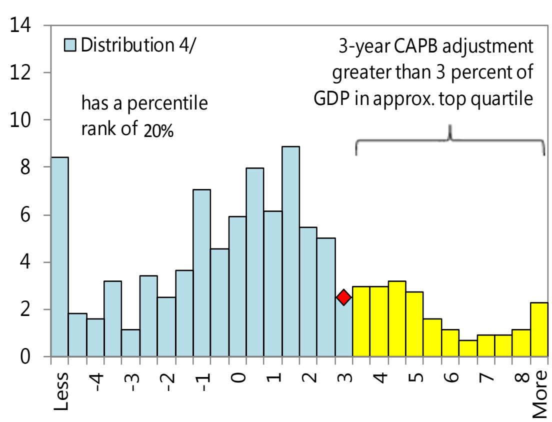



**Real Output Level**
(Baseline real output in 2017=100)

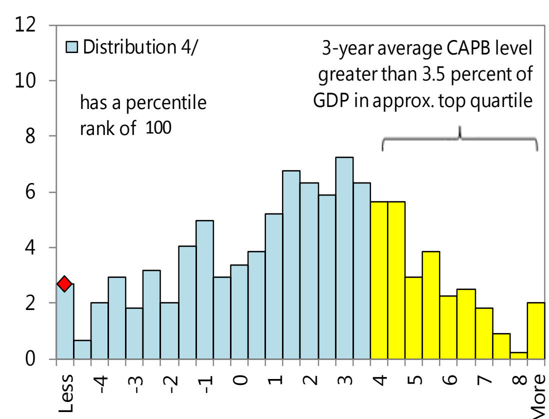



### Assessing the Realism of Projected Fiscal Adjustment

**3-Year Adjustment in Cyclically-Adjusted Primary Balance (CAPB)**
(Percent of GDP)




**3-Year Average Level of Cyclically-Adjusted Primary Balance (CAPB)**
(Percent of GDP)

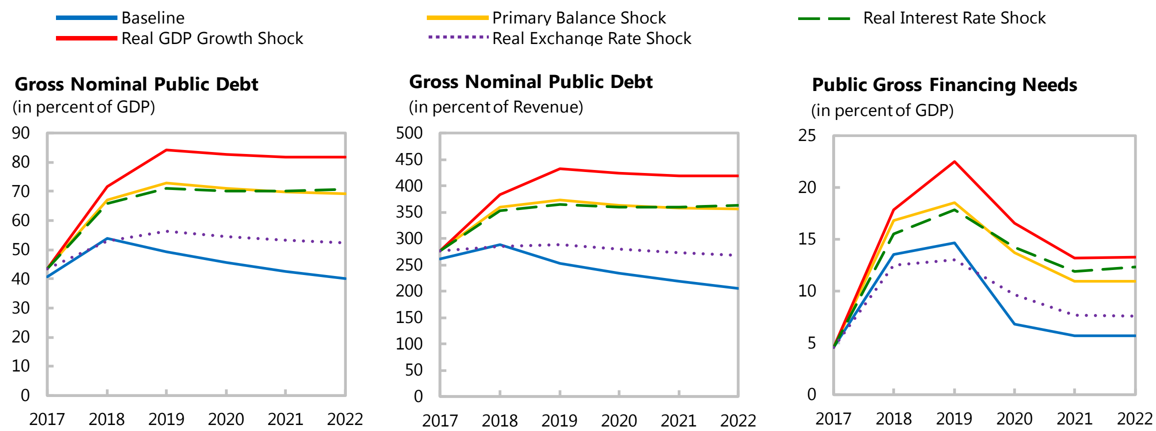



Source : IMF staff.

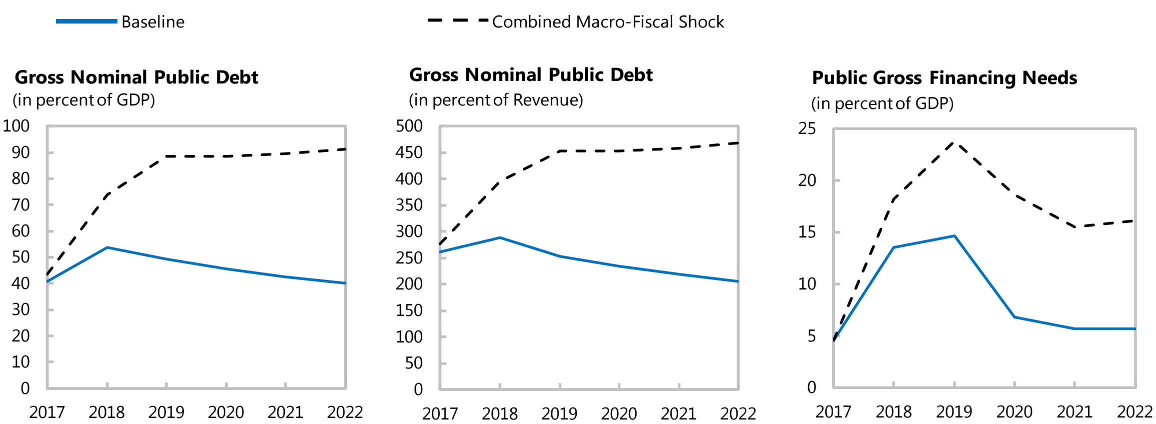
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis. Iran's CAPB is structurally low reflecting the large share of oil receipts in total government revenue.

## Figure 3. Islamic Republic of Iran: Public DSA—Stress Tests

### Macro-Fiscal Stress Tests




### Additional Stress Tests




### Underlying Assumptions [1/]

(in percent)

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|
| **Primary Balance Shock** | | | | | | |
| Real GDP growth | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Primary balance | -2.2 | -2.3 | 0.8 | 2.1 | 2.3 | 2.3 |
| Effective interest rate | 0.4 | 2.5 | 12.9 | 14.9 | 16.6 | 17.5 |
| **Real Interest Rate Shock** | | | | | | |
| Real GDP growth | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 16.7 | 11.3 | 10.2 | 10.3 | 10.1 |
| Primary balance | -2.2 | -1.0 | 2.1 | 2.1 | 2.3 | 2.3 |
| Effective interest rate | 0.4 | 2.5 | 14.2 | 16.4 | 18.4 | 19.6 |
| **Combined Shock** | | | | | | |
| Real GDP growth | 4.3 | -1.5 | -1.5 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 15.3 | 9.9 | 10.2 | 10.3 | 10.1 |
| Primary balance | -2.2 | -2.3 | -0.4 | 2.1 | 2.3 | 2.3 |
| Effective interest rate | 0.4 | 3.3 | 14.4 | 16.7 | 18.6 | 19.7 |

| | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 |
|---|---|---|---|---|---|---|
| **Real GDP Growth Shock** | | | | | | |
| Real GDP growth | 4.3 | -1.5 | -1.5 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 15.3 | 9.9 | 10.2 | 10.3 | 10.1 |
| Primary balance | -2.2 | -2.3 | -0.4 | 2.1 | 2.3 | 2.3 |
| Effective interest rate | 0.4 | 2.5 | 12.9 | 15.1 | 16.8 | 17.7 |
| **Real Exchange Rate Shock** | | | | | | |
| Real GDP growth | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 |
| Inflation | 11.3 | 50.2 | 11.3 | 10.2 | 10.3 | 10.1 |
| Primary balance | -2.2 | -1.0 | 2.1 | 2.1 | 2.3 | 2.3 |
| Effective interest rate | 0.4 | 3.3 | 12.7 | 14.6 | 16.2 | 17.1 |

Source: IMF staff.

1/ The primary balance shock assumes a total primary balance lowered by 1.3 percent over the projection period, with interest rate increased by 0.25 percent. The real GDP growth shock assumes growth lower by 1 percentage point in 2017 and 2018, while inflation and interest rates increase by 0.25 percent. The real effective exchange rate assumes a real depreciation of 100 percent, with a passthrough of 25 percent. The interest rate shock assumes a real interest higher by 2 percent. The combined shock takes the worse impact on each variables of the shocks mentioned above.

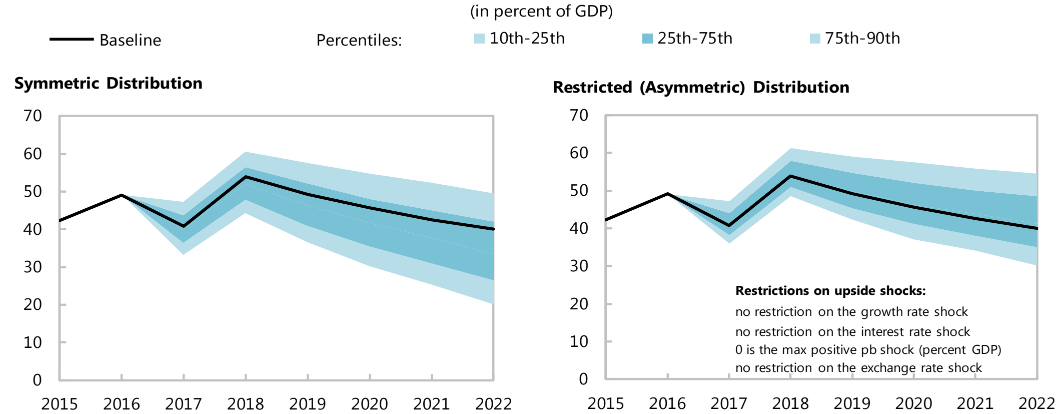
## Figure 4. Islamic Republic of Iran: Public DSA—Risk Assessment

### Heat Map

| | | | | | |
|---|---|---|---|---|---|
| Debt level 1/ | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability shock |
| Gross financing needs 2/ | Real GDP Growth Shock | Primary Balance Shock | Real Interest Rate Shock | Exchange Rate Shock | Contingent Liability Shock |
| Debt profile 3/ | Market Perception | External Financing Requirements | Change in the Share of Short-Term Debt | Public Debt Held by Non-Residents | Foreign Currency Debt |

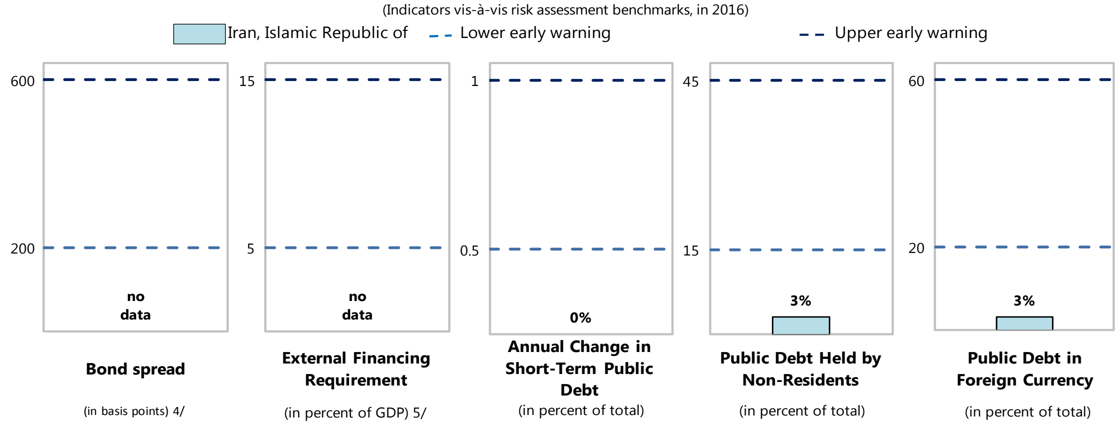
### Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)




### Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2016)




Source: IMF staff.

1/ The cell is highlighted in green if debt burden benchmark of 70% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

2/ The cell is highlighted in green if gross financing needs benchmark of 15% is not exceeded under the specific shock or baseline, yellow if exceeded under specific shock but not baseline, red if benchmark is exceeded under baseline, white if stress test is not relevant.

3/ The cell is highlighted in green if country value is less than the lower risk-assessment benchmark, red if country value exceeds the upper risk-assessment benchmark, yellow if country value is between the lower and upper risk-assessment benchmarks. If data are unavailable or indicator is not relevant, cell is white.

Lower and upper risk-assessment benchmarks are:

200 and 600 basis points for bond spreads; 5 and 15 percent of GDP for external financing requirement; 0.5 and 1 percent for change in the share of short-term debt; 15 and 45 percent for the public debt held by non-residents; and 20 and 60 percent for the share of foreign-currency denominated debt.

4/ Long-term bond spread over German bonds, an average over the last 3 months, 10-Nov-17 through 08-Feb-18.

5/ External financing requirement is defined as the sum of current account deficit, amortization of medium and long-term total external debt, and short-term total external debt at the end of previous period.

# Appendix III. External DSA

## Table 1. Islamic Republic of Iran: External Debt Sustainability Framework, 2012–22

(In percent of GDP, unless otherwise indicated)

| | Actual | | | | | | | Projections | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | 2016 | | | 2017 | 2018 | 2019 | 2020 | 2021 | 2022 | Debt-stabilizing non-interest current account 6/ |
| 1 **Baseline: External debt** | 2.0 | 1.7 | 1.2 | 2.7 | 2.3 | | | **2.0** | **2.2** | **2.3** | **2.6** | **2.5** | **2.5** | **-1.2** |
| 2 Change in external debt | -1.3 | -0.3 | -0.5 | 1.5 | -0.4 | | | -0.3 | 0.2 | 0.2 | 0.2 | 0.0 | 0.0 | |
| 3 Identified external debt-creating flows (4+8+9) | -4.2 | -7.4 | -3.3 | -0.3 | -4.8 | | | -4.6 | -7.3 | -6.6 | -6.1 | -7.3 | -7.4 | |
| 4 Current account deficit, excluding interest payments | -6.3 | -6.9 | -3.4 | -0.8 | -4.3 | | | -4.9 | -7.3 | -6.6 | -6.1 | -6.2 | -6.3 | |
| 5 Deficit in balance of goods and services | -5.6 | -6.3 | -2.7 | -0.1 | -3.7 | | | -4.2 | -6.5 | -5.8 | -5.2 | -5.3 | -5.4 | |
| 6 Exports | 26.8 | 25.2 | 23.6 | 19.8 | 23.4 | | | 25.4 | 31.1 | 30.9 | 31.7 | 30.8 | 30.0 | |
| 7 Imports | 21.2 | 19.0 | 20.9 | 19.7 | 19.7 | | | 21.2 | 24.6 | 25.1 | 26.5 | 25.6 | 24.6 | |
| 8 Net non-debt creating capital inflows (negative) | 0.2 | -0.7 | 0.0 | -0.1 | -0.6 | | | -0.2 | -0.2 | -0.2 | -0.2 | -1.4 | -1.3 | |
| 9 Automatic debt dynamics 1/ | 1.9 | 0.2 | 0.1 | 0.6 | 0.1 | | | 0.5 | 0.3 | 0.3 | 0.3 | 0.3 | 0.2 | |
| 10 Contribution from nominal interest rate | 0.3 | 0.2 | 0.2 | 0.5 | 0.3 | | | 0.6 | 0.3 | 0.3 | 0.4 | 0.4 | 0.3 | |
| 11 Contribution from real GDP growth | 0.4 | 0.0 | -0.1 | 0.0 | -0.3 | | | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | |
| 12 Contribution from price and exchange rate changes 2/ | 1.2 | 0.0 | -0.1 | 0.1 | 0.1 | | | ... | ... | ... | ... | ... | ... | |
| 13 Residual, incl. change in gross foreign assets (2-3) 3/ | 2.8 | 7.1 | 2.8 | 1.8 | 4.5 | | | 4.3 | 7.5 | 6.8 | 6.3 | 7.3 | 7.4 | |
| External debt-to-exports ratio (in percent) | 7.4 | 6.7 | 5.1 | 13.4 | 9.8 | | | 7.9 | 7.0 | 7.5 | 8.0 | 8.3 | 8.4 | |
| **Gross external financing need (in billions of US dollars) 4/** | -9.8 | -23.3 | -12.5 | -0.4 | -12.4 | | | -13.7 | -25.6 | -22.4 | -19.2 | -20.6 | -22.5 | |
| in percent of GDP | -2.5 | -5.9 | -3.0 | -0.1 | -3.1 | 10-Year | 10-Year | -3.2 | -6.1 | -5.4 | -4.8 | -4.9 | -5.0 | |
| **Scenario with key variables at their historical averages 5/** | | | | | | | | **2.0** | **3.4** | **3.8** | **3.4** | **4.0** | **4.6** | **0.2** |
| **Key Macroeconomic Assumptions Underlying Baseline** | | | | | | Historical Average | Standard Deviation | | | | | | | |
| Real GDP growth (in percent) | -7.7 | -0.3 | 3.2 | -1.6 | 12.5 | 2.2 | 5.5 | 4.3 | 4.0 | 4.0 | 4.1 | 4.2 | 4.4 | |
| GDP deflator in US dollars (change in percent) | -26.9 | 2.2 | 3.5 | -9.9 | -4.3 | 3.0 | 14.4 | 2.4 | -6.8 | -5.2 | -7.4 | 1.4 | 1.6 | |
| Nominal external interest rate (in percent) | 5.6 | 12.1 | 12.4 | 35.2 | 12.6 | 11.0 | 9.0 | 28.7 | 16.7 | 15.6 | 15.0 | 14.6 | 14.2 | |
| Growth of exports (US dollar terms, in percent) | -32.6 | -4.0 | -0.1 | -25.5 | 26.9 | 3.9 | 23.0 | 15.9 | 19.0 | -2.1 | -1.1 | 2.8 | 3.3 | |
| Growth of imports (US dollar terms, in percent) | -13.6 | -8.8 | 18.0 | -16.6 | 7.5 | 3.3 | 13.5 | 15.1 | 12.8 | 0.4 | 1.6 | 2.0 | 2.3 | |
| Current account balance, excluding interest payments | 6.3 | 6.9 | 3.4 | 0.8 | 4.3 | 5.4 | 3.0 | 4.9 | 7.3 | 6.6 | 6.1 | 6.2 | 6.3 | |
| Net non-debt creating capital inflows | -0.2 | 0.7 | 0.0 | 0.1 | 0.6 | 0.0 | 0.4 | 0.2 | 0.2 | 0.2 | 0.2 | 1.4 | 1.3 | |

1/ Derived as [r - g - r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock, with r = nominal effective interest rate on external debt; r = change in domestic GDP deflator in US dollar terms, g = real GDP growth rate, e = nominal appreciation (increase in dollar value of domestic currency), and a = share of domestic-currency denominated debt in total external debt.

2/ The contribution from price and exchange rate changes is defined as [-r(1+g) + ea(1+r)]/(1+g+r+gr) times previous period debt stock. r increases with an appreciating domestic currency (e > 0) and rising inflation (based on GDP deflator).

3/ For projection, line includes the impact of price and exchange rate changes.

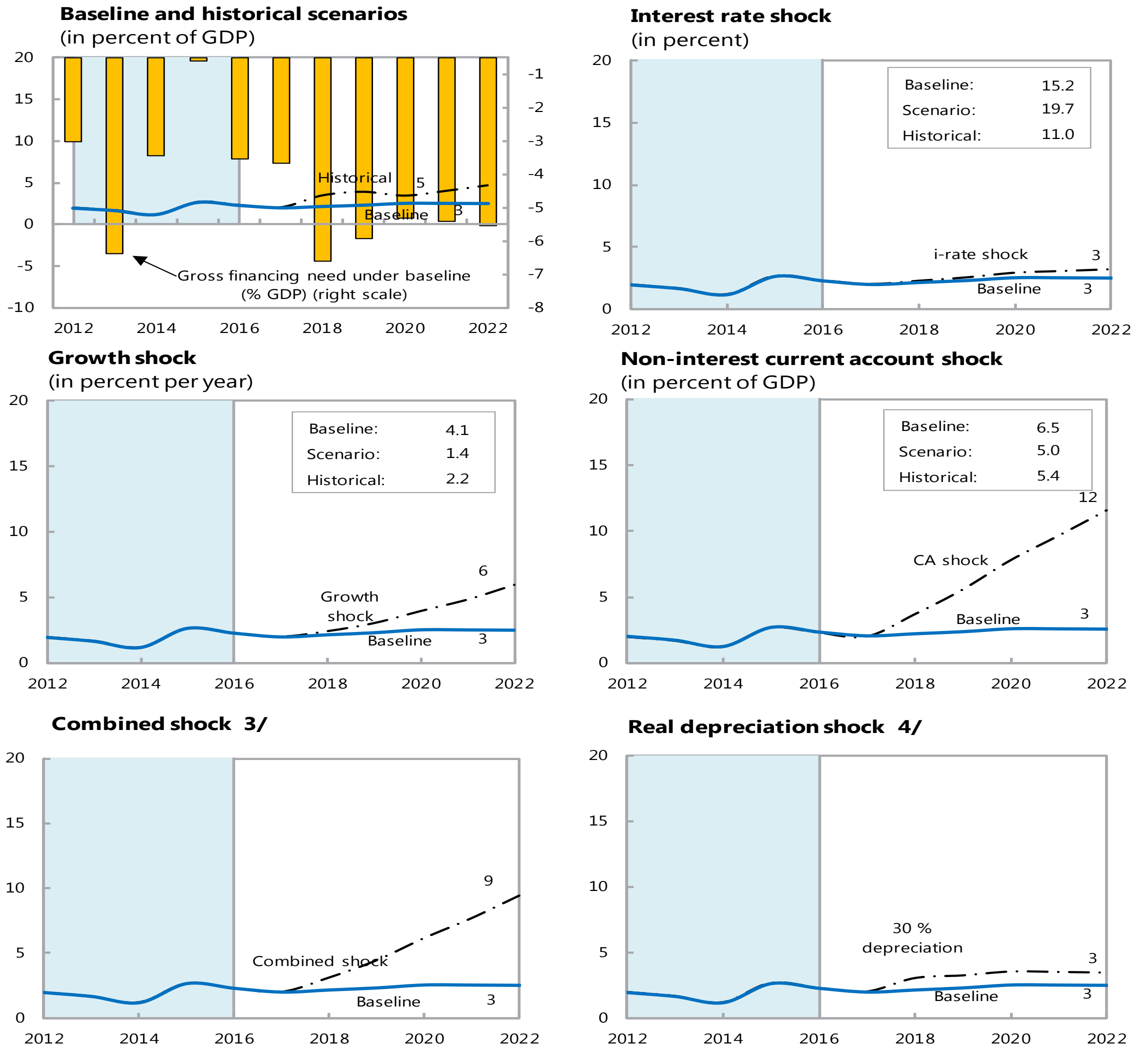
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

5/ The key variables include real GDP growth; nominal interest rate; dollar deflator growth; and both non-interest current account and non-debt inflows in percent of GDP.

6/ Long-run, constant balance that stabilizes the debt ratio assuming that key variables (real GDP growth, nominal interest rate, dollar deflator growth, and non-debt inflows in percent of GDP) remain at their levels of the last projection year.

## Figure 1. Islamic Republic of Iran: External Debt Sustainability: Bound Tests 1/ 2/

(External debt in percent of GDP)




Sources: International Monetary Fund, Country desk data, and staff estimates.

1/ Shaded areas represent actual data. Individual shocks are permanent one-half standard deviation shocks. Figures in the boxes represent average projections for the respective variables in the baseline and scenario being presented. Ten-year historical average for the variable is also shown.
2/ For historical scenarios, the historical averages are calculated over the ten-year period, and the information is used to project debt dynamics five years ahead.
3/ Permanent 1/4 standard deviation shocks applied to real interest rate, growth rate, and current account balance.
4/ One-time real depreciation of 30 percent occurs in 2016.

INTERNATIONAL MONETARY FUND

# ISLAMIC REPUBLIC OF IRAN

March 7, 2018

## STAFF REPORT FOR THE 2018 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Prepared By

Middle East and Central Asia Department
(In Consultation with Other Departments)

## CONTENTS

# FUND RELATIONS

## A. Financial Position in the Fund as of February 28, 2018

**Membership Status**:

Date of membership: December 29, 1945
Status: Article VIII

**General Resources Account**

| | SDR Million | Percent Quota |
|---|---|---|
| Quota | 3,567.10 | 100.00 |
| Fund Holdings of Currency | 3,049.65 | 85.49 |
| Reserve Tranche Position | 517.49 | 14.51 |

**SDR Department**

| | SDR Million | Percent Allocation |
|---|---|---|
| Net cumulative allocation | 1,426.06 | 100.00 |
| Holdings | 1,536.82 | 107.94 |

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements**

| Type | Date of Arrangement | Expiration Date | Amount Approved (SDR Million) | Amount Drawn (SDR Million) |
|---|---|---|---|---|
| Stand-by | Oct 10, 1960 | Mar 20, 1962 | 35.00 | 22.50 |
| Stand-by | May 18, 1956 | Nov 17, 1956 | 17.50 | 17.50 |

**Projected Payments to the Fund[1]**
(SDR million; based on existing use of resources and present holdings of SDRs)

| | | | Forthcoming | | |
|---|---|---|---|---|---|
| | 2017 | 2018 | 2019 | 2020 | 2021 |
| Principal | | | | | |
| Charges/Interest | 0.04 | 0.04 | 0.04 | 0.04 | 0.04 |
| **Total** | **0.04** | **0.04** | **0.04** | **0.04** | **0.04** |

[1] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Implementation of HIPC Initiative**: Not Applicable

**Implementation of Multilateral Debt Relief Initiative (MDRI)**: Not Applicable

**Implementation of Catastrophe Containment and Relief (CCR):** Not Applicable

As of February 4, 2015, the Post-Catastrophe Debt Relief Trust has been transformed to the Catastrophe Containment and Relief (CCR) Trust.

## B. Exchange System

The official exchange rate's *de jure* classification is a managed float. *De facto*, however, it has followed a crawl-like arrangement since March 2014, depreciating about one percent per month against the U.S. dollar. The bureau market has displayed greater flexibility as it is largely market-determined. With effect from September 6, 2004, the Islamic Republic of Iran accepted the obligations under Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement. Iran maintains multiple currency practices and an exchange restriction subject to Fund jurisdiction under Article VIII, Sections 2(a) and 3:

- A multiple currency practice and an exchange restriction, arises from the establishment of an official exchange rate for use in some exchange transactions, which in practice differs by more than 2 percent from the rate used by foreign exchange bureaus.

- A multiple currency practice arises from the differences of more than 2 percent between the current official and exchange bureaus rates and the preferential rates for certain imports for which foreign exchange commitments were made through letters of credit opened prior to March 21, 2002 under the previous multiple exchange rate system.

- A multiple currency practice arises from the differences of more than two percent between the current official and exchange bureaus rates and the preferential rates for certain imports for which foreign exchange payment commitments were made through letters of credits or bank drafts prior to July 24, 2012.

## C. Last Article IV Consultation

Iran is on the standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on February 24, 2017, and was published on February 27, 2017: (http://www.imf.org/en/Publications/CR/Issues/2017/02/27/Islamic-Republic-of-Iran-2016-Article-IV-Consultation-Press-Release-Staff-Report-and-44707).

## D. Technical Assistance

Since FY 2009, Iran received the following technical assistance:

| Department | Date | Purpose |
|---|---|---|
| **FAD** | FY 2009 | Tax administration and VAT |
| | FY 2010 | Tax policy |
| | FY 2010 | Tax Administration—Risk Management and Audit |
| | FY 2011 | Tax Administration |
| | FY 2013 | Tax Administration |
| | FY 2014 | Tax Administration |
| | FY 2016 | Public Financial Management |
| | FY 2016 | Tax Administration |
| | FY 2017 | Tax Policy |
| | FY 2017 | Pension System Assessment |
| | FY 2017 | Reform of Financial Supervision |
| | FY 2017 | Implementation of Accrual Accounting |
| **LEG** | FY 2009 | Anti-Money Laundering/Combating Financing of Terrorism (AML/CFT) |
| | FY 2017 | AML/CFT Pre-Assessment Course |
| **MCM** | FY 2010 | Macrofinancial Policies and Financial Stability (with MCD and LEG) |
| | FY 2015 | Banking Supervision |
| | FY 2015 | Exchange Rate Unification |
| | FY 2016 | Monetary Policy Instruments |
| | FY 2017 | Capacity building/ TA workshop on Banking Resolution (MCD and LEG) |
| | FY 2017 | Bank restructuring and Resolution |
| **STA** | FY 2011 | GDDS: Metadata Development |
| | FY 2015 | National Accounts |
| | FY 2017 | Multisector Sector Statistics Mission |

# RELATIONS WITH THE WORLD BANK GROUP

The World Bank Group does not have a country program strategy in the Islamic Republic of Iran. The last Interim Assistance Strategy covered FY 2002–05, and the last IBRD project closed in 2012. The IFC has no exposure to the Islamic Republic of Iran. MIGA issued two guarantees in 2005, and no guarantees have been provided since then. Iran is currently a member of the Bank in good standing.

The Bank prepares a bi-annual economic monitoring note (Iran Economic Review) that analyzes recent economic developments in Iran and provides a medium-term economic outlook as well as special focus sections on selected issues. The Bank has also recently initiated an analytical work program on Iran that comprises a number of topics including air pollution, pensions and assisting Iran with a National Risk Assessment for AML/CFT.

# STATISTICAL ISSUES

| Assessment of Data Adequacy for Surveillance |
|---|
| **General**<br><br>Data provision is broadly adequate for surveillance with some data shortcomings noted below. Data are reported with delays and also provided infrequently.<br><br>The Central Bank of Iran (CBI) disseminates key statistical aggregates in its quarterly Economic Trends, also available at http://www.cbi.ir/default_en.aspx. |
| **National Accounts**<br><br>National accounts estimates published by the CBI and the Statistical Center of Iran (SCI) are significantly different. Improved coordination and cooperation between these two agencies may reduce duplication of tasks and improve the quality of real sector statistics. The current-price GDP estimates for main economic activities do not cover significant parts of the non-observed economy, and the estimates of imputed rent of owner occupied dwellings appear overestimated. Accessibility of the quarterly estimates could be improved and made available with a consistent time lag. The accuracy of estimates of constant-price GDP can be improved by implementing double deflation for selected activities, and by improving the compilation of taxes on products. |
| **Price Statistics**<br><br>A monthly consumer price index (CPI) and producer price index (PTI) for main urban areas are produced and disseminated by the CBI. The indices use 2011 as the base year, are of good quality, and are released in a timely manner. |
| **Government Finance Statistics**<br><br>Fiscal data provided for surveillance cover only the central government, and are released on a cash basis without full details on all the components of expenditure, and on an irregular basis. However, the Treasury General's Office collects budget execution data reported by the spending units for internal control purposes. These data include expenditure breakdowns according to the budget classification and is available for all budgetary central government units. This source evidences the availability of data to enable the compilation of complete GFS data for budgetary central government. The authorities do not have the capacity to compile general government fiscal data at present due to shortcomings in the chart of accounts and their inability to track and record general government transactions. Efforts are being made to strengthen the Treasury functions—a new debt management office was created and the authorities plan to transition over the coming years to a treasury single account and are planning a gradual move to accrual based accounting for which they have received Fund TA—which is expected to enhance data quality and availability. The reporting of GFS data for publication in the Fund's Government Finance Statistics Yearbook (GFSY) was discontinued in 2010. The resumption of GFS data reporting for GFSY is encouraged. |

Developing general government and public sector debt statistics is key to improving the scope and usefulness of fiscal statistics. In particular, expanding the coverage of fiscal data to general government (or beyond to cover nonfinancial public enterprises) to include public agencies such as the National Development Fund of Iran, the Targeted Subsidy Organization and public pension funds would provide a more complete view of fiscal activities to policy makers. Improving the scope and coverage of GFS would safeguard against arrears and allow better monitoring of liabilities, guarantees and fiscal risks.

**Monetary and Financial Statistics**

The Central Bank of Iran (CBI) is yet to compile and submit monetary data to STA using standardized report forms (SRFs). Monthly monetary data on central bank and other depository corporations are reported to STA using old reporting forms with long lags, the latest being for February 2017. The data is highly aggregated hindering proper classification and sectoring of financial instruments necessary for improving data quality. The authorities are planning to undertake improvements in these areas, in line with the recommendations of the December 2017 STA multisector statistics mission. Data for other financial corporations are yet to be compiled and reported to STA.

**Financial Sector**

Financial soundness indicators (FSIs) are compiled semi-annually by the CBI for internal supervision, and are shared with Fund staff but are not disseminated to the public. They comprise 23 indicators, which partially cover the Fund's recommended list of core and encouraged FSIs, while others go beyond this list. To improve the usefulness of the FSIs for supervisory purposes and assessment of the financial sector, these FSIs should be compiled at least quarterly, and should be disseminated to the public. The December 2017 multisector statistics mission made recommendations to improve the quality of the compiled FSIs and urged submission of these data to STA for publication in the IMF website.

**External Sector Statistics**

The CBI does not submit quarterly or annual balance of payments data to the Fund for re-dissemination in the IFS. However, based on the data provided to Fund staff for surveillance, the sizeable errors and omissions undermines the reliability of the balance of payments data. This is primarily the result of undercoverage of transactions in financial instruments under other investment—including foreign deposits (assets) of resident nonfinancial corporations, and loans and deposit liabilities of resident sectors. Further, direct investment source data deviate from international standards in key areas of concepts and definitions, coverage and scope, and basis of recording.

To enhance the coverage of the current account, the December 2017 multisector statistics mission recommended a revival of the bank reporting system to aid improvements in the estimates of services, investment income, and personal transfers. It also cited gaps in the unpublished gross external debt statistics by sector/financial instruments.

International investment position (IIP) statistics are compiled but not disseminated. Only data on public and publicly-guaranteed external debt are disseminated, but classifications do not fully accord with the guidelines of the 2003/2013 External Debt Statistics: Guide for Compilers and Users. Iran does not participate in the World Bank's Quarterly External Debt Statistics (QEDS) database. Reserve asset

| | |
|---|---|
| positions are not publicly disseminated. The foreign assets in domestic currency terms as reported in the monetary survey, together with within year preliminary data on the change in official reserves shared with staff, may imply sizeable valuation changes once annual data on the change in gross international reserves become available. The data template on international reserves and foreign currency liquidity is not compiled.<br><br>With a view to enhancing the transparency of Iran's external sector statistics, the authorities should publish the IIP, and disseminate more comprehensive financial account data (including separately identifying assets and liabilities by financial instrument). | |
| **Data Standards and Quality** | |
| Participant in the General Data Dissemination System (GDDS) since 2012. Iran still needs to improve the scope and timeliness of data dissemination to meet the Enhanced-GDDS, and is encouraged to develop and maintain a national summary data page. | No data ROSC is available. |

## Islamic Republic of Iran: Common Indicator Required for Surveillance

(February 2018)

| | Date of latest Observation | Date Received | Frequency of Data[6] | Frequency of Reporting[6] | Frequency of Publication[6] |
|---|---|---|---|---|---|
| Exchange Rates | February 2018 | February 2018 | D | D | D |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1] | January 2018 | February 2018 | M | I | I |
| Reserve/Base Money | December 2017 | February 2018 | M | I | I |
| Broad Money | December 2017 | February 2018 | M | M | M |
| Central Bank Balance Sheet | January 2018 | February 2018 | M | M | M |
| Consolidated Balance Sheet of the Banking System | December 2017 | February 2018 | M | M | M |
| Interest Rates[2] | December 2017 | December 2017 | M | Q | Q |
| Consumer Price Index | January 2018 | February 2018 | M | M | M |
| Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4] | N/A | N/A | N/A | N/A | N/A |
| Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government | November 2017 | February 2018 | M | I | I |
| Stocks of Central Government and Central Government-Guaranteed Debt[5] | June 2017 | January 2018 | Q | I | I |
| External Current Account Balance | September 2017 | December 2017 | Q | Q | Q |
| Exports and Imports of Goods and Services | December 2017 | February 2018 | M | M | M |
| GDP/GNP | September 2017 | January 2018 | Q | Q | Q |
| Gross External Debt | December 2017 | February 2018 | M | Q | Q |
| International Investment Position[7] | N/A | N/A | N/A | N/A | N/A |

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions. Data received in local currency.
[2]Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, and notes and bonds.
[3]Foreign, domestic bank, and domestic nonbank financing.
[4]The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5]Including currency and maturity composition.
[6]Daily (D), weekly (W), monthly (M), quarterly (Q), annually (A), irregular (I), and not available (NA).
[7]Includes the external financial assets and liabilities vis-à-vis nonresidents of the financial sector.

**Statement by Jafar Mojarrad, Executive Director for the Islamic Republic of Iran**
**March 21, 2018**

My Iranian authorities thank Ms. Purfield and her capable team for the high-quality report and for their candid assessment and sound policy advice. The authorities are also thankful for Fund technical assistance in support of their reforms. The Article IV discussions this year rightly focused on parameters, pace, and sequencing of an economic reform agenda aimed at macroeconomic stability and job creation. The authorities agree with the thrust of staff assessment and recommendations.

## Recent Economic Developments and Outlook

The landslide re-election of President Rouhani for a second term in May 2017 ensured the continuation of economic policy reforms. The implementation of the Joint Comprehensive Plan of Action (JCPOA) and the lifting of nuclear-related sanctions in January 2016 paved the way for Iran's reintegration into the global economy. Notwithstanding external uncertainties, Iran has made significant gains since 2016 in restoring macroeconomic stability and pushing ahead with structural reforms, with the welfare of population as its focus. The restoration of Iran's oil production to pre-sanction levels and the firming up of international oil prices provided a major boost to the oil sector, with significant knock-on effects on nonoil activity. After the initial spurt to 12.5 percent in 2016/17 (Iranian year starting March 21), real GDP growth moderated to around 4 percent, but with greater depth and breadth. Staff projects growth to be range-bound around 4 percent over the medium term. The authorities feel that, given the country's abundance of natural resources and human capital, Iran's growth potential is conceivably higher; indeed, higher growth rates are needed to strengthen the economy's resilience to external shocks, absorb Iran's highly educated youth in the labor force, and eradicate absolute poverty. They further believe that prudent macroeconomic policies and deep and multi-faceted structural reforms are key to achieving these objectives, but with the recognition that realizing the economy's potential will be facilitated by the full normalization of international trade and financial relations.

One of the major achievements during the government's first term was to lower inflation from over 40 percent in 2013 to around 10 percent by end-2015—a level that has been maintained since—through prudent fiscal and monetary policies. Stabilizing inflation at low levels, while reducing fuel subsidies, anchored economic policy and lessened the burden on the population, especially the vulnerable who were also supported by income transfers during the transition. Unemployment also edged down, but remained high, especially among Iran's educated youth and women.

With higher oil exports and firmer prices, and despite higher imports following removal of nuclear-related sanctions, the current account recorded a surplus of around 4 percent of GDP in the past two years. In 2016, the full year in which sanctions were lifted, exports to the EU jumped by 344 percent and imports by 26 percent, albeit from sanction-depressed levels, and this accelerating trend is likely to have continued into 2017. Despite the positive current account outcome, foreign reserves declined, and Central Bank of Iran

(CBI) had difficulties in accessing its foreign assets maintained with some trade partners. Still, foreign reserves remain sizable (15 months of imports) and foreign debt is minimal (2 percent of GDP). With inflation more firmly anchored around 10 percent, the CBI depreciated the official exchange rate more aggressively and moved more imports from the priority list to market rate, but market pressures intensified in late 2017 and early 2018 mainly because of speculative activities.

My authorities are in broad agreement with staff regarding the balance of risks to the medium-term outlook. Adverse geopolitical developments and lower oil prices are the major external risks and constant reminders of the need for a proactive policy of building strong fiscal and external buffers. While external factors may affect the pace of reforms, they will not sway the authorities from the path of reforms. The authorities are indeed committed to pushing ahead with the reform agenda enshrined in the Sixth Five Year Development Plan ($6^{th}$ FYDP, 2016/17-2020/21) and many of the initiatives planned for 2018/19 and beyond are consistent with the $6^{th}$ FYDP medium-term objectives and targets.

**Fiscal Policy**

The "augmented" central government deficit narrowed to 2.3 percent of GDP in 2017/18 through expenditure restraint and strengthened tax administration. As noted by staff, tax collections have exceeded oil revenues as the main source of budget revenue since 2015/16—a major step towards reducing Iran's reliance on natural resources. Regularization of historical government arrears in the last two years brought greater transparency to government obligations, while at the same time increasing the debt-to-GDP ratio almost four-fold to close to 50 percent in 2016/17. Higher oil revenues in 2018/19 will allow government to increase spending on infrastructure and social welfare, while trimming the deficit even further to 2.1 percent of GDP. The authorities are cognizant of the need to create fiscal space, not only to meet the interest bill related to bank recapitalization and arrears securitization—which together is estimated to increase from 0.2 percent of GDP in 2017/18 to 5.2 percent of GDP in five years—but also to meet infrastructure needs and take a leap forward towards the longer-term objective of eradicating absolute poverty in Iran. The staff recommendation of generating 4-5 percent of GDP in savings over the next 4-5 years through subsidy reform, expenditure restraint, and revenue effort seems feasible, but contingent on garnering broad political and public support. Fuel subsidies will be eliminated before end-2020/21 and the cash transfer program will be better targeted by removing the richest 20 percent of household recipients. More targeted means testing will be conducted to restrict cash transfers to the neediest. Disbursements by the National Development Fund of Iran (NDFI) will also be curtailed as a smaller share of oil revenues will be transferred to it, and as a better-capitalized banking sector will assume a larger role in lending to the private sector. NDFI financing will also be gradually restricted to infrastructure development in needy and remote areas where bank financing is not typically available. On the revenue front, the focus will be on expanding the tax base and reducing and, to the extent feasible, eliminating tax exemptions, especially those benefiting foundations and other entities. In this regard, tax exemption of the largest religious foundation in Iran was withdrawn earlier this month, with significant revenue implications. Review of other entities' exemptions is in progress.

On the institutional side, performance-based budgeting is already in place in one third of all ministries and transition to accrual-based accounting is in progress. Together with greater transparency by recognizing government obligations, the authorities are developing a comprehensive debt management strategy. The medium-term budgetary framework will also be strengthened, and annual budgets will be better aligned with 5-year plans, placing greater focus on nonoil primary balance for formulating fiscal policy.

**Monetary and Exchange Rate Policies**

The CBI is determined to preserve the significant gains already achieved on the inflation front. Formally establishing low and stable inflation as the central bank's primary policy objective is one the key elements of the CBI bill before parliament. Inflation pressures in past years have generally stemmed from pass-through of exchange rate depreciation, administered price adjustments, and high rates of liquidity expansion. While these pressures are moderating, they are expected to persist until the ongoing reforms are well entrenched. With this in mind, the CBI is determined to tighten monetary conditions: measured by CD rates issued by banks (with a return of 20 percent on rial-denominated CDs and 4 percent on exchange rate-linked but rial-denominated CDs), real interest rates are significantly positive. Additionally, CBI lending to banks—including paying depositors of Unlicensed Financial Institutions (UFIs), all closed since September 2017; assistance to distressed banks; and targeted schemes—is being contained, and the CBI is making emergency liquidity support to banks contingent on advance submission of liquidity management plans. The CBI bill before parliament also contains provisions to modernize the monetary policy framework, including through greater use of market-based instruments for liquidity management, developing an interbank market, and enhancing central bank independence and operational autonomy.

On the exchange rate front, the gap between the official rate and market rate, which was around 30 percent in early 2018, narrowed somewhat after the CBI allowed banks in February to issue high-yield CDs. The premium that the market rate holds over the official rate has, however, widened somewhat in more recent weeks largely due to seasonal factors ahead of the Iranian New Year.

My authorities consider exchange rate unification as the lynchpin of their reform program. The initial timeline to unify the rates by March 2018 has slipped by one full year, primarily because of heightened external uncertainties that are pressuring the market, and weak correspondent banking relationships (CBR). These constraints make it difficult for the CBI to step in effectively at times of intense exchange market pressures. Nevertheless, in preparation for eventual unification, and in addition to tightening macroeconomic policies and depreciating the official rate, the implicit subsidy element in the official rate is being gradually eroded by trimming the priority list imports that are effected at the official rate; as of February 2018, 78 percent of all imports in terms of product code and 48 percent in terms of value were at the market rate, and the shares are rising. The intention is that, starting in early 2018/19, all imports are moved from the priority list to the market rate, with notable exception of basic foodstuffs and medicine. Once a critical mass of imports with a sufficiently high share of total value is moved to the market rate, and once other supporting conditions are comfortably in place, the rates could be unified with a lower risk of undershooting or chasing a moving target. Following unification, the intention is to revert to the managed floating system of the past.

**Financial Sector**

The Iranian banking system, still burdened by past policy mismanagement and legacy issues, has been in distress for a few years. Although the situation varies considerably among banks, many banks—both in the public and private domain—are saddled by high NPLs, inadequate capitalization and bad-loan provisioning, and low profitability. The UFI problem that surfaced in earnest last year prompted the CBI to close several UFIs or merge them with commercial banks, transfer their balance sheets to licensed credit institutions, and amend the legal framework to make the CBI the sole responsible body for licensing and regulating all financial institutions. Important progress has also been achieved on several other fronts. As mentioned earlier, an audit identified additional legacy government debt to various creditors, including banks. Interest-bearing and marketable securities were issued by the government to partially clear its arrears and support banks' income, while restricting dividend payments. Banks are undercapitalized; the government also issued securities to partially recapitalize some state banks. The CBI is planning to launch an Asset Quality Review in early 2018/19, with MCM advice, to quantify the exact recapitalization need of banks. Amendments to banking law, pending with parliament, aim to strengthen the CBI's supervisory authority and its resolution powers, which are critical in the major restructuring of the banking system that is underway.

Amendments are also with parliament to bring the AML and CFT laws fully in line with international standards, and dedicated AML/CFT units are already operational in virtually all banks. Progress is evident in Iran gaining observer status in the Eurasian AML/CFT group. Moreover, the CBI has already requested an IMF assessment of the AML/CFT framework to be completed by late 2019. My authorities once again reiterate their commitment to full compliance with AML/CFT international norms, guidelines, and provisions.

The authorities are concerned about the rising deficit of the pension system, and are aware that the current high youth unemployment and the evolving demographics over the next 2-3 decades are not working in Iran's favor as far as financing of the social security system is concerned. Many of the largest public employers in Iran (e.g., the national oil company, state banks, national railways) have their own well-funded pension schemes, but that does not diminish the importance or urgency of increasing the transparency, broadening the coverage, and improving the finances of the general pension system. Iran has already benefitted from Fund TA and a parametric pension reform plan is being developed in line with staff recommendations.

**Structural Reforms**

Iran's structural challenges and policy and reform agenda are outlined in the 6th FYDP. Broadly, the aim is to reduce the economy's reliance on the energy sector through diversification, notwithstanding the country's abundant oil and gas reserves; improve the business climate and broaden the role of the private sector; close the infrastructure gap; and most importantly create jobs for Iran's highly-educated youth. Youth unemployment in Iran has a deep-rooted structural element and addressing it requires a holistic approach, long-term commitment, and adequate funding. The problem arises, inter alia, from the high capital-intensity of production (oil and gas and other minerals), a young population profile, skill mismatch, high reservation wages, limited labor mobility due to the high housing cost, family protection for the unemployed, and social norms. The coverage of female employment issues in the report is praiseworthy; however, in the context in which it is raised, we fail to see the link between limitations on women foreign travel and the issue of women seeking employment or starting businesses in Iran. Young women in Iran are, on average, better educated than men and the share of women with tertiary education is above men's. It is more likely that the low female labor force participation (FLFP) reflects under-or-nonreporting of part time work, social norms against women working in certain occupations (i.e. construction, transportation, forestry and fishery, but not agriculture), and limited availability of affordable child care. Despite the low FLFP, the share of women in total employment increased by 4 percentage points between mid-2014 to mid-2017. Nevertheless, increasing FLFP is imperative to raising Iran's growth potential.

Creating jobs for Iranian youth, both men and women, has many overlapping elements, but it may be more difficult for women as the skill mismatch is greater and social and cultural norms are stronger. As also noted by staff, the authorities are planning to introduce a nation-wide pilot internship program in conjunction with a two-year exemption from social security contributions to employers retaining interns. Courses on entrepreneurship skills are now being taught in secondary schools and it is planned to create incentives, or increase penalties, in the reformed pension system to extend employment tenure.

Most other structural reforms hinge on the normalization of international trade, investment, and financial relations. FDI is critical to Iran's future growth in both the oil and nonoil sectors. As reported by staff, FDI approvals jumped almost five-fold in 2016 following the removal of nuclear-related sanctions early that year, although because of their typically long gestation period the associated inward flows are still to be reflected in the balance of payments data. In the oil sector, the new model of oil contracts (Iran Petroleum Contracts) created greater incentives for foreign operators and investors. New large-scale projects with foreign participation were also approved in copper and other minerals, of which Iran holds substantial reserves. The business environment is improving, despite difficult external circumstances—notably weak CBR—but much remains to be done. The high administrative cost of delays in processing exports is expected to be greatly alleviated by the proposed amendments to the customs law. Access to finance is probably the greatest constraint on businesses, which a recapitalized and healthier banking system is expected to address more effectively. Finally, Iran is tackling a number of important environmental issues in the areas of water management, air pollution control, and protection of green areas and forests, and is an active participant in international environmental fora.

**Conclusion**

The Iranian economy continued to strengthen in 2016 and 2017, supported by sound economic and financial policies and major reforms, successful implementation of the JCPOA, and recovery of oil production and prices. The implementation of the JCPOA generated optimism in Iran that trade and financial normalization will usher in investment and durable economic prosperity. The "dividend" however has been so far small and uncertain. My Iranian authorities expect that most JCPOA P5+1 signatories will adhere to the letter and the spirit of the agreement, and with that expectation, they are pressing ahead with their economic reform program, with the ultimate objective of bringing back Iran and its people to a level of prosperity that is more in line with the country's wealth of natural resources and human capital. At the same time, they are confident that greater global integration benefits all.

On this auspicious day of Iranian New Year, which conveys a message of peace and prosperity to mankind in a tradition that goes back thousands of years, I join my Iranian authorities in thanking Fund staff, management, and the Executive Directors for their continuous support.