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ISLAMIC REPUBLIC OF IRAN

December 2015

2015 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 2015 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 December 7, 2015 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 December 7, 2015, following discussions that ended on September 30, 2015, 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 November 18, 2015.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Islamic Republic of Iran.

The documents listed below have been or 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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December 21, 2015

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Washington, D. C. 20431 USA

IMF Executive Board Concludes 2015 Article IV Consultation with Iran

On December 7, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Iran.

The sharp decline in global oil prices, tight corporate and bank balance sheets, and postponed consumption and investment decisions ahead of the expected lifting of economic sanctions, have significantly slowed down economic activity since the fourth quarter of 2014/15. Real GDP growth is projected to decline from 3 percent in 2014/15[2] to somewhere between 0.5 to -0.5 percent in 2015/16. Twelve-month (point-to-point) inflation has declined to around 10 percent in recent months, largely reflecting lower food and beverage inflation, and the inflation rate is expected to remain close to 14 percent by year-end.

Prospects for 2016/17 are brighter, owing to the prospective lifting of economic sanctions. Higher oil production, lower costs for trade and financial transactions, and restored access to foreign assets, are expected to lift real GDP to about 4–5.5 percent next year. Much of the acceleration in growth will also depend on the spillovers from increased oil production to the rest of the economy. Higher oil revenue and terms of trade, and renewed access to foreign assets and capital can lead to appreciation pressures on the real exchange rate. Continued gradual fiscal consolidation—including by sustaining tax revenue mobilization and subsidy reform efforts—

[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.

[2] Iran fiscal year ends March 20.

and prudent monetary policy, anchored by the authorities' goal of achieving single-digit inflation by the end of 2016/17, can mitigate these upward pressures. With reforms to the policy framework, bank balance sheets, and taxation, real GDP growth would stabilize at around 4 percent over the medium term. Comprehensive reforms to the business environment are needed over the medium term to ensure that the expected lifting of economic sanctions has a significant impact on confidence and investment and places the economy on a higher and more inclusive growth trajectory.

Executive Board Assessment[3]

Directors commended the authorities for the progress in improving macroeconomic conditions in a difficult economic environment. Notwithstanding the sharp drop in global oil prices, Directors noted that economic conditions should improve in 2016 and beyond, with the expected lifting of economic sanctions. However, they stressed the need to advance comprehensive reforms to the policy framework and the economy to sustain progress on macroeconomic stability and to improve growth prospects.

Directors encouraged the authorities to maintain their focus on disinflation. While acknowledging the current weaknesses in the economy, they urged the authorities to implement the recent stimulus package cautiously and to support it by announcing broad money and inflation objectives for 2016/17 to better anchor inflation expectations and the exchange rate. Directors looked forward to the enactment of the new Money and Banking law to strengthen the central bank's legal mandate on price stability, and encouraged efforts to improve communication and transparency.

Directors underlined the importance of prompt and comprehensive reforms to address financial sector challenges. They welcomed the steps taken to assess the financial health of banks and the draft bill to strengthen the prudential supervision framework. Directors stressed the need for a steadfast restructuring of nonperforming loans and banks and addressing unlicensed financial institutions, which would also help lower the high levels of real interest rates. Decisive action on addressing government arrears would also help strengthen banks' balance sheets. Directors

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[3] 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.

urged the authorities to bolster the AML/CFT framework to facilitate the re-integration of the domestic financial system into the global economy.

Directors welcomed the commitment to fiscal consolidation, noting the progress in mobilizing domestic revenue and advancing the subsidy reform agenda. Looking forward, they stressed the importance of public finance management reform, and encouraged the authorities to establish a medium-term perspective to fiscal policy formulation, targeting the non-oil balance, rebuilding buffers, and enhancing transparency. Directors underlined that bringing the non-oil fiscal deficit closer to its long-run sustainable level would also support the disinflation objective. To achieve this goal, continued efforts to mobilize domestic revenue will be needed, as well as further adjustment in domestic fuel prices to help contain the deficit of the Targeted Subsidy Organization.

Directors encouraged the authorities to press ahead with an ambitious structural reform agenda, including by fostering conditions for more inclusive growth, particularly for youth and female employment. These efforts will require further development of the private sector, reforms to unlock productivity, including by lifting price and administrative controls, and greater transparency and accountability. With comprehensive reforms, the expected lifting of sanctions should help place the economy on a higher growth trajectory.

Directors welcomed the authorities' commitment to unify the foreign exchange market by end-September 2016, and encouraged the prompt removal of the foreign exchange restriction and multiple currency practices. While welcoming recent progress, Directors advised further improving the timeliness and quality of official statistics.

Table 1. Islamic Republic of Iran: Selected Macroeconomic Indicators, 2013/14–2020/21 1/

	2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
	(Annual change, in percent, unless otherwise indicated)							
National accounts								
Nominal GDP at market prices (in billions of Iranian rials)	9,421,216	11,033,666	11,992,122	14,042,908	15,934,661	17,694,609	19,371,763	21,150,347
Real GDP at factor cost	-1.9	3.0	0.0	4.3	4.0	4.1	4.4	4.4
Real oil and gas GDP	-8.9	4.8	0.5	16.9	8.8	2.9	2.5	2.5
Real nonoil GDP	-1.1	2.8	-0.1	2.8	3.4	4.3	4.6	4.6
CPI inflation (average)	34.7	15.5	15.1	11.5	8.3	6.3	5.0	5.0
CPI inflation (end of period)	19.7	16.2	14.0	9.0	7.5	5.0	5.0	5.0
GDP deflator at factor cost	34.3	12.2	8.7	12.3	9.1	6.6	4.9	4.6
Unemployment rate (in percent of labor force)	10.4	10.6	11.9	12.5	12.6	12.4	12.2	11.9
	(In percent of GDP)							
Budgetary operations								
Revenue	14.1	14.6	13.2	14.5	15.5	15.4	15.4	15.4
Taxes	5.2	6.4	6.8	7.2	7.6	7.7	7.9	8.1
Other revenue	8.8	8.1	6.4	7.3	7.9	7.7	7.6	7.3
Of which: oil revenue	6.5	5.7	3.9	4.9	5.6	5.5	5.4	5.2
Expenditure	15.0	15.7	15.4	15.9	15.8	15.7	15.6	15.6
Expense	12.7	13.0	12.8	12.7	12.5	12.3	12.2	11.9
Net acquisition of nonfinancial assets	2.3	2.7	2.7	3.2	3.3	3.4	3.5	3.7
Net lending/borrowing (overall balance)	-2.2	-1.2	-2.5	-1.3	-0.3	-0.3	-0.2	-0.2
Net lending/borrowing (budget)	-0.9	-1.2	-2.2	-1.3	-0.3	-0.3	-0.2	-0.2
Balance of Targeted Subsidy Organization	-1.3	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Non-oil net lending/borrowing (in percent of non-oil GDP)	-10.6	-8.2	-7.2	-7.1	-6.9	-6.7	-6.5	-6.3
Financial assets	-0.5	-1.0	-1.1	-0.5	0.4	0.4	-0.1	0.0
Liabilities	1.7	0.2	1.4	0.9	0.7	0.7	0.1	0.1
	(Annual change in percent, unless otherwise indicated)							
Monetary sector								
Net foreign assets	131.0	1.3	31.2	15.0	14.6	11.8	10.5	9.5
Net domestic assets	-5.4	43.4	8.2	18.0	14.7	14.3	14.8	15.3
Credit to the private sector in rials	30.7	16.7	17.3	18.2	17.5	16.0	15.7	14.5
Base money	18.8	14.5	21.0	18.2	15.4	13.7	13.1	12.8
Narrow money (M1)	8.1	1.6	10.5	13.7	14.3	11.7	12.7	12.8
Broad money (M2)	39.5	22.4	20.0	17.1	15.4	13.7	13.1	12.8
	(In billions of U.S. dollars, unless otherwise indicated)							
External sector								
Current account balance	26.5	15.9	4.5	8.5	11.7	13.2	12.5	12.1
In percent of GDP at market prices	7.8	4.1	1.3	2.1	2.6	2.8	2.4	2.2
Exports of goods and services	100.1	93.9	74.3	90.5	104.0	111.9	117.8	124.4
Imports of goods and services	-75.2	-80.1	-72.5	-85.9	-97.5	-104.6	-111.1	-118.1
External and publicly guaranteed debt	6.7	5.1	8.9	10.7	13.3	15.9	18.7	21.8
Of which: short-term debt	0.8	0.4	4.6	6.2	7.8	9.3	10.7	12.2
Gross official assets/reserves	117.6	126.2	128.9	142.1	159.9	179.3	198.2	217.2
Oil and gas sector								
Total oil and gas exports (billions)	64.9	55.4	35.3	48.6	59.8	65.3	68.6	71.2
WEO Oil Price adjusted for Iranian year (per barrel)	103.7	83.3	50.7	52.9	57.6	61.0	62.6	63.0
Average oil export price (per barrel)	101.1	79.1	49.7	52.9	57.6	61.0	62.6	63.0
Crude oil exports (in millions of barrels/day)	1.13	1.16	1.24	1.81	2.13	2.22	2.29	2.38
Crude oil production (in millions of barrels/day)	2.85	3.09	3.11	3.7	4.0	4.2	4.3	4.4
	(In U.S. dollars, unless otherwise indicated)							
Memorandum items:								
Average exchange rate (Iranian rials per U.S. dollar)	24,770	26,492	...	…	…	…	…	…
End-of-period exchange rate (Iranian rials per U.S. dollar)	24,770	28,000	…	…	…	…	…	…

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

1/ The Iranian fiscal year ends March 20.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF IRAN

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION

November 18, 2015

KEY ISSUES

Context. After a 9 percent contraction over the previous two years, interim sanctions relief and prudent policies eased constraints on trade and financial transactions, improved economic activity, and lowered inflation in 2014/15. Although the decline in oil prices has negatively affected economic activity in 2015/16, the comprehensive agreement between Iran and the P5+1, if implemented successfully, should improve Iran's external environment and economic performance substantially going forward. However, Iran faces multiple constraints to unleash its growth potential and to achieve single-digit inflation sustainably. The economy's dependency on hydrocarbons remains high, the policy framework is not well-designed to respond to shocks, and structural vulnerabilities abound. Corporate and bank balance sheets are weak, unemployment is high, particularly among youth and women, and doing business is costly. Placing the Iranian economy among the top emerging market economies over the next decades will require comprehensive reforms.

Focus of the consultation: (i) sustain the progress made toward stabilizing macroeconomic conditions; (ii) enhance the policy framework, (iii) repair corporate and bank balance sheets; and (iv) strengthen growth potential and inclusive growth.

Key policy recommendations: (i) remain focused on disinflation through prudent fiscal policy and greater operational autonomy of the central bank; (ii) replenish fiscal buffers to better respond to shocks, while bringing a medium-term perspective to fiscal policy formulation; (iii) enhance the transparency and communications of monetary policy goals; (iv) strengthen the prudential and supervisory framework for the financial sector and proceed with banks' restructuring, resolution of nonperforming loans, and strengthening the AML/CFT framework; and (v) advance reforms to boost productivity and reduce the cost of doing business to foster employment and private-sector development.

Approved By
Aasim M. Husain and Taline Koranchelian

Discussions took place in Tehran during September 19–30, 2015. Staff representatives comprised M. Cerisola (head), O. Basdevant, R. Blotevogel (all MCD), C. El Khoury, and H. Pham (LEG). Mr. Husain (MCD) and Mr. Mojarrad (OED) also participated in some of the discussions. The mission met with Central Bank Governor (CBI) Seif, as well other senior government officials and private sector representatives. A. Sadeghi, M. Orihuela-Quintanilla, and N. Cayo assisted in the preparation of the report.

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CONTEXT

1. **The agreement on Iran's nuclear program and the envisaged lifting of economic sanctions have set the stage for improved macroeconomic performance, provided comprehensive reforms are implemented**. Prudent policies and the interim sanctions relief improved macroeconomic performance in 2014/15. But global oil prices have declined markedly and the economy faces complex structural challenges, with still high inflation and unemployment, weak bank and corporate balance sheets, and sizable government arrears. Reforming the policy framework and addressing these structural challenges are required to ensure macroeconomic stability, unleash high, inclusive, and sustainable growth (Figure 1). The authorities have made some progress in implementing recommendations made during the 2014 Article IV Consultation under difficult conditions. Further progress would require resolute action, greater coordination, and strong political support, against a complex socio-economic environment and parliamentary elections in February 2016.

Status of Staff Recommendations Made During the 2014 Article IV Consultation

Recommendations	Status
A Three-Pronged Strategy to Deal with Stagflation	
Tighter monetary policy to reduce inflation	Base money growth contained on the back of the termination of Central Bank of Iran (CBI) direct credit to the *Mehr* housing project. Government deposits at the CBI supported sterilization.
Fiscal consolidation to support disinflation	The fiscal deficit contained well below 2 percent of GDP in 2014/15 owing to revenue measures and tight spending.
Supply-side reforms	The authorities established a one-stop window for businesses and simplified administrative procedures.
Strengthening the Policy Framework for Macroeconomic Stability	
Strengthen the fiscal policy framework by improving coordination among the budget, the Oil Stabilization Fund (OSF) and the National Development Fund of Iran (NDFI)	There is still limited coordination between the management of OSF/NDFI and the budget, and medium-term fiscal objectives are not defined or used to anchor the budget. The authorities have yet to decide on how to rebuild buffers and bring more of a medium-term perspective to fiscal policy.
Advancing subsidy reform	Domestic fuel prices have been adjusted upwards by 20 to 40 percent in 2015 and the deficit of the Targeted Subsidy Organization (TSO) eliminated in 2014/15. No price-adjustment mechanism implemented yet.

Recommendations	Status
Strengthen price stability through improvements in monetary policy and the exchange rate	No change to the legal framework underpinning monetary policy. Several imports shifted from the official to the bureau market, and Fund TA has been provided on exchange rate unification.
Reforms to Promote Jobs and Growth	
Improving the business climate and address high unemployment	The cost of doing business and unemployment remain high.
Address banking sector vulnerabilities	Following Fund TA, the authorities have taken steps to improve banking sector surveillance. They are also preparing a strategy to deal with nonperforming loans (NPLs) and banking sector reform.
Strengthening the AML/CFT framework	CFT draft bill still pending.

Source: IMF staff.

MACRO-FINANCIAL DEVELOPMENTS, OUTLOOK, RISKS AND SPILLOVERS

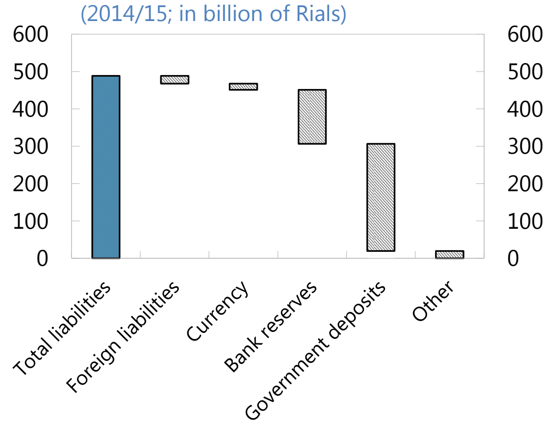
A. Recent Macro-Financial Developments and Outlook

2. **After growing 3 percent in 2014/15, economic activity is poised for a significant slowdown in 2015/16.**[1] The easing of trade and financial sanctions associated with the November 2013 interim agreement with the P5+1 provided a significant, but short-lived, impulse to the economy (Tables 1 and 2). The sharp decline in global oil prices, tight balance sheets, and postponed consumption and investment decisions ahead of the expected lifting of economic sanctions, have significantly slowed economic activity since the fourth quarter of 2014/15. Key sectors in the economy, such as manufacturing and construction, have contracted in the first quarter of 2015/16 (Figure 2). As a result, real GDP growth is projected to be between 0.5 and -0.5 percent in 2015/16, depending on the timing of the expected lifting of economic sanctions. Twelve-month inflation has declined to around 12 percent in recent months, largely reflecting lower food and beverage inflation, and is expected to rebound slightly to 14 percent by year-end, as the temporary effect of lower food prices wanes. (Figure 3).

[1] The Iranian calendar and fiscal years end on March 20th.

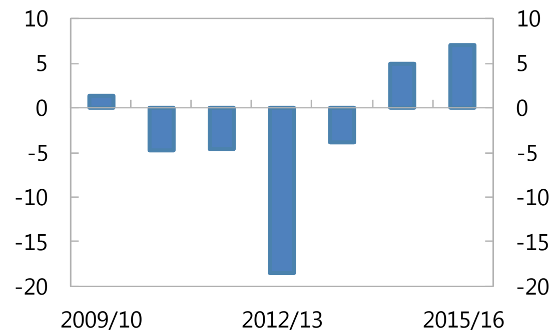
3. **The authorities have preserved prudent fiscal and monetary policies**. The overall fiscal deficit (cash basis) declined from 2.25 percent of GDP in 2013/14 to 1.25 percent of GDP in 2014/15, due to increased domestic revenues and the implementation of the subsidy reform, which brought the TSO into balance (Tables 3 and 4, and Figure 4). With the decline in inflation, interest rates became positive in real terms. In April 2014, an agreement between the CBI and commercial banks, aimed at better aligning market rates with inflation developments, capped deposit interest rates at 7–22 percent for maturities up to one year, while longer-term deposits were disallowed (Figure 5). Enforcing this agreement has been difficult due to weak bank balance sheets and competition from unlicensed financial institutions (UFIs).[2] In April 2015, the Money and Credit Council (MCC) of the CBI reduced the maximum deposit rate to 20 percent (Table 5). With the economy slowing down in 2015/16, the authorities announced measures to stimulate demand and activity (Box 1).

Change in CBI's Liabilities
(2014/15; in billion of Rials)



Source: Iranian authorities.

Real Lending Rate on Transaction Contracts
(end-of-period; in percent)



Note: 2014/15 lending rates on profit-and-loss sharing contracts were about five percentage points higher.
Source: Iranian authorities and IMF staff.

[2] Six UFIs reportedly represent 15 percent of deposits.

Box 1. Islamic Republic of Iran: The Package of Economic Stimulus

In mid-October, the authorities announced a series of measures that will be implemented to stimulate demand. Given the tight budget condition and the commitment to sustaining fiscal consolidation, most of the announced measures relate to monetary policy, to improving access to finance, and to easing "financial bottlenecks." Specifically:

Monetary policy. The CBI will supply resources in the interbank market to reduce the interbank rate and ease the tight liquidity conditions for some banks, and lower the cost of funding. The CBI would also reduce statutory reserve requirements for commercial banks from 13 percent to 10, differentiated by banks based on risk management, asset quality, and discipline. The MCC is considering to lower one-year deposit rates from 20 to 18 percent by late November.

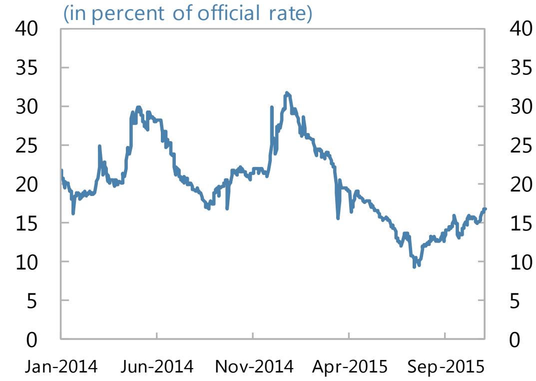
Access to finance. The CBI will instruct and provide sales revenue-backed funding to banks to grant facilities for the acquisition of durable consumer goods, such as automobiles. It will also provide incentives to extend the repayment and maturity of new facilities. It would also support some specific non-oil exports through the provision of $200 million in foreign exchange deposits at the Export Development Bank.

Financial bottlenecks. Continue to improve banks' balance sheets and capitalization through sales of assets and shares; advancing with the regulation of unlicensed financial institutions; developing a public debt market by securitizing government debt through the issuance of Sukuk and other Islamic debt instruments; and facilitating the use of letters of credit.

Staff estimates that a 1 percentage point reduction in statutory requirements for all banks would increase M2 by 4–5 percent. The impact of monetary and credit policies on economic activity is constrained by high inventories, low capacity utilization, and uncertainties ahead of the expected lifting of economic sanctions.

4. **The foreign exchange market has remained stable**. In the year to mid-October 2015/16, the rial depreciated by about 13 percent against the U.S. dollar in the official market, while the bureau market rate depreciated by about 7 percent. Given the strength of the U.S. dollar and high domestic inflation, the rial has appreciated by about 12 percent on a real effective basis over the past year. Following the interim sanctions relief in late 2013, the CBI has reduced import queues, gradually shifted some import categories to the bureau market, and took regulatory steps to strengthen its operational framework (Table 5).[3] The premium between the official and bureau exchange rates stabilized at 10–15 percent over the past several months, rising toward 18 percent following the announcement of package of economic stimulus.

Premium in the Bureau Foreign Exchange Market
(in percent of official rate)



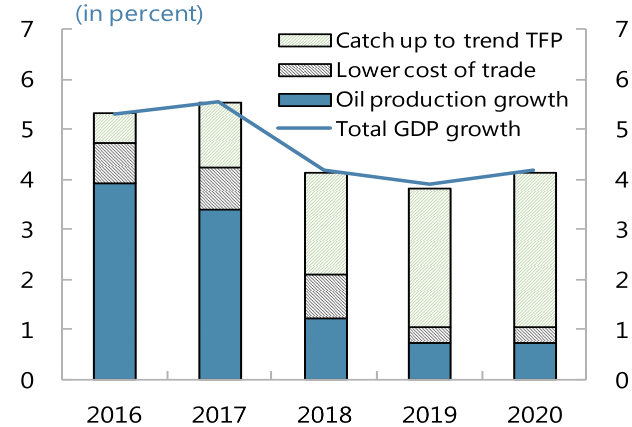
Source: Iranian authorities.

[3] Iran was able to drawdown about $700 million per month from its frozen foreign assets from international current payments.

5. **Structural weaknesses have become pressing**. Many large corporations have faced tight liquidity, lower equity prices, and pressures to reduce their leverage (Figure 6). Bank credit growth to the private sector has slowed to 15 percent (year-on-year) in July 2015/16, while bank credit to the public sector grew by 25 percent. Reported NPLs have remained high (at 12 percent of gross loans). Several weak state-owned banks have increasingly relied on the CBI's liquidity assistance, while the share of equity in banks' funding has dropped (Figure 7). The government accumulated arrears to suppliers over the past two years, which contributed to the rise in NPLs and also to higher bank credit to the government, as some contractors discounted government obligations with banks. As of June 2015, under- and unemployment rates remained high, at 9.2 percent and 10.8 percent, respectively.

6. **In spite of lower global oil prices, near- and medium-term prospects are brighter**. Higher oil production and exports on account of sanctions relief, lower costs for trade and financial transactions, and restored access to foreign assets, would be expected to lift real GDP growth to about 4–5.5 percent in 2016/17–2017/18.[4] A significant part of this growth would be the result of higher oil production, which could range from at least 0.6 millions of barrels per day (mbpd) to an official estimate of 1 mbpd. Lower trade and financial transaction costs would account for 0.75–1 percentage point of growth. Real GDP growth would then stabilize at around 4 percent annually over the next several years. Much of the acceleration in growth would depend on the spillovers from higher oil production to the rest of the economy and on addressing structural weaknesses—on the policy framework, taxation, and bank balance sheets—that should help productivity growth to gradually return to its long-run average (Box 2). Higher oil revenue and lower cost of trade and financial transactions, and capital inflows could lead to appreciation pressures on the real exchange rate. Continued gradual fiscal consolidation and prudent monetary policy, anchored by the authorities' goal of achieving single-digit inflation by end-2016/17, can mitigate these upward pressures and thereby preserve competitiveness (Table 6 and Figure 8).

Simulated GDP Growth
(in percent)



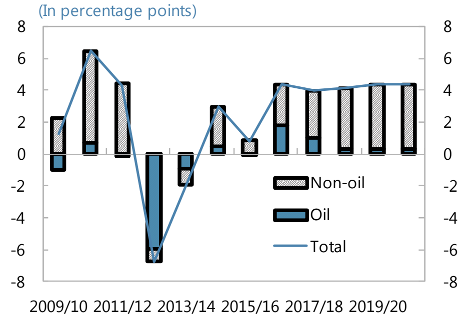
Source: IMF staff calculations.

[4] The amount of foreign assets that would become available for payment purposes is uncertain. Some of the CBI's foreign exchange assets are encumbered and/or illiquid, as they act as collateral for investments.

Box 2. The Current State of the Economy and the Growth Outlook

The Joint Comprehensive Plan of Action (JCPOA) between the Islamic Republic of Iran and the P5+1 comes after several difficult years for the Iranian economy. The economic sanctions imposed in 2012 led to a sharp contraction in economic activity, as well as higher inflation and unemployment. Over the previous decade, Iran had achieved significant convergence in per-capita income, mostly led by factor accumulation. TFP had decelerated substantially from the mid-2000s reflecting structural weaknesses in the economy (see 2014 Article IV Report).

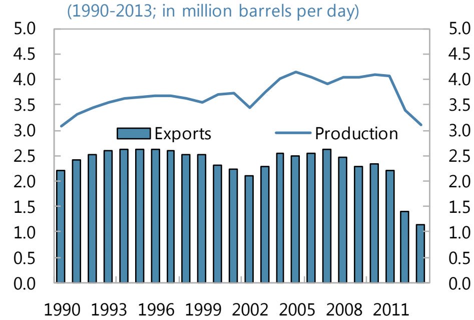
Contributions to Real GDP Growth
(In percentage points)



Sources: Iranian authorities and Fund staff estimates.

Much of the contraction in the economy was due to sharp drops in oil production and non-oil productivity. Oil production and total factor productivity (TFP) in the non-oil economy had already been on a stagnant/declining trend prior to the intensification of sanctions in 2012. The intensification of sanctions pushed TFP growth into negative territory and led to sharp contractions in production and exports in the hydrocarbon sector.

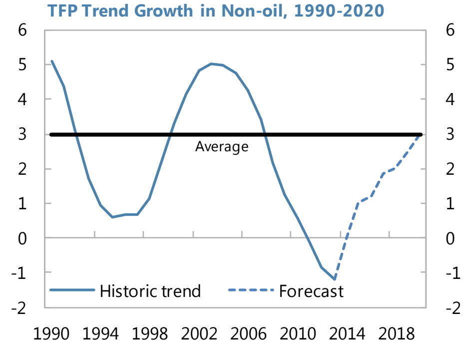
Crude Oil Production and Exports
(1990-2013; in million barrels per day)



Sources: EIA and OPEC.

The expected lifting of economic sanctions paves the way for an improved economic outlook. Higher oil output would bring spillovers to the rest of the economy and account for the bulk of the projected pick-up in activity in 2016/17 and 2017/18. In addition, lower trade and financial transaction costs could add about 0.75–1 percentage points to growth. With sanctions to be lifted, the non-oil economy should gradually improve its efficiency. In the near term, factor accumulation should contribute about half to non-oil GDP growth in the earlier years, which is projected to pick up gradually toward its historic average growth of 3 percent by 2020.

TFP Trend Growth in Non-oil, 1990-2020



Sources: Iranian authorities and Fund staff estimates.

The growth outlook is subject to large uncertainties. The path of oil production and exports in the years ahead depends on Iran's capacity to re-activate shut oil wells, regain market share, and mobilize foreign investment and technological expertise. In addition, the expected recovery in non-oil productivity growth could be impaired if balance sheet vulnerabilities in the corporate and banking sectors are not addressed.

Medium-Term Baseline Scenario, 2013/14–2020/21 1/

	2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
Real nonoil GDP growth (percent)	-1.1	2.8	-0.1	2.8	3.4	4.3	4.6	4.6
CPI inflation (end of period)	19.7	16.2	14.0	9.0	7.5	5.0	5.0	5.0
Non-oil net lending/borrowing (percent of non-oil GDP)	-10.6	-8.2	-7.2	-7.1	-6.9	-6.7	-6.5	-6.3
Current account balance (percent of GDP at market prices)	7.8	4.1	1.3	2.1	2.6	2.8	2.4	2.2
WEO Oil Price adjusted for Iranian year (per barrel)	103.7	83.3	50.7	52.9	57.6	61.0	62.6	63.0
Crude oil exports (millions of barrels/day)	1.13	1.16	1.24	1.81	2.13	2.22	2.29	2.38
Crude oil production (millions of barrels/day)	2.85	3.09	3.11	3.7	4.0	4.2	4.3	4.4

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

1/ The Iranian fiscal year ends March 20.

B. Risks and Spillovers

7. **Risks are significant and weighted to the downside**. On the external side, uncertainties associated with the post-sanctions regime and with risks of AML/CFT counter-measures could constrain foreign direct investment and capital inflows. Iran's full return to the oil market could bring oil prices down further, and force additional fiscal adjustment, with some negative impact on growth. Domestically, lack of progress with policy framework and structural reforms, including on bank and corporate balance sheets, would reduce prospects for safeguarding macroeconomic stability and fostering inclusive growth (Table 7). A faster recovery in oil production and exports, along with strong foreign direct investment and broader structural reforms, could result in higher growth over the medium term.

8. **The global and regional implications of sanctions relief will be felt mainly through oil prices and trade**. The expected increase in oil supply from Iran would put downward pressure on global prices, by an estimated \$5–\$15 per barrel, boosting global GDP by an estimated 0.3 percentage point. While part of this impact may be already discounted in futures markets, a further decline could materialize when Iran's exports rise, depending on how other OPEC producers react. The potential for Iran to increase its non-oil trade is also large, with estimates from a gravity model suggesting that Iran's exports, at about 20 percent of GDP, are less than half of their potential.[5]

[5] For more on the regional implications, please refer to Chapter 5 of the Regional Economic Outlook for Middle East and Asia, October 2015. Available via the Internet: http://www.imf.org/external/pubs/ft/reo/2015/mcd/eng/mreo1015.htm

Risk Assessment Matrix 1/

Source of Risks	Relative Likelihood	Potential impact
Spillover Risks		
Risk to energy prices: • Increased volatility due to uncertainty about oil prices. • Persistently low prices.	Medium Medium	High A decline of $10 per barrel would put pressure on the fiscal balance by about 1 percent of GDP, and on the trade balance by about 1.75 percent of GDP. It could reduce private investment because of adverse impact on expectations and perceived increased credit risks. Persistent lower prices would also put pressure on the exchange rate and warrant further fiscal adjustment over the medium term.
Heightened risk of fragmentation/state failure/security dislocation in the Middle East, leading to a sharp rise in oil prices, with negative spillovers.	Medium	Medium Higher oil prices would improve Iran's external and fiscal positions with the reverse magnitude mentioned above. However, an economic slowdown in the world economy and potential disruptions in the region would imply adverse spillovers to Iran.
Growth in China • Weak medium-term growth • Sharp slowdown in 2015–16	Medium Low	Medium While China accounts for about 40 percent of Iranian oil exports since mid-2012, the expected lifting of economic should allow Iran to replace Chinese import demand with exports to other destinations. Non-oil exports could be more significantly affected.
Domestic Risks		
Intensification of weaknesses in bank and corporate sector balance sheets	High	High Cash flow problems in the corporate sector would further impair the financial health of Iranian banks. Pressures for the CBI to ease monetary policy to avoid bankruptcies may undermine the CBI's commitment to price stability.
Uncertainties related to the implementation of the nuclear-deal and post-sanctions "snapback provisions."	Medium	High Growth would be negatively affected by the re-imposition of sanctions, and related lower direct investment and capital inflows.
Delayed structural reforms to buttress economic growth, improve governance, and reduce unemployment	Medium	High A further delay in structural reforms could reduce growth prospects and limit progress in reducing the high unemployment rate.
Continued procyclical policies and limited progress in strengthening the monetary and policy frameworks	High	Medium Without fiscal and monetary policy reform there is a risk of continued procyclical policies, persistent inflation, real exchange rate appreciation, and eroding competitiveness.

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 of risks listed 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.

POLICY DISCUSSIONS

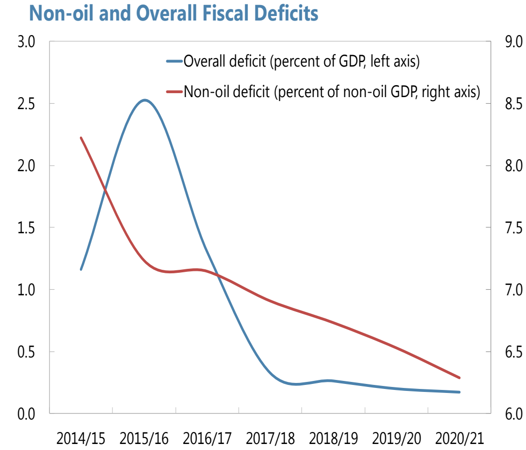
Discussions focused on policies and reforms needed to sustain progress toward macroeconomic stability in a lower oil price environment, to strengthen corporate and bank balance sheets, and to promote high and sustainable growth to reduce unemployment, particularly among youth and women.

A. The Macro Policy Setting in a Post-Sanction Economy with Lower Oil Prices

9. **The authorities remain committed to pursuing sound macroeconomic policies but acknowledged rising pressures to ease the policy stance**. The slowing of the economy, high real interest rates, stagnant credit, and the weak state of the corporate and banking sectors, exacerbated by the sharp decline in global oil prices, have intensified pressures to ease the stance of policies ahead of the expected lifting of sanctions in late 2015/16 or soon after. The authorities expect that the lifting of sanctions would provide a better environment to sustain sound macroeconomic policies and advance needed reforms. In the meantime, they stressed that fiscal consolidation would remain the backbone of macroeconomic stability and saw a need for monetary policy to stimulate economic activity.

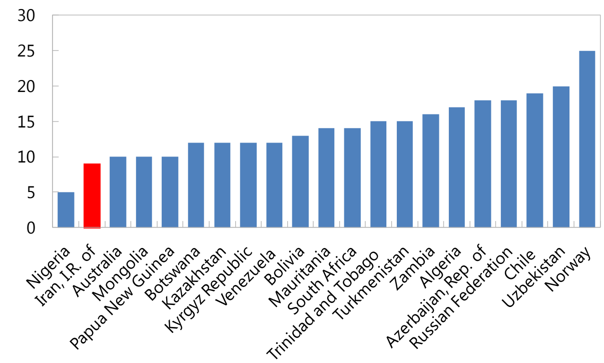
10. **While the sharp decline in oil prices complicated fiscal sustainability, the authorities remained committed to sustaining fiscal consolidation ahead**. The government deficit is expected to rise to 2.5 percent of GDP in 2015/16 (from 1.25 percent in 2014/15), mostly as a result of lower oil budget revenues, which would also result in a deficit at the TSO. The authorities intend to keep current spending restrained, which would allow for the non-oil deficit to decline from 8.25 percent of non-oil GDP to about 7.5 percent of non-oil GDP in 2015/16. Staff recommended not going beyond letting automatic stabilizers work in the event of a further slowdown in economic activity in 2015/16. Looking ahead, it was agreed that fiscal policy should remain focused on lowering the non-oil deficit to support disinflation, while also creating space for capital spending. In particular:

Non-oil and Overall Fiscal Deficits



- ***Staff recommended lowering the non-oil fiscal deficit to 6.5 percent of non-oil GDP over the medium-term***. A lower non-oil deficit would also bring it closer to the Permanent Income Hypothesis (PIH)[6] norm (estimated at about 5.5 percent of non-oil GDP). This would require continued efforts to mobilize domestic tax revenue and to reduce fuel subsidies, to also create much needed space for increased investment spending and support a growth-friendly consolidation. Staff encouraged the authorities to consider further increases in the VAT rate (which has been raised to 9 percent), a capital gains tax, and sustained efforts to reduce exemptions (including on the VAT). The authorities noted that a higher VAT rate was difficult to implement in current weak conditions. They were confident that the legislation removing exemptions to large nontaxpayers (in manufacturing and statutory bodies) and the implementation of an integrated tax system would help achieve fiscal sustainability, create more space for public investment, and reach the goal of financing 80 percent of current spending with tax revenues by 2020/21 (currently at 60 percent).

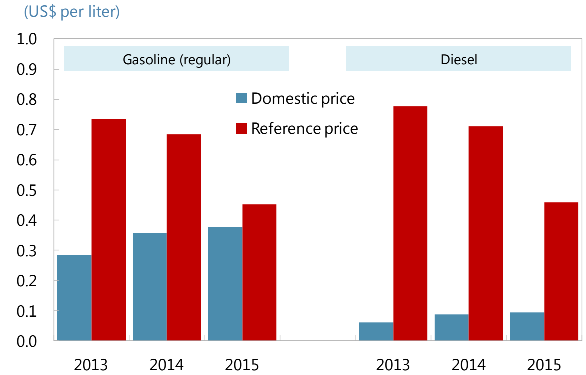
VAT Rates Accross Ressource-Rich Countries
(Percent)



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

- ***With lower oil prices and weakening TSO revenue, further domestic fuel price adjustments (particularly for diesel) are needed to rebalance TSO accounts, and to continue reducing implicit subsidies***. The authorities have persevered with the subsidy reform over the past year, by continuing to adjust domestic prices and by also eliminating some recipients from the cash transfer program. Staff noted that further adjustments could be underpinned by a formula-based price adjustment mechanism, such as price bands. The authorities noted that removing less vulnerable households remained challenging and agreed that doing so would help address other pressing needs and help consolidate the TSO balance.

Fuel Prices
(US$ per liter)



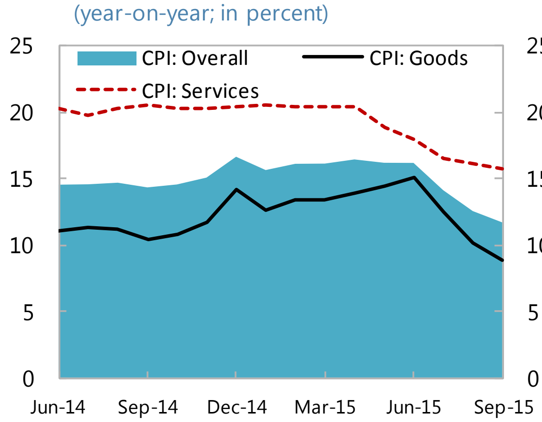
Sources: IEA, Iran authorities, and IMF staff estimates.

[6] Under the standard PIH approach, the non-oil fiscal deficit would be equal to the permanent income derived from the government wealth generated by oil revenue. The PIH is computed based on the net-present value of fiscal oil revenue from 2015/16 to 2050. See the Selected Issues Paper for further details.

11. **The authorities underscored the need for monetary policy to provide stimulus to economic activity in the near term without jeopardizing disinflation**. With inflation declining further this year and a benign outlook, they felt that some temporary relief to the economy was needed ahead of the expected lifting of economic sanctions. They noted that the complex difficulties experienced in the financial system, reflected by high nonperforming loans and competition from unlicensed financial institutions (UFIs), have brought real interest rates to very high levels that threaten macroeconomic stability. Therefore, they saw a need to continue to intervene in setting market interest rates and were considering implementing a package of measures to support demand and economic activity, most notably by lowering reserve requirements. In particular:

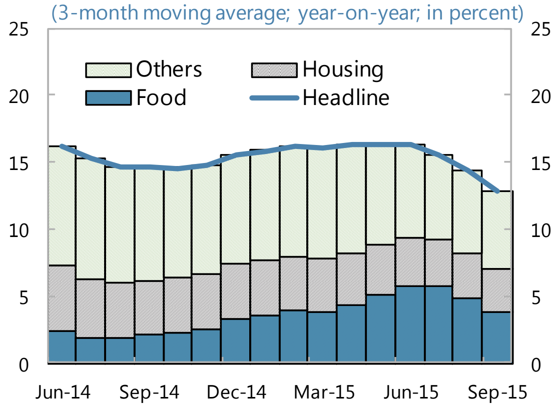
- ***Staff encouraged the CBI to remain focused on lowering inflation***. Staff cautioned that it was too early to assess whether the underlying inflation dynamics and its outlook had sufficiently changed to warrant an easing of monetary policy. Staff also stressed that real interest rates needed to remain positive for disinflation and lowering them sustainably required an urgent and steadfast restructuring of nonperforming loans and banks more broadly. Staff cautioned that the authorities' plans to ease monetary conditions brought risks to the exchange rate and inflation and, if implemented, needed to be done gradually and contingent on the inflation outlook. The authorities were confident that their policy package would be implemented prudently and would not jeopardize their gradual disinflation strategy. Additional steps to anchor inflation expectations, including by announcing broad money and inflation targets for 2016/17, would also assist in the disinflation efforts. CBI senior officials saw some merits in announcing targets in the near future and stressed the need to have better tools to support them.

Consumer Price Inflation
(year-on-year; in percent)



Source: Fund staff calculations.

CPI Inflation
(3-month moving average; year-on-year; in percent)



Source: Iranian authorities and Fund staff calculations.

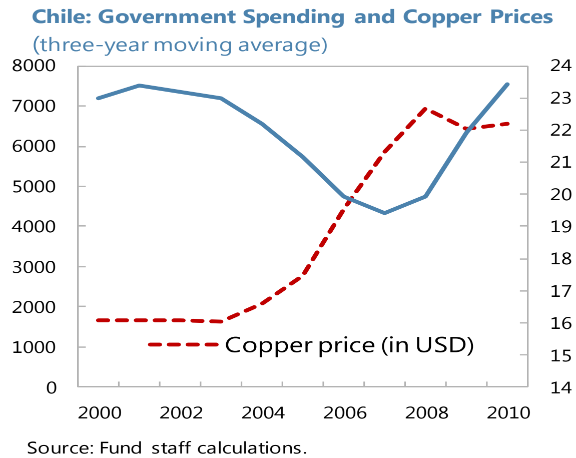
- ***Dealing with UFIs was also viewed as essential to lowering real interest rates***. Staff noted that the caps on deposit and lending interest rates were, in some instances, proving ineffective and, when effective, contributing to disintermediation, given the active role by UFIs in attracting deposits. The authorities noted that problems in one large UFI had discouraged disintermediation but noted that, given the long-standing presence of these institutions and financial stability risks, bringing them into the prudential supervisory framework was essential but still politically challenging. In addition, conducting on-site audits of all UFIs and penalizing licensed banks that provided UFIs operational support are also difficult to implement, but it was agreed that there was some scope to further encourage depositors to switch to licensed banks, including by taxing earnings on their deposits at UFIs. Staff emphasized that, with progress in restructuring nonperforming loans, market-determined interest rates would better reflect liquidity and risks across banks and thwart competition from UFIs.

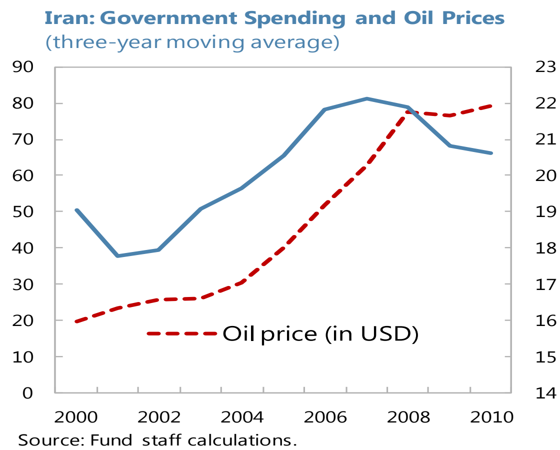
12. **The authorities reiterated their commitment to unifying the foreign exchange market and to preserving a competitive real exchange rate**. They noted that it would be easier to proceed with unification and to return to a managed float once sanctions were lifted. They are committed to implementing these measures by no later than September 2016. They also stressed the need to preserve flexibility and sound policies, given high inflation differentials and external risks. While the uncertainties beleaguering Iran's external environment cloud the assessment of the exchange rate, the authorities and staff agreed that the official exchange rate seems overvalued. In staff's view, the bureau exchange rate, which is about 10–15 percent more depreciated, appears better aligned with post-sanctions fundamentals (Appendix II).

B. The Policy Framework

13. **The authorities recognize the need for the policy framework to be able to respond to shocks preemptively and counter-cyclically**. Iran has saved part of its past oil revenue, but lacks formal buffers to protect the budget against oil price shocks—the Oil Stabilization Fund (OSF) has no resources and the National Development Fund of Iran (NDFI) cannot lend to the government. Fiscal policy lacks a medium-term perspective, with limited quantification of fiscal objectives and links with inflation and sustainable use of oil resources. Monetary policy had consistently prioritized output growth over price stability and would also benefit from greater transparency and communication.

14. **The authorities seek to strengthen the CBI's mandate on price stability**. They have presented to the government a new Money and Banking law that would strengthen the CBI's legal mandate on price stability and increase the role of technical experts in the decision-making process. Staff encouraged the authorities to issue a statement on the longer run goals and strategy for monetary policy, broadly similar to those of many advanced economy central banks. Such a statement would also better explain the tradeoffs and limitations inherent in monetary policy and the CBI's response to shocks. The authorities could also look for ways to strengthen communication and transparency, including by publishing a monetary policy report.





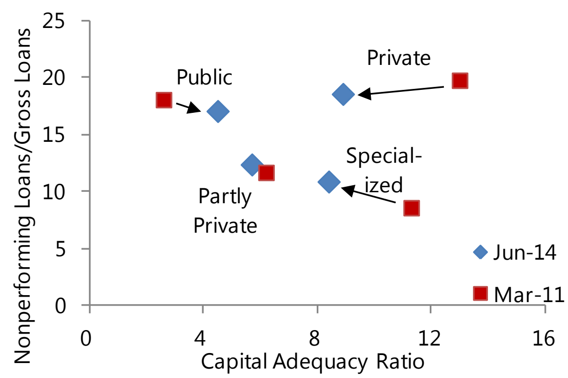
15. **The authorities agreed on the need for fiscal policy to be formulated within a medium-term framework, with increased buffers and improved transparency**. They were hopeful to develop a medium-term framework by improving the links between annual budgets and their 5-year development plans. They also saw merits in reinstating buffers, although they have yet to agree on how best to do it. Staff noted the need for oil revenues to continue supporting the budget in the coming years and the opportunity to also allocate instead a small portion of oil revenues to the OSF, subject to clear rules and accountability.[7] Discussions with senior government officials also revealed some consensus on articulating annual budgets around medium-term goals and having adequate fiscal buffers to smooth expenditure. While work on strengthening the framework for the NDFI continues, staff encouraged the authorities to clarify its intergenerational and developmental goals, with clear targets and greater transparency, including on its domestic lending and foreign investment policy.

[7] The general guidelines of the Sixth Five-Year Development plan stipulate the allocation of a third of oil revenues to the NDFI over the next five years, starting in 2016/17. For 2015/16, the allocation to the NDFI was reduced to 20 percent. No allocation to the OSF is envisaged under the guidelines.

C. Unlocking Balance Sheets: an Immediate Priority to Support Growth

16. **The complexity and severity of the challenges facing the banking system require immediate action**. There was agreement that these challenges were largely a legacy of past policies and external shocks. Banks are under-capitalized and asset quality is weak, with high nonperforming loans and low provisioning, and wanting risk management systems. Staff also noted that the financial difficulties among key shareholders, as private banks tend to be part of business conglomerates, was an important challenge for the CBI's prudential supervisory duties and for resolving nonperforming loans and recapitalizing banks.

Banking Sector: Financial Soundness Indicators
(March 2011 - June 2014; in percent)



Source: Iranian authorities.

17. **The authorities acknowledged the severity of the challenges and the need for comprehensive reforms**. The authorities emphasized that there is strong political support to advance reforms and are working on a strategy to reform the financial sector. They explained that an initial financial health check of banks had been finalized, suggesting substantially higher levels of NPLs, and they expect to initiate a more detailed assessment of the largest banks soon. As a condition to approve banks' full-year financial results, the CBI has mandated higher provisions and restricted dividend payments to protect bank capital. The authorities intend to submit soon an amendment to the Money and Banking law for Parliamentary approval that would strengthen the CBI's supervisory framework and help in supporting an overhaul of the financial system.

18. **The authorities and staff discussed several critical areas as part of their strategy to reform the financial system**. While the authorities saw a need to prioritize efforts in strengthening supervision and restructuring banks, they agreed that advancing simultaneously on all these areas was important to achieve lasting improvements. In particular:

- ***Supervision***. It is essential that the new banking law substantially strengthens the CBI's enforcement powers for supervision, bank resolution, and for dealing with UFIs. Within the existing legal mandate, the authorities saw scope to further improve the coordination between on- and off-site supervision, strengthen follow-up, and scale back noncore supervisory work. In moving towards risk-based supervision, the authorities aim to refocus on-site inspections on governance and risk management and address problems in supervisory data submissions.

- ***Restructuring NPLs***. Many successful episodes of bank restructuring in other countries have involved the establishment of a centralized asset management company (AMC) that could better deal with common debtors and avoid asset fire sales. Alternatively, a more mixed-approach involving private bank-operated AMCs with potential private/foreign participation could be a promising strategy for some better managed private banks. The authorities have yet to agree on a strategy and observed that the tight budgetary situation could constrain the funding of an AMC.

- ***Provisioning and capital***. The authorities intend to continue pressing banks to increase provisioning, based on realistic collateral valuations. Staff underscored the need for undercapitalized banks to expeditiously present recapitalization plans with clear timetables and be disallowed from paying dividends. These efforts should be facilitated by strictly enforcing loan classification standards. Enhancing tax incentives for provisioning loans of all vintages and imposing time limits to write-off nonperforming loans can also help accelerate NPL resolution.

- ***Reforming banks***. They need to be put on a sound commercial footing, so as for any recapitalization and resolution of NPLs to yield lasting improvements. The authorities agreed, noting that addressing shortcomings in risk management and governance was also critical. They also agreed that the elimination of government-mandated credit policies would help avoid a repeat of the many vulnerabilities present in the system.

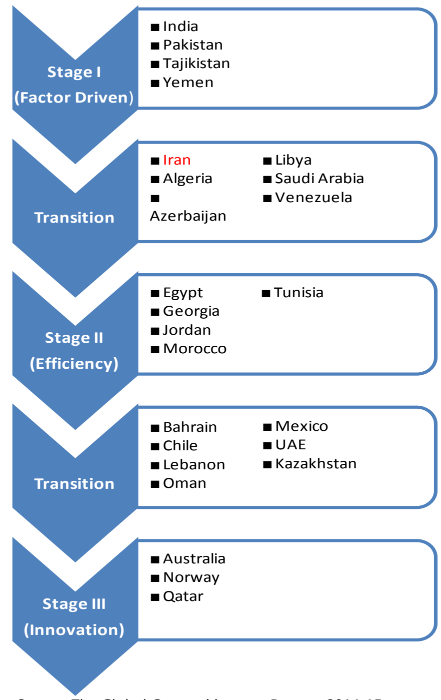
19. **The authorities viewed the securitization of government arrears and debt as an important reform to make banks' balance sheet more liquid**. Government arrears, mostly linked to suppliers and guarantees on infrastructure projects, were affecting banks' balance sheets and crowding out private-sector credit. The authorities were finalizing an inventory of all government arrears and a strategy to clear them with marketable securities. A pilot in October, involving the issuance of about 60 billion rials (about 0.5 percent of GDP) of securities to contractors was successful, with market conditions determining the yield. Staff recommended continued issuance of government securities at marketable terms, to repay or restructure these arrears, supported by a public issuance schedule. Staff also noted that the strategy needs to balance the inflationary implications of clearing arrears with cash with the potential pressure on market yields that could undermine the existing caps on banks' interest rates. A market for these securities would enhance the liquidity management toolkit of banks and the CBI, and help develop domestic capital markets.

20. **Bolstering the AML/CFT framework would facilitate the re-integration of the domestic financial system into the global economy, lower transaction costs, and reduce the size of the informal sector.** It will also help better detection of illegal proceeds, including those related to tax evasion and corruption. Staff urged the authorities to adopt a comprehensive CFT law that properly criminalizes terrorist financing (TF) and contains mechanisms for the implementation of United Nations Security Council Resolutions related to terrorism and TF. The authorities expressed commitment to advancing reforms to the AML/CFT framework. They have requested a Fund assessment of the AML/CFT regime against the FATF standard, which they

intend to use for joining the Eurasian AML/CFT group. Staff encouraged the authorities to conduct a national risk assessment and move towards risk-based AML/CFT supervision.

D. Structural Reforms: A more Efficient and Inclusive Economy

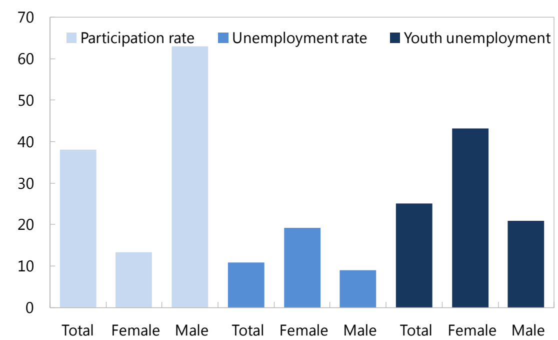
21. **The authorities and staff agreed that higher growth and reforms are critical to lowering unemployment**. Absorbing the large number of currently unemployed and future entrants to the labor market, notably youth and women, will require boosting productivity growth and other reforms to facilitate new jobs (Box 3). Addressing high underemployment and unemployment requires further development of the private sector, by bolstering private ownership and control, which in turn requires investment in human capital and infrastructure. Several issues were discussed:



Source: The Global Competitiveness Report, 2014-15

- ***Fostering greater youth and female employment***. Some specific measures could be targeted to arrest low participation and employment. Expanding child care in-work facilities for women and/or ensuring that adequate financial incentives are effectively provided in their absence is important. Reducing payroll taxes for youth and women would promote employment, which could be limited in duration or compensated with other indirect taxes to preserve budget-neutrality. These measures could be supported by establishing cost-effective skill-matching and training programs, for example along the lines of several programs in Europe and in the region. Unemployment insurance benefits are large, as they could exceed four years, and could be reassessed.

Employment Survey, June 2015
(Percent)

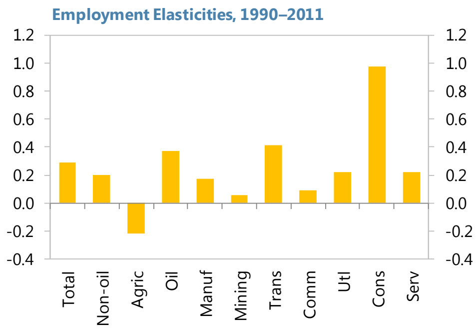


Sources: Iran authorities.

- ***Greater efficiency and innovation to unlock productivity gains***. There was agreement on the benefits of accelerating privatization and WTO accession. Discussions with private sector representatives revealed a need to reduce the cost of doing business, by improving governance, the rule of law, and transparency. Increasing competition and efficiency in key sectors of the economy, including through subsidy reform and the restructuring of the energy-intensive corporate sector, would be important steps forward.

Box 3. Iran's Employment Challenge and Sectoral Growth Pattern

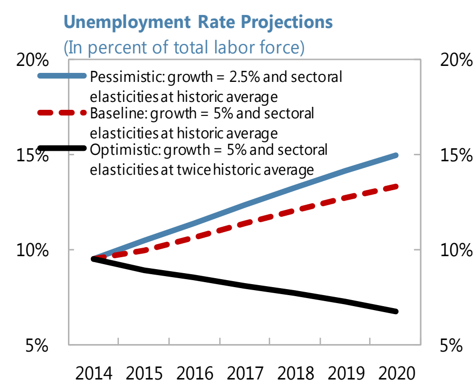
Unemployment is bound to rise unless growth accelerates or the job-intensity of growth improves significantly. Iran's labor force comprised 24 million people at end-2014: 21.5 million employed and 2.5 million unemployed, corresponding to an unemployment rate of 9.5 percent. Because of Iran's large student population, the labor force will grow by about 2.5 percent per year in the next five years, equivalent to about 3 million job market entrants.



Sources: Iranian authorities and Fund staff calculations.

Iran's economic sectors have, overall, displayed only a weak tendency to create jobs. The empirical (arch) elasticity of employment for Iran's economy from 1990–2011 was 0.3, relatively low compared to other emerging market economies such as Brazil and Lebanon. Large industry sectors, such as the oil and mining, are capital-intensive and can only employ a limited number of workers. The labor-intensive agricultural sector has underdone structural change, with a shrinking share of employment as workers search for better careers in other sectors. Other sectors such as construction and transportation have exhibited the largest employment sensitivity to growth, accounting for more than half of all jobs created. Job creation in services, the largest sector in the economy, has been weak, with a below-average employment elasticity.

Simulations reinforce the need to boost growth and enhance job creation. In an optimistic scenario, the combination of high growth rates following sanctions relief and reforms to boost job creation in six job-generating sectors (manufacturing, transportation, communications, utilities, construction, and services; oil, mining, and agriculture would add no additional jobs) would bring down the unemployment rate to single digits. If, on the other hand, growth were to disappoint at an average of 2.5 percent and sectoral employment elasticities in six sectors at their historical averages, the unemployment rate would rise to 16 percent over the medium term. Finally, the baseline scenario with high growth following sanctions relief and unchanged employment elasticities would still see unemployment rising to 14 percent.



Source: IMF staff calculations.

The sectoral pattern of growth will also determine the prospects for sufficient job creation. The construction sector absorbed more than a third of all new labor over the past two decades. Accordingly, the best-case scenario projects that the construction sector will add another 1 million new jobs by 2020, accounting for a quarter of the employment increase. However, construction has traditionally not been well suited for Iran's skilled and well-educated student population, which will make up the bulk of future labor market entrants. Employment growth in sectors better suited for high skilled workers—such as professional services, IT, and communication—is the key to addressing the employment challenge in Iran. Accelerating employment creation in these sectors will require comprehensive labor, product, and capital market reforms, which will boost productivity growth and increase the sectoral elasticity of labor demand.

OTHER ISSUES

22. **Staff noted that broader data provision and dissemination could strengthen the depth and quality of surveillance**. A broader range of economic indicators and reporting on policy outcomes at a higher frequency, such as on fiscal-related data, economic activity, and the labor market would be especially useful. Staff welcomed the authorities' efforts to strengthen national accounts statistics, with support from Fund TA. The authorities were still working on the reconciliation of external (technical) arrears and their repayment modalities.

23. **The current exchange rate regime continues to give rise to several multiple currency practices and an exchange restriction subject to Fund approval under Article VIII, Section 2(a)**. The continuing legal existence of both the official and bureau markets with their respective exchange rates, which differ by more than two percent, gives rise to both a multiple currency practice and an exchange restriction.[8] Two other multiple currency practices are in place, which arise from the differences of more than two percent between the current official 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.[9] The authorities' recent clarification of foreign investors' right under the Foreign Investment Promotion and Protection Act to obtain foreign exchange for profit transfers and for making other investment-related current international payments removed the previously identified exchange restriction relating to this act.

STAFF APPRAISAL

24. **The agreement on Iran's nuclear program and the envisaged lifting of economic sanctions bring a unique opportunity to build on and broaden the achievements of the past two years**. Prudent policies have allowed the economy to return to positive growth last year and to significantly reduce inflation. The authorities have also regained stability in the foreign exchange market and advanced with subsidy reform. These are commendable efforts.

25. **But the economy faces severe and complex challenges that require resolute policy action and comprehensive reforms**. The sharp decline in global oil prices has cooled off the momentum in economic activity. The corporate sector confronts weak demand with large inventories and low capacity utilization. The banking system faces high nonperforming assets that have resulted in unsustainably high real interest rates, which jeopardize future growth and

[8] Based on staff's recent assessment, the previously identified exchange restriction due to the limitations on the availability of foreign exchange for travel and studies abroad as well as for the payment for imports based on priority lists is considered to be subsumed into this multiple currency practice and exchange restriction arising from the more than two percent deviation between the official and bureau market rates.

[9] The former MCP was previously identified and will be phased out once commitments under the pre-March 2002 letters of credit mature. The latter was identified recently and the authorities are committed to eliminate them by end-September 2016.

employment. Arrears accumulated by the public sector over the past two years compound these problems. As of December 2014, the under- and unemployed represented almost 20 percent of the labor force. The complexity and extent of the challenges require strong political leadership and support that translates into decisive and coordinated action ahead of the expected lifting of economic sanctions.

26. **The economy is weak at present but prospects for 2016/17 are brighter**. The economy is expected to stagnate in 2015/16 and twelve-month inflation is expected to remain close to 14 percent by year-end. The envisaged lifting of economic sanctions would lift real GDP growth to about 4–5½ percent next year. This acceleration will also depend on the spillovers from higher oil production to the rest of the economy. Continued gradual fiscal consolidation and prudent monetary policy, anchored by the authorities' desire to sustain gradual disinflation is needed to mitigate upward pressures on the real exchange rate.

27. **Staff urges the authorities to keep the focus on disinflation by striving to achieve single digit inflation by end-2016/17**. The commitment to and success in lowering inflation has been beneficial to the economy and has also exposed some structural weaknesses in the banking sector. The high levels of interest rates in real terms require a steadfast restructuring of nonperforming loans and banks in general, as well as promptly dealing with unlicensed financial institutions. The recent package of stimulus measures needs to be implemented cautiously, as it is still uncertain whether the underlying inflation dynamics and their outlook have sufficiently changed to warrant a substantial easing of monetary policy. The authorities could take advantage of the package to announce broad money and inflation objectives for 2016/17, to better anchor expectations toward achieving single-digit inflation.

28. **Staff commends the authorities for their commitment to fiscal consolidation**. The progress in broadening the tax base, increasing the VAT rate, stepping up tax administration efforts, and enacting tax legislation that simplifies direct taxation and removes exemptions to some large non-taxpayers is particularly noteworthy. The authorities have also advanced subsidy reform under difficult conditions. Bringing the non-oil fiscal deficit closer to its long-run sustainable level over the medium term remains an important goal to support disinflation. To achieve this goal, additional revenue-enhancing measures are needed. These measures would also allow for increasing infrastructure spending in support of employment and growth. Further adjustment in domestic fuel prices is needed, which could be formula-based, such as a price-band mechanism. With prospects for a deficit in the Targeted Subsidy Organization, continuing to remove less vulnerable households from the cash transfer program remains a priority.

29. **The policy framework needs to be able to respond more effectively to shocks**. A more effective policy framework would require bringing more of a medium-term perspective to fiscal policy formulation, targeting the non-oil balance, and rebuilding buffers and enhancing transparency. Fiscal buffers are needed, which could be put in place by replenishing the Oil Stabilization Fund and by temporarily reducing the share of oil revenues allocated to the National Development Fund of Iran. This latter fund should better define its lending and investment goals, and achieve the levels of accountability and transparency of international peers. Enhancing the price stability mandate of the Central Bank of Iran would make it more effective operationally, which should be supported by greater communication and transparency.

30. **Staff welcomes the steps taken by the authorities to address the many challenges in the financial system but reforms need to proceed faster**. The initial financial health check of the banking system and the draft bills to strengthen the frameworks for prudential supervision and monetary policy are important steps. The authorities have also started to work on measures to address the linkages between government arrears to suppliers, nonperforming loans, and public debt to banks. However, these steps have not helped restore banks' profitability and asset quality. A decision needs to be made on how to restructure banks and promote a sustainable recapitalization. An integral element of the reform will be a strategy for resolving nonperforming assets, restructuring banks and corporates, and empowering the Central Bank of Iran's supervisory framework. Staff acknowledges that these reforms take considerable time to design and implement, and therefore urges the authorities to begin financial sector reform ahead of the envisaged lifting of sanctions. There is also a need to bolster the AML/CFT framework to facilitate the re-integration of the domestic financial system into the global economy.

31. **Addressing the challenges in the labor market will require higher growth and reforms**. The authorities could adopt a holistic approach to improving living standards for the population. Reducing underemployment and unemployment issues requires further development of the private sector, more efficiency and innovation to unlock productivity gains, and greater transparency and accountability. There is a need to foster youth and female employment, by expanding childcare in-work facilities, potentially by reducing payroll taxes in a budget-neutral manner, and by implementing cost-effective skill-matching and training programs. With comprehensive reforms implemented, the expected lifting of sanctions should have a significant impact on confidence and investment and place the economy on a higher growth trajectory.

32. **The authorities' commitment to unify the foreign exchange market by end-September 2016 is welcome**. While the external environment clouds the assessment of the exchange rate, staff considers the bureau exchange rate better aligned with post-sanctions fundamentals than the official rate. Preserving flexibility and sound policies is essential given high inflation differentials and other risks to the outlook. Staff recommends Executive Board approval of the retention of the multiple currency practice and exchange restriction arising from 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 in light of the authorities' commitment to unify the exchange rate regime by end-September 2016. Staff also recommends Executive Board approval

of the retention of the two multiple currency practices relating to the use of preferential exchange rates for certain imports, as referred to in paragraph 23 through end-September 2016. These measures are not maintained for balance of payments reasons, do not impede balance of payments adjustment, and do not discriminate among members or harm the interests of other members.

33. **The authorities could continue broadening data provision and dissemination**. Staff welcomes the authorities' efforts to strengthen national accounts statistics, with support from Fund TA, and encourages the authorities to broaden the reporting and dissemination of official statistics.

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

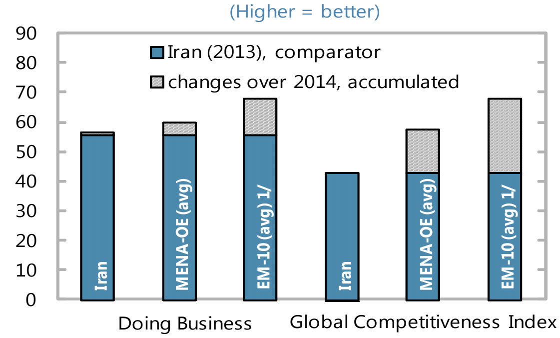
Figure 1. Islamic Republic of Iran: Business Environment Indicators, 2010/11–2014/15

While there have been some recent improvements, the business environment remains difficult ….

Evolution of the Business Environment
(Higher = Better)

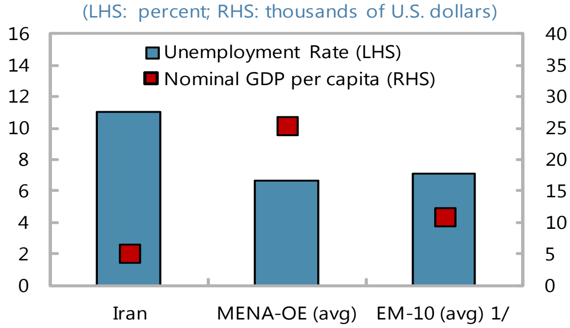
…. the Iranian economy continues to lag other oil-exporting countries and emerging markets

Business Environment in International Perspective
(Higher = better)



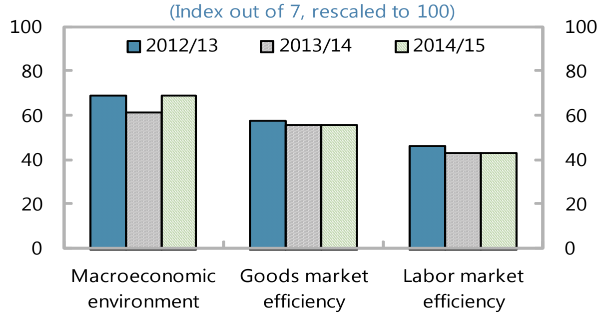
The economy faces high unemployment relative to its per capita income and comparator countries.

Unemployment and Nominal GDP per capita, 2014
(LHS: percent; RHS: thousands of U.S. dollars)



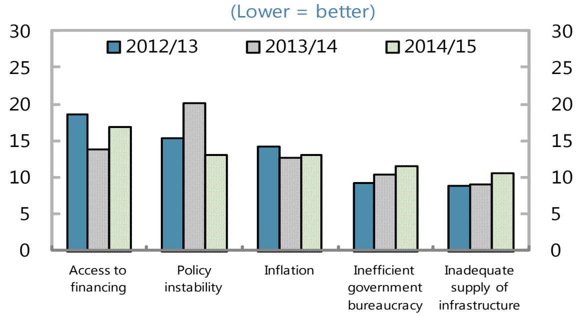
While macroeconomic conditions have improved, the efficiency of goods and labor markets has been stagnant.

Deterioration in Competitiveness (GCI)
(Index out of 7, rescaled to 100)



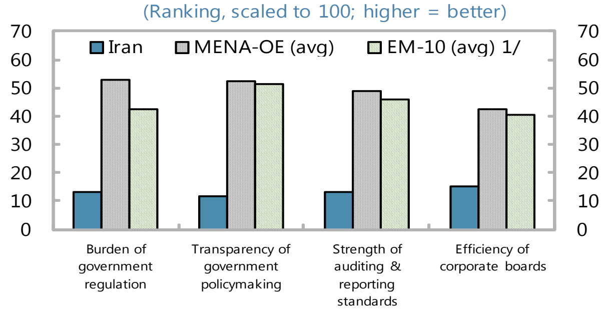
Progress with policy stability has been surpassed by other structural problems …

Main Constraints to Growth 2/
(Lower = better)



… that offers opportunities for significant productivity gains.

GCI - First Pillar Basic Requirements
(Ranking, scaled to 100; higher = better)



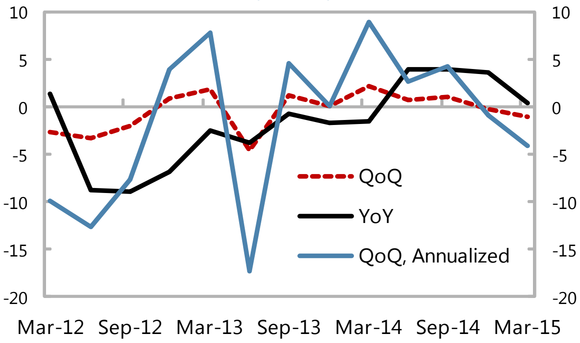
Source: World Bank Doing Business; World Economic Forum Global COmpetitiveness; IMF WEO; IMF REO; and IMF staff calculations.

1/ Includes Brazil, Chile, China, India, Mexico, Russia, South Africa, South Korea, Thailand, and Turkey.
2/ Each bar shows the percent of survey respondents who feel the particular issue in question is the most problematic for doing business in Iran.

Figure 2. Islamic Republic of Iran: Macroeconomic Indicators, 2010/11–2014/15

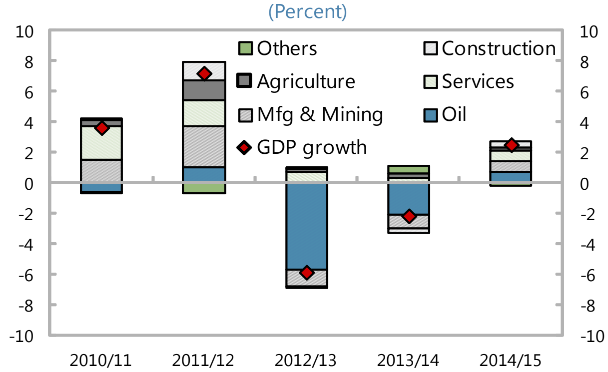
Growth has rebounded following the interim easing of economic sanctions ...

Real GDP Growth
(Percent)



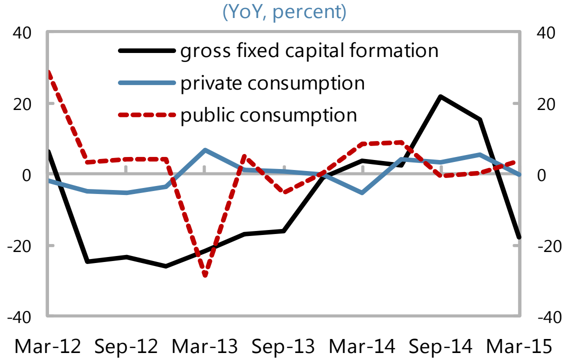
... and the impact has been particularly pronounced in oil and manufacturing.

Contribution to GDP grwoth
(Percent)



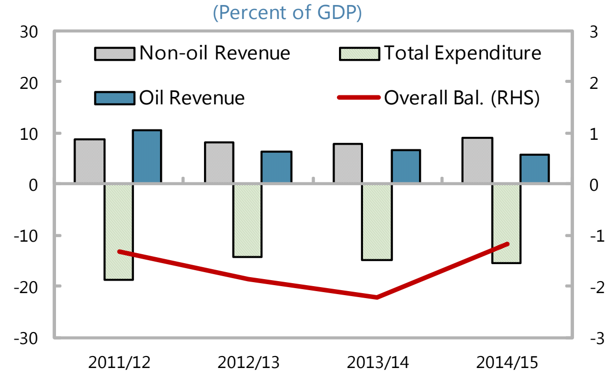
Since mid-2013 investment has picked up along with private consumption.

Demand Components Growth
(YoY, percent)



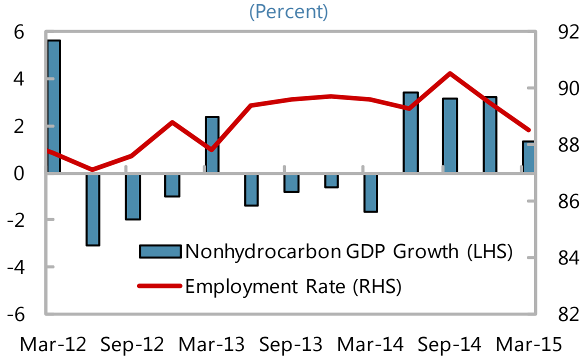
The fiscal position has been strengthened.

Fiscal Balance
(Percent of GDP)



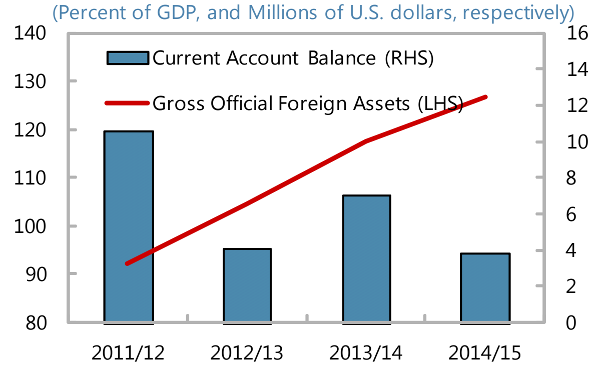
The recovery in non-oil GDP grwth has helped contain unemployment.

Unemployment and Non-Oil Growth
(Percent)



The current account surplus has stablized and gross foreign assets continued to grow.

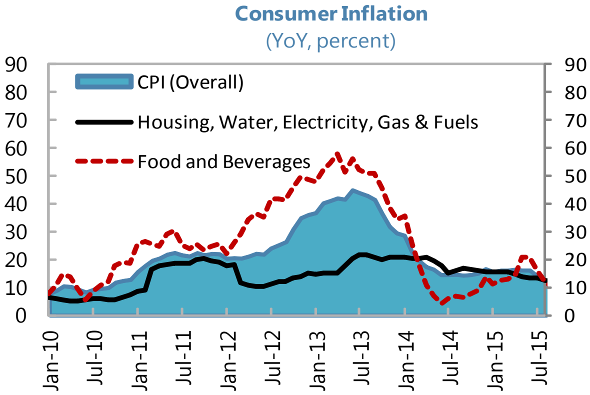
Current Account Balance and Gross Official Foreign Assets
(Percent of GDP, and Millions of U.S. dollars, respectively)



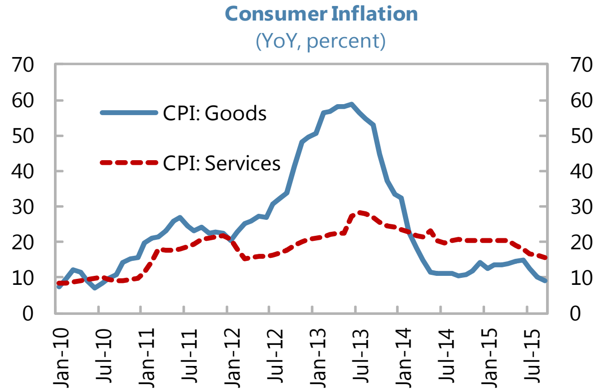
Source: Iranian authorities; and IMF staff calculations.

Figure 3. Islamic Republic of Iran: Macroeconomic and Price Developments, 2010/11–2014/15

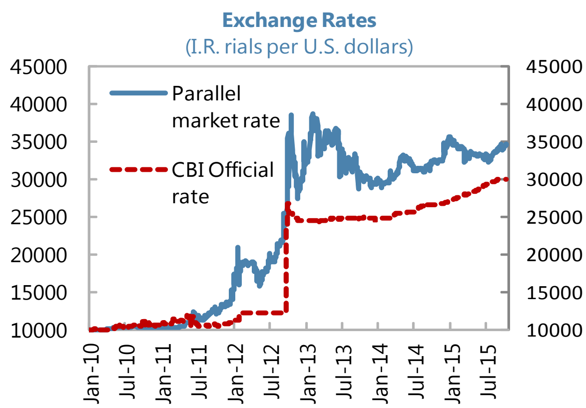
12-month inflation has stablized at around 15 percent, helped by food disinflation ...



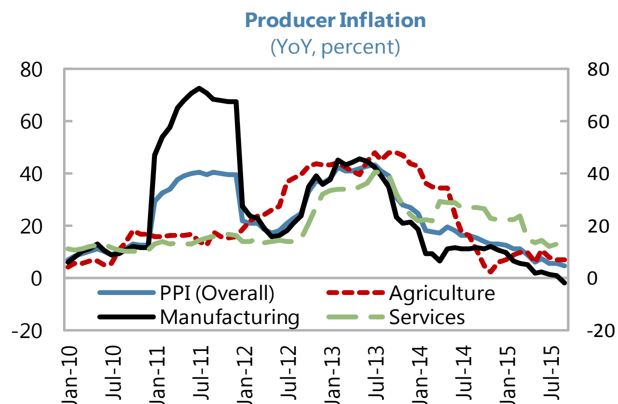
... and supporting disinflation broadly ....



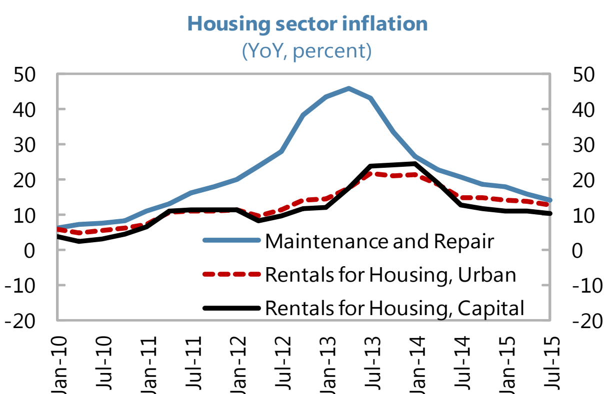
The foreign exchange market has remained stable with the premium narrowing toward 10 percent.



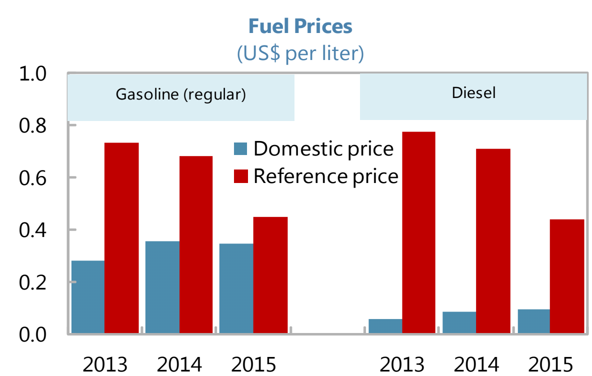
A sharp deceleration in producer prices has also contributed ...



Difficult conditions in the housing market has also helped contain inflation.



... and notwithstanding the significant adjustments in domestic energy prices since 2014.

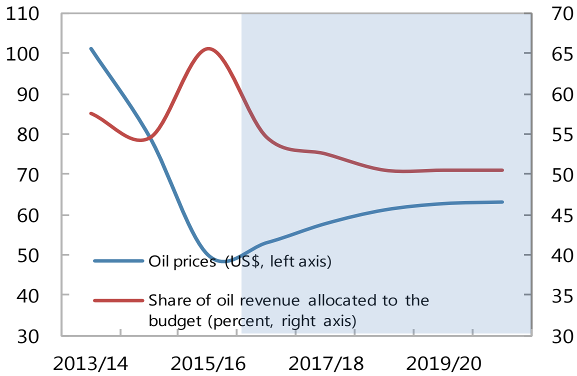


Source: IEA, Iranian authorities; and IMF staff calculations.

Figure 4. Islamic Republic of Iran: Fiscal Developments and Outlook, 2013/14–2020/21

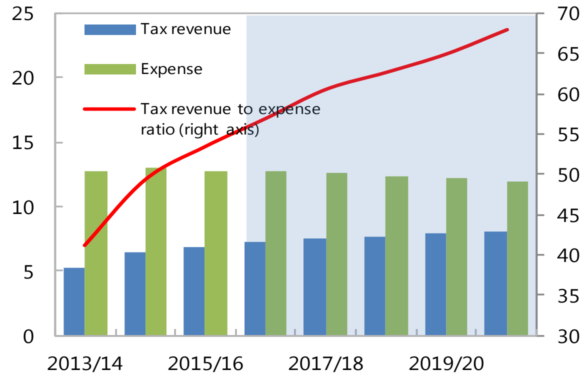
Oil revenue has been negatively affected by lower oil prices and a declining share allocated to the budget.

Parameters Affecting Budget Share in Oil Revenue



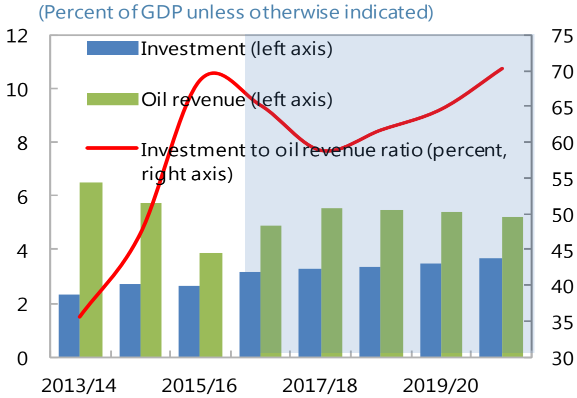
The authorities have stepped up efforts to raise domestic revenue to finance recurrent spending.

Expenditure and Tax Revenue
(Percent of GDP unless otherwise indicated)



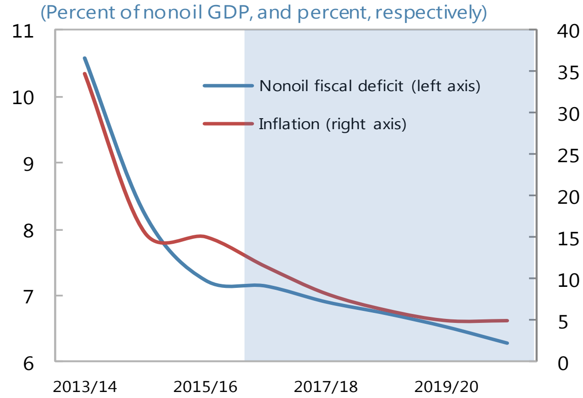
higher tax revenue will allow for investment spending to be largely financed by oil revenue.

Investment and Oil Revenue
(Percent of GDP unless otherwise indicated)



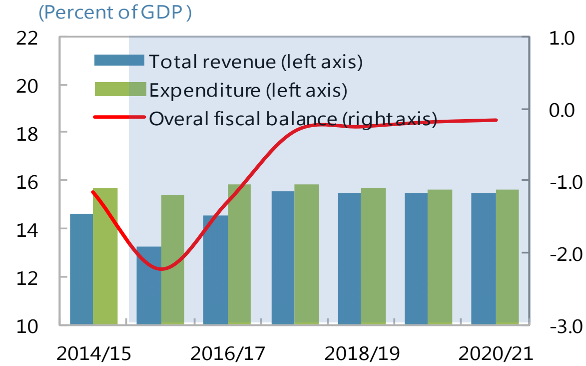
Reducing the nonoil fiscal deficit will be essential to achieve the authorities' single-digit inflation objective...

Nonoil Fiscal Deficit and Inflation
(Percent of nonoil GDP, and percent, respectively)



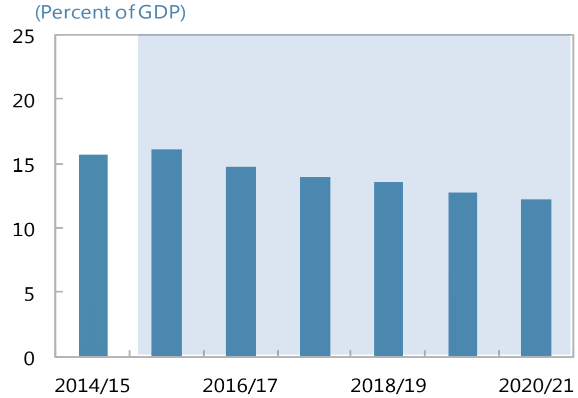
... with the overal fiscal deficit stabilizing close to 0.

Overal Budget
(Percent of GDP)



Public debt is still low and should decline as arrears are settled.

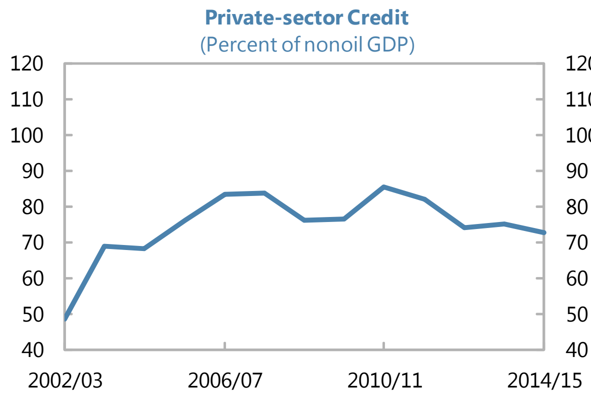
Public Debt
(Percent of GDP)



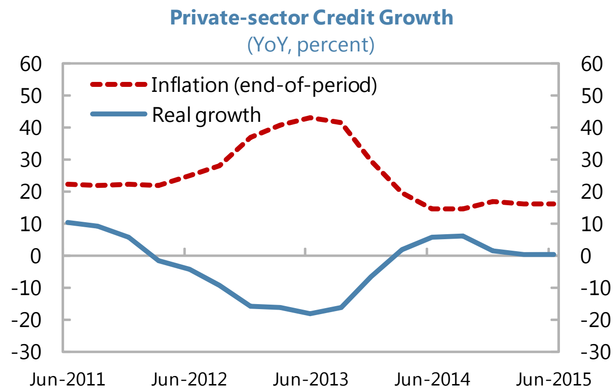
Sources: Iran authorities, and IMF staff estimates and projections.

Figure 5. Islamic Republic of Iran: Monetary Indicators, 2002/03–2014/15

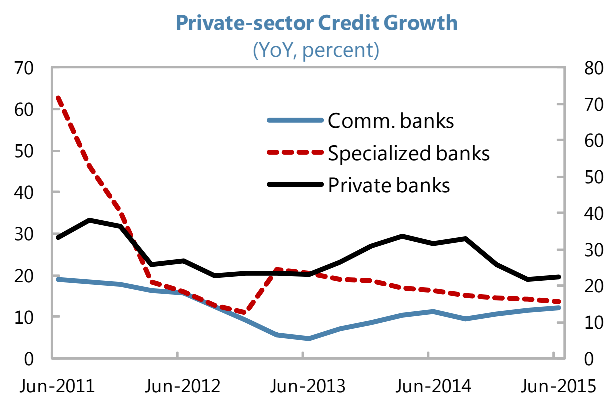
The economy has deleveraged in recent years ...



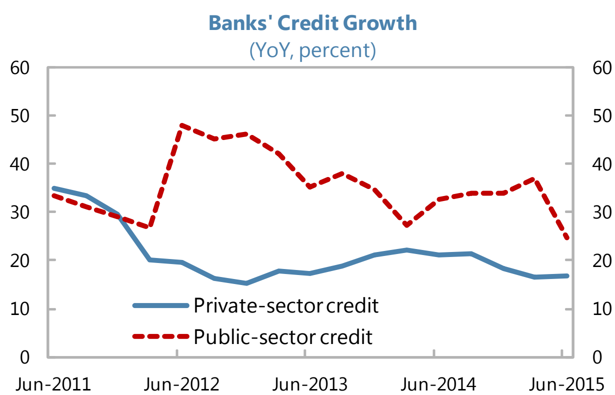
... as banks struggled to find sufficient credit-worthy customers in times of high inflation.



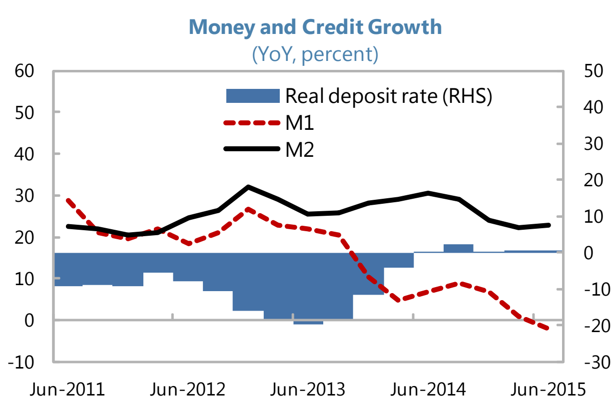
The slowdown in private-sector credit was broad based and includes the private banks ...



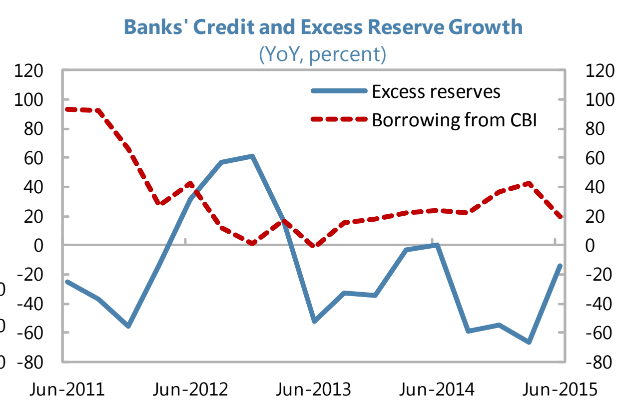
... partly because banks rebalanced their portfolios towards government credit.



M1 growth has slowed down and money demand is shifting toward M2 ...



... leading to liquidity pressures of some banks that relied on sight deposits for funding.

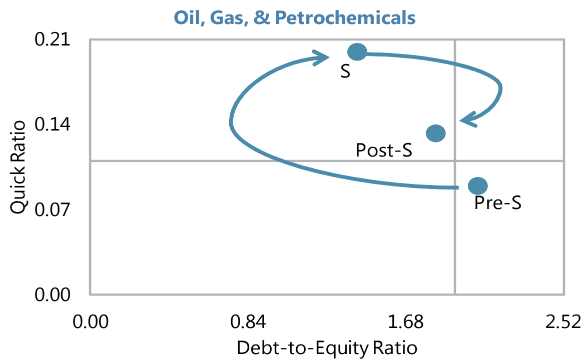


Source: Iranian authorities; and IMF staff calculations.

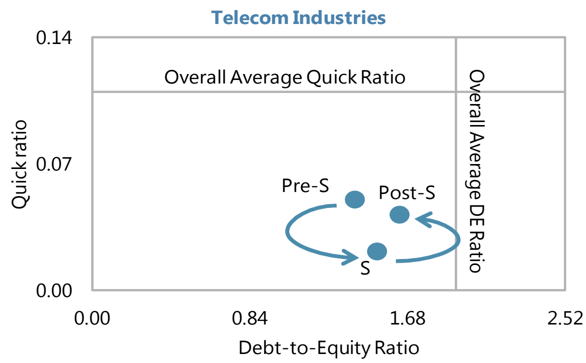
Figure 6. Islamic Republic of Iran: A Broad Look at Liquidity and Indebtedness Across Sectors, 2012–15

The interim agreement in November 2013 brought some relief to several sectors of the economy ...

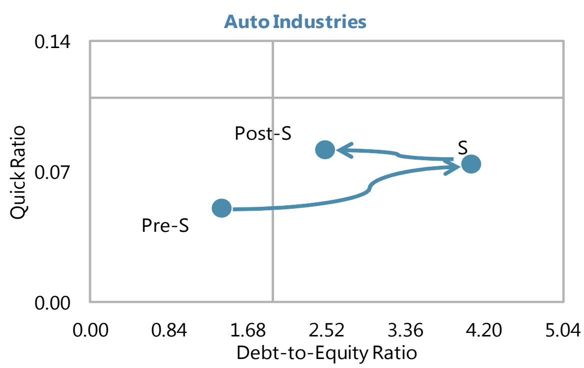
Oil and gas companies have been able to bring their leverage back to pre-sanction levels ...

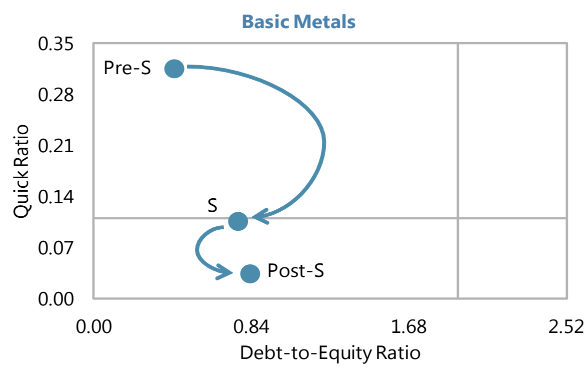


... while telecom companies' liquidity remains tight.

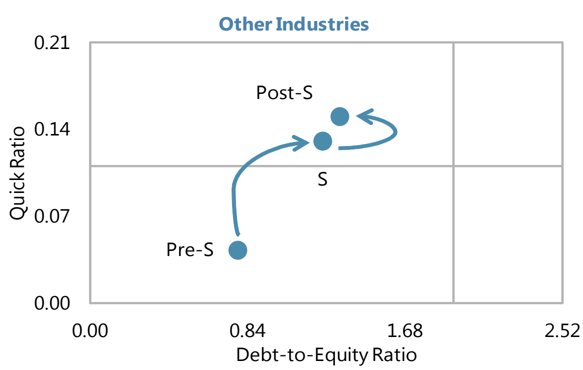


Automobile and metal companies continue to face relatively high indebtedness, relative to their pre-sanction levels, and tight lquidity relative to other companies over the past two years...





While other sectors, such as investment companies and engineering services, have seen their indebtedness and liquidity rise.

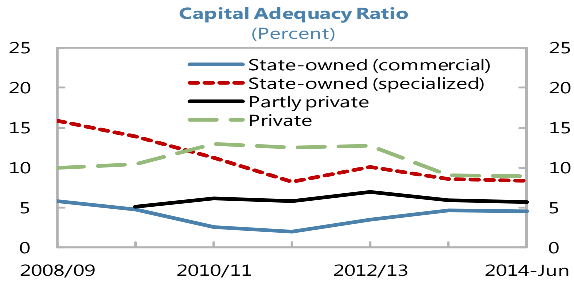


Source: IMF Staff calculations based on TSE companies' financial statements available in the TSE website. (http://codal.ir/)

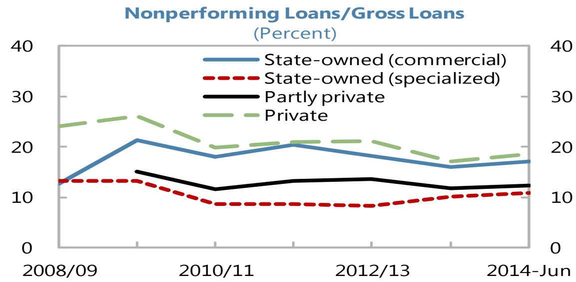
1/ the sample includes top 30 companies in Tehran Stock Exchange, according to their market capitalization values.
2/ The three periods, i.e., Sanction, Pre-Sanction, and Post-Sanction, are: **Pre-Sanction**: fiscal year ending in March-June 2012; **Sanction**: fiscal year ending in June–December 2013; **Post-Sanction**: fiscal year ending in March–June 2015.
3/ Quick Ratio is defined as the ratio of Short-Term Liquid Assets to Current Liabilities.

Figure 7. Islamic Republic of Iran: Financial Sector Indicators, 2008/09–2014/15

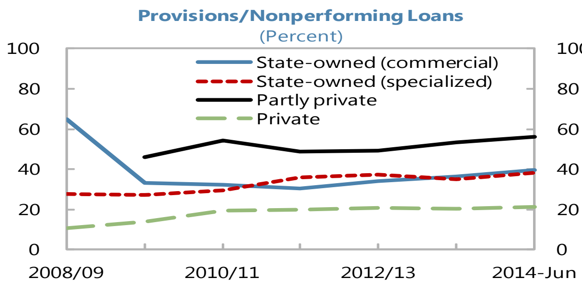
Capitalization levels vary considerably among banks…



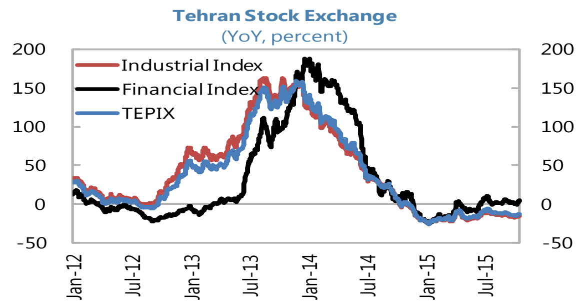
Non-performing loans are also high, particularly for private banks



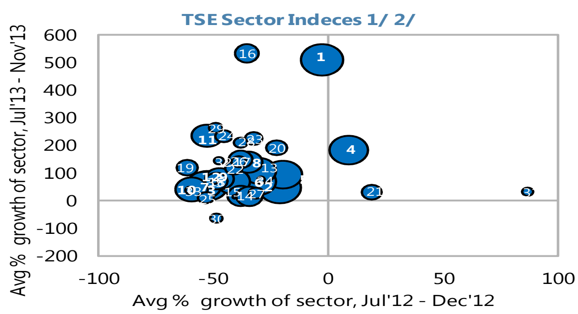
… with overall provisioning low, especially for private banks.



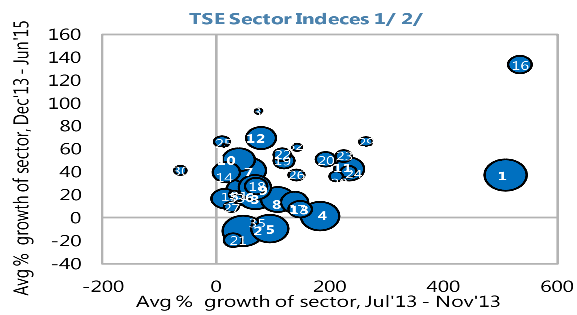
The stock market has been less buoyant over the past year.



Most sectors that had been negatively affected by the intensification of sanctions…



… have been recovering since the interim nuclear deal.



Source: Tehran Stock Exchange; Central Bank of Iran; and IMF staff calculations.

1/ In counterclockwise order, the four quadrants represent the following scenarios: (i)positive growth for both periods.; (ii)positive growth for recent period, negative growth for past period.;(iii) negative growth for both periods.; and (iv) negative growth for recent period, positive growth for past period.
2/ Growth rates are computed using the parallel market exchange rate. We then take the geometric average of the YoY growth rates for the given period.

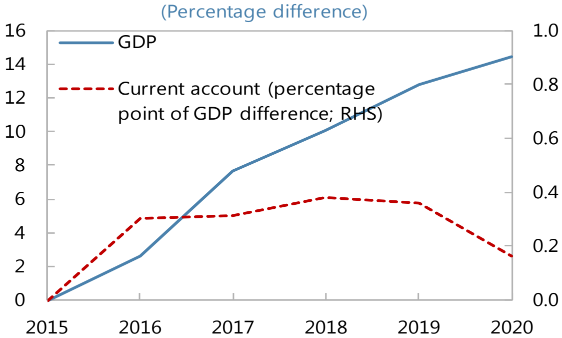
The data labels in the bubble charts represent the rank of each sector in terms of market capitalization. Below see the corresponding sectors and percent market share (July 2013). The dimensions of the bubbles are relative (approximately) to

1 - Chemicals & By-products (22.9%)
2 - Basic Metals (14.7%)
3 - Monetary Intermediation (11.3%)
4 - Refined Petrol. Products (10.8%)
5 - Metal Ores Mining (9.0%)
6 - Diversified Industrials (7.8%)
7 - Post and Telecomm. (4.2%)
8 - Cement, Lime & Plaster (3.1%)
9 - Investment Companies (2.4%)
10 - Motor Vehicles (2.3%)
11 - Technical & Engineering Services (2.0%)
12 - Pharmaceuticals (1.9%)
13 - Food Products (1.6%)
14 - Computer and Related Activities (1.0%)
15 - Real Estate and Construction (0.8%)
16 - Transportation and Storage (0.6%)
17 - Oil and Gas Extraction (0.5%)
18 - Insurance and Pension (0.5%)
19 - Electric Machinery (0.4%)
20 - Rubber and Plastic Products (0.4%)
21 - Sugar and Byproducts (0.4%)
22 - Machinery and Equipment (0.4%)
23 - Other Non-metal Mineral Products (0.3%)
24 - Fabricated Metal Products (0.3%)
25 - Financial Leasing (0.2%)
26 - Ceramic and Tiles (0.2%)
27 - Medical and Precision Instruments (0.1%)
28 - Paper and Byproducts (<0.1%)
29 - Radio, TV and Comm. Equipment (<0.1%)
30 - Tanning and Dressing of Leather (<0.1%)
31 - Agriculture (<0.1%)
32 - Textiles (<0.1%)
33 - Coal and Lignite Mining (<0.1%)
34 - Publishing and Printing of Media (<0.1%)
35 - Wood and Byproducts (<0.1%)
36 - Other Mining (<0.1%)

Figure 8. Islamic Republic of Iran: An Illustrative Model Simulations (G20MOD)

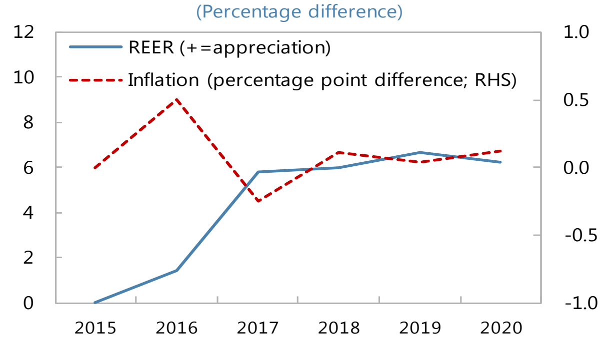
The lifting of sanctions would have positive effects on growth and external balances ...

Baseline Scenario
(Percentage difference)



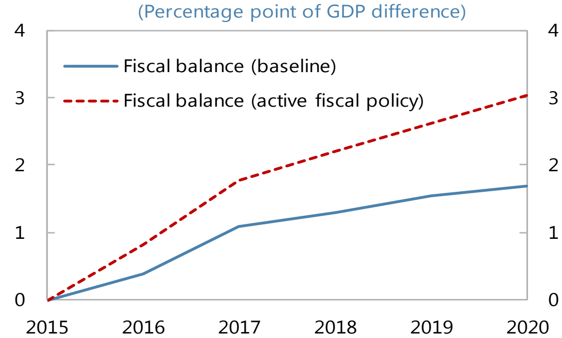
... but would not meet the authorities' objective of continuing disinflation and keeping the real effective exchange rate constant.

Baseline Scenario
(Percentage difference)



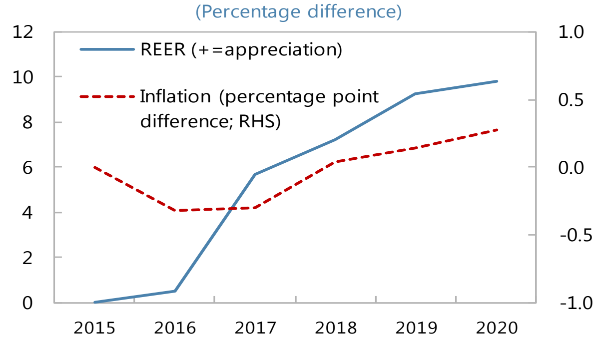
A greater fiscal effort, based on increases in VAT and corporate taxation reduces fiscal deficits ...

Active Fiscal Policy
(Percentage point of GDP difference)



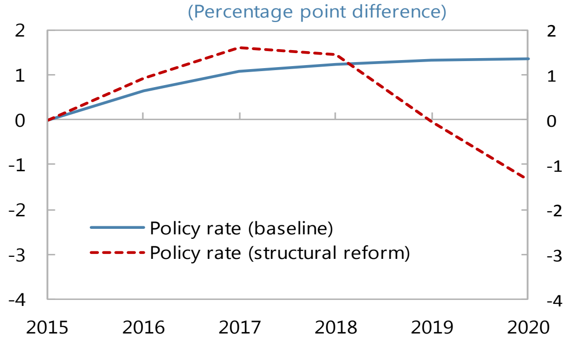
... and contains the appreciation of the real effective exchange rate.

Active Fiscal Policy
(Percentage difference)



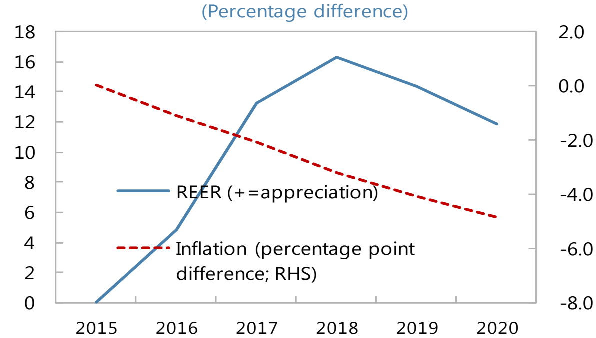
Structural reforms to the monetary policy framework that help anchor inflation expectations would eventually allow monetary policy to ease ...

Structural Reforms
(Percentage point difference)



... and continue disinflation, which will protect price competitiveness.

Structural Reform
(Percentage difference)



Source: IMF staff calculations.

Note: The baseline scenario contemplates an increase in oil production, lower sovereign risk premium, and lower trade and financial costs, relative to a scenario of no lifting of sanctions. Charts show differences from a no-sanction relief scenario.

Table 1. Islamic Republic of Iran: Selected Macroeconomic Indicators, 2013/14–2020/21[1/]

	2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
	(Annual change, in percent, unless otherwise indicated)							
National accounts								
Nominal GDP at market prices (in billions of Iranian rials)	9,421,216	11,033,666	11,992,122	14,042,908	15,934,661	17,694,609	19,371,763	21,150,347
Real GDP at factor cost	-1.9	3.0	0.0	4.3	4.0	4.1	4.4	4.4
Real oil and gas GDP	-8.9	4.8	0.5	16.9	8.8	2.9	2.5	2.5
Real nonoil GDP	-1.1	2.8	-0.1	2.8	3.4	4.3	4.6	4.6
CPI inflation (average)	34.7	15.5	15.1	11.5	8.3	6.3	5.0	5.0
CPI inflation (end of period)	19.7	16.2	14.0	9.0	7.5	5.0	5.0	5.0
GDP deflator at factor cost	34.3	12.2	8.7	12.3	9.1	6.6	4.9	4.6
Unemployment rate (in percent of labor force)	10.4	10.6	11.9	12.5	12.6	12.4	12.2	11.9
	(In percent of GDP)							
Budgetary operations								
Revenue	14.1	14.6	13.2	14.5	15.5	15.4	15.4	15.4
Taxes	5.2	6.4	6.8	7.2	7.6	7.7	7.9	8.1
Other revenue	8.8	8.1	6.4	7.3	7.9	7.7	7.6	7.3
Of which: oil revenue	6.5	5.7	3.9	4.9	5.6	5.5	5.4	5.2
Expenditure	15.0	15.7	15.4	15.9	15.8	15.7	15.6	15.6
Expense	12.7	13.0	12.8	12.7	12.5	12.3	12.2	11.9
Net acquisition of nonfinancial assets	2.3	2.7	2.7	3.2	3.3	3.4	3.5	3.7
Net lending/borrowing (overall balance)	-2.2	-1.2	-2.5	-1.3	-0.3	-0.3	-0.2	-0.2
Net lending/borrowing (budget)	-0.9	-1.2	-2.2	-1.3	-0.3	-0.3	-0.2	-0.2
Balance of Targeted Subsidy Organization	-1.3	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Non-oil net lending/borrowing (in percent of non-oil GDP)	-10.6	-8.2	-7.2	-7.1	-6.9	-6.7	-6.5	-6.3
Financial assets	-0.5	-1.0	-1.1	-0.5	0.4	0.4	-0.1	0.0
Liabilities	1.7	0.2	1.4	0.9	0.7	0.7	0.1	0.1
	(Annual change in percent, unless otherwise indicated)							
Monetary sector								
Net foreign assets	131.0	1.3	31.2	15.0	14.6	11.8	10.5	9.5
Net domestic assets	-5.4	43.4	8.2	18.0	14.7	14.3	14.8	15.3
Credit to the private sector in rials	30.7	16.7	17.3	18.2	17.5	16.0	15.7	14.5
Base money	18.8	14.5	21.0	18.2	15.4	13.7	13.1	12.8
Narrow money (M1)	8.1	1.6	10.5	13.7	14.3	11.7	12.7	12.8
Broad money (M2)	39.5	22.4	20.0	17.1	15.4	13.7	13.1	12.8
	(In billions of U.S. dollars, unless otherwise indicated)							
External sector								
Current account balance	26.5	15.9	4.5	8.5	11.7	13.2	12.5	12.1
In percent of GDP at market prices	7.8	4.1	1.3	2.1	2.6	2.8	2.4	2.2
Exports of goods and services	100.1	93.9	74.3	90.5	104.0	111.9	117.8	124.4
Imports of goods and services	-75.2	-80.1	-72.5	-85.9	-97.5	-104.6	-111.1	-118.1
External and publicly guaranteed debt	6.7	5.1	8.9	10.7	13.3	15.9	18.7	21.8
Of which: short-term debt	0.8	0.4	4.6	6.2	7.8	9.3	10.7	12.2
Gross official assets/reserves	117.6	126.2	128.9	142.1	159.9	179.3	198.2	217.2
	(In U.S. dollars, unless otherwise indicated)							
Oil and gas sector								
Total oil and gas exports (billions)	64.9	55.4	35.3	48.6	59.8	65.3	68.6	71.2
WEO Oil Price adjusted for Iranian year (per barrel)	103.7	83.3	50.7	52.9	57.6	61.0	62.6	63.0
Average oil export price (per barrel)	101.1	79.1	49.7	52.9	57.6	61.0	62.6	63.0
Crude oil exports (in millions of barrels/day)	1.13	1.16	1.24	1.81	2.13	2.22	2.29	2.38
Crude oil production (in millions of barrels/day)	2.85	3.09	3.11	3.7	4.0	4.2	4.3	4.4
Memorandum items:								
Average exchange rate (Iranian rials per U.S. dollar)	24,770	26,492	...	...	...	...	...	...
End-of-period exchange rate (Iranian rials per U.S. dollar)	24,770	28,000	...	...	...	...	...	...

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

1/ The Iranian fiscal year ends March 20.

Table 2. Islamic Republic of Iran: Balance of Payments, 2013/14–2020/21[1/]

(Millions of U.S. dollars, unless otherwise indicated)

	2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
Current account balance	26,523	15,861	4,529	8,466	11,709	13,204	12,538	12,133
(in percent of GDP at market prices)	7.8	4.1	1.3	2.1	2.6	2.8	2.4	2.2
Trade balance	33,078	21,392	7,956	14,449	20,767	23,475	24,634	24,888
Exports	93,125	86,471	67,185	81,990	94,841	102,021	107,111	111,516
Oil and gas	64,882	55,352	35,343	48,645	59,819	65,299	68,646	71,239
Crude oil	38,783	33,458	22,527	34,989	44,876	49,398	52,247	54,693
Petroleum products and natural gas	26,099	21,894	12,816	13,657	14,943	15,901	16,399	16,546
Non-oil and gas	28,243	31,119	31,842	33,345	35,022	36,722	38,465	40,277
Imports	-60,047	-65,079	-59,230	-67,541	-74,074	-78,546	-82,477	-86,628
Services and Income (net)	-7,137	-6,042	-4,139	-6,753	-9,896	-11,185	-13,092	-13,840
Credits	8,946	9,717	10,391	13,151	15,574	17,506	18,740	21,408
Debits	-16,083	-15,758	-14,530	-19,904	-25,470	-28,690	-31,833	-35,248
Transfers (net)	582	511	712	769	838	914	996	1,086
Capital and financial account balance	-12,181	-1,587	-1,754	1,575	3,621	5,077	5,634	6,231
Foreign direct investment and portfolio equity	2,100	1,360	0	2,063	3,324	4,767	5,121	5,501
Medium- and long-term debt	-213	135	-366	140	1,007	1,200	1,400	1,500
Trade credit	-10,429	634	1,413	1,673	1,590	1,412	1,414	1,530
Other capital [2/]	-3,639	-3,716	-2,801	-2,301	-2,301	-2,301	-2,301	-2,301
Errors and omissions	-1,167	-5,712	0	0	0	0	0	0
Overall balance	13,175	8,562	2,775	10,040	15,330	18,281	18,172	18,364
Change in gross official assets/reserves (increase -)	-13,175	-8,562	-2,775	-10,040	-15,330	-18,281	-18,172	-18,364
Memorandum items:								
Net official reserves (in millions of U.S. dollars)	113,714	122,624	125,399	138,555	156,357	175,768	194,652	213,628
Gross official assets/reserves (in millions of U.S. dollars)	117,603	126,166	128,940	142,096	159,898	179,310	198,194	217,170
(in months of the following year's imports)	17.6	20.9	18.0	17.5	18.3	19.4	19.4	19.4
Gross foreign liabilities of the Central Bank of Iran (in millions of dolla	3,889	3,542	3,542	3,542	3,542	3,542	3,542	3,542
External debt service (as percent of exports)	2.5	2.2	3.4	2.9	2.4	2.8	3.2	3.6
External debt (in percent of GDP)	2.0	1.3	2.5	2.6	3.0	3.3	3.7	4.0

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 3. Islamic Republic of Iran: Statement of Government Operations, 2013/14–2020/21[1/]

(In billions of rials)

	2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
	(Billions of rials, unless otherwise indicated)							
Revenue	1,326,785	1,606,800	1,582,676	2,042,922	2,468,425	2,728,803	2,992,124	3,266,745
Tax revenue	494,250	709,652	818,509	1,012,755	1,208,582	1,362,702	1,528,663	1,712,965
Taxes on income, profits and capital gains	256,037	334,085	384,284	464,932	526,976	591,589	666,314	749,966
Taxes on property	21,846	25,115	30,716	35,220	39,406	43,674	47,969	52,684
Taxes on goods and services	135,969	217,026	270,485	335,766	425,607	486,923	551,068	622,826
Of which: value added tax	103,202	167,040	216,157	272,147	353,418	406,761	463,307	527,009
Taxes on international trade and transactions	80,398	133,426	133,024	176,837	216,593	240,516	263,312	287,488
Other revenue	832,535	897,148	764,168	1,030,168	1,259,844	1,366,101	1,463,461	1,553,781
Property income	708,502	748,003	592,613	821,309	1,026,165	1,107,110	1,178,998	1,241,360
Of which: rents (oil revenue)	609,400	628,837	463,095	684,808	886,765	967,793	1,041,728	1,106,474
Other	124,033	149,145	171,555	389,524	523,614	594,091	639,477	679,222
Expenditure	1,415,138	1,735,115	1,849,632	2,226,037	2,520,269	2,774,957	3,030,492	3,302,759
Expense	1,197,647	1,438,316	1,531,567	1,780,057	1,998,274	2,177,615	2,357,160	2,525,306
Net acquisition of nonfinancial assets	217,491	296,799	318,065	445,981	521,994	597,342	673,332	777,453
Gross operating balance	129,138	168,484	51,109	262,866	470,151	551,188	634,964	741,439
Net lending/borrowing (including TSO)	-210,271	-128,115	-303,041	-183,115	-51,843	-46,154	-38,368	-36,014
Net lending/borrowing (budget, excluding TSO)	-88,353	-128,315	-266,956	-183,115	-51,843	-46,154	-38,368	-36,014
Balance of Targeted Subsidy Organization	-121,918	200	-36,085	0	0	0	0	0
Financial assets	-50,397	-105,053	-132,269	-63,300	62,020	77,212	-13,673	-8,204
Financial liabilities	159,874	23,062	170,772	119,815	113,863	123,366	24,695	27,810
Memorandum items:								
Nonoil net lending/borrowing	-819,671	-756,952	-766,136	-867,923	-938,608	-1,013,947	-1,080,096	-1,142,488
Nonoil net lending/borrowing incl. NDFI loans	-923,504	...	...	...	...	...	...	...
Oil prices (US$ per barrel)	101	79	50	53	58	61	63	63
Exchange rate (rial per US$, average over the period)	24,770	26,492	...	...	...	...	...	...
Oil exports (millions of barrels per day)	1.1	1.2	1.2	1.8	2.1	2.2	2.3	2.4

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

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

Table 4. Islamic Republic of Iran: Statement of Government Operations, 2013/14–2020/21

	Est. 2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
				(Percent of GDP)				
Revenue	14.1	14.6	13.2	14.5	15.5	15.4	15.4	15.4
Tax revenue	5.2	6.4	6.8	7.2	7.6	7.7	7.9	8.1
Taxes on income, profits and capital gains	2.7	3.0	3.2	3.3	3.3	3.3	3.4	3.5
Taxes on property	0.2	0.2	0.3	0.3	0.2	0.2	0.2	0.2
Taxes on goods and services, of which	1.4	2.0	2.3	2.4	2.7	2.8	2.8	2.9
Value added tax	1.1	1.5	1.8	1.9	2.2	2.3	2.4	2.5
Taxes on international trade and transactions	0.9	1.2	1.1	1.3	1.4	1.4	1.4	1.4
Other revenue, of which	8.8	8.1	6.4	7.3	7.9	7.7	7.6	7.3
Property Income	7.5	6.8	4.9	5.8	6.4	6.3	6.1	5.9
Of which: rents (Oil Revenue)	6.5	5.7	3.9	4.9	5.6	5.5	5.4	5.2
Other	1.3	1.4	1.4	2.8	3.3	3.7	3.3	3.2
Expenditure	15.0	15.7	15.4	15.9	15.8	15.7	15.6	15.6
Expense	12.7	13.0	12.8	12.7	12.5	12.3	12.2	11.9
Net acquisition of nonfinancial assets	2.3	2.7	2.7	3.2	3.3	3.4	3.5	3.7
Gross operating balance	1.4	1.5	0.4	1.9	3.0	3.1	3.3	3.5
Net lending/borrowing (including TSO)	-2.2	-1.2	-2.5	-1.3	-0.3	-0.3	-0.2	-0.2
Net lending/borrowing (budget, excluding TSO)	-0.9	-1.2	-2.2	-1.3	-0.3	-0.3	-0.2	-0.2
Balance of Targeted Subsidy Organization	-1.3	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Financial assets	-0.5	-1.0	-1.1	-0.5	0.4	0.4	-0.1	0.0
Financial liabilities	1.7	0.2	1.4	0.9	0.7	0.7	0.1	0.1
Memorandum items:			(Percent of nonoil GDP)					
Tax revenue	6.4	7.7	7.7	8.3	8.9	9.0	9.2	9.4
Income tax	3.3	3.6	3.6	3.8	3.9	3.9	4.0	4.1
VAT	1.3	1.8	2.0	2.2	2.6	2.7	2.8	2.9
Non-oil net lending/borrowing	-10.6	-8.2	-7.2	-7.1	-6.9	-6.7	-6.5	-6.3
Change in nonoil net lending (+ = tightening)	...	2.4	1.0	0.1	0.2	0.2	0.2	0.2
Non-oil net lending/borrowing including NDFI loans	-12.5	...	...	...	...	...	...	...

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

1/ 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: Monetary Survey, 2013/14–2020/21[1/]

(Billions of rials, unless otherwise indicated)

	2013/14	Est. 2014/15	Proj. 2015/16	Proj. 2016/17	Proj. 2017/18	Proj. 2018/19	Proj. 2019/20	Proj. 2020/21
Net foreign assets (NFA)	4,229,218	4,283,513	5,621,446	6,467,231	7,414,586	8,292,596	9,161,028	10,031,703
In millions of U.S. dollars	*170,740*	*152,983*	*170,800*	*183,956*	*201,758*	*221,169*	*240,053*	*259,029*
Foreign assets	4,717,292	4,723,379	6,138,485	7,019,521	7,991,910	8,881,613	9,760,542	10,640,102
In millions of U.S. dollars	*190,444*	*168,692*	*186,509*	*199,665*	*217,467*	*236,879*	*255,763*	*274,739*
Foreign liabilities [2/]	488,073	439,866	517,039	552,290	577,324	589,018	599,513	608,399
In millions of U.S. dollars	*19,704*	*15,710*	*15,710*	*15,710*	*15,710*	*15,710*	*15,710*	*15,710*
Net domestic assets (NDA)	2,945,275	4,223,997	4,570,833	5,393,022	6,184,269	7,068,693	8,115,412	9,360,449
Net domestic credit	5,344,973	6,194,014	7,562,526	8,871,761	10,139,790	11,459,317	13,105,839	14,873,583
Net credit to government [3/]	-752,126	-838,870	-739,004	-892,578	-1,257,166	-1,670,812	-1,991,279	-2,323,850
Claims on nonfinancial public enterprises (NFPEs)	222,973	279,641	379,315	462,846	541,653	620,409	704,028	795,514
Claims on the private sector	5,874,126	6,753,243	7,922,215	9,301,493	10,855,303	12,509,720	14,393,089	16,401,919
Domestic currency claims	5,408,158	6,309,054	7,400,094	8,743,774	10,272,305	11,914,578	13,787,009	15,786,526
Foreign currency claims	465,968	444,189	522,121	557,719	582,998	595,141	606,080	615,393
Other items, net, excluding CPPs	-2,399,698	-1,970,017	-2,991,693	-3,478,740	-3,955,520	-4,390,624	-4,990,426	-5,513,134
Broad money (M3)	7,162,844	8,507,510	10,192,279	11,860,252	13,598,856	15,361,288	17,276,441	19,392,152
M2	6,428,210	7,865,144	9,437,212	11,053,706	12,755,751	14,501,107	16,400,931	18,503,666
Cash	335,299	351,673	380,222	433,200	481,389	547,257	618,955	698,310
Deposits	6,092,912	7,513,471	9,056,990	10,620,506	12,274,362	13,953,849	15,781,977	17,805,357
Demand deposits	893,435	897,182	999,980	1,135,436	1,312,250	1,456,919	1,639,902	1,850,151
Time deposits	5,199,477	6,616,289	8,057,009	9,485,069	10,962,113	12,496,931	14,142,074	15,955,206
CPPs held by nonbanks	30,000	0	0	0	0	0	0	0
Foreign currency deposits	704,634	642,366	755,067	806,547	843,105	860,182	875,509	888,486
Memorandum items:								
Net credit to government (without valuation effect) [3/]	-223,691	-278,032	-45,923	-52,842	-210,538	-407,671	-478,054	-530,725
Base money	1,180,929	1,351,812	1,636,069	1,933,066	2,230,719	2,535,946	2,868,186	3,235,911
M1	1,228,734	1,248,856	1,380,203	1,568,636	1,793,639	2,004,176	2,258,857	2,548,461
Multiplier (M2/base money)	5.4	5.8	5.8	5.7	5.7	5.7	5.7	5.7
Velocity of M2	1.4	1.3	1.2	1.2	1.2	1.1	1.1	1.1
GDP	9,421,216	11,033,666	11,992,122	14,042,908	15,934,661	17,694,609	19,371,763	21,150,347
				(Annual change, in percent)				
NFA	131.0	1.3	31.2	15.0	14.6	11.8	10.5	9.5
NDA	-5.4	43.4	8.2	18.0	14.7	14.3	14.8	15.3
Base money	18.8	14.5	21.0	18.2	15.4	13.7	13.1	12.8
M1	8.1	1.6	10.5	13.7	14.3	11.7	12.7	12.8
M2	39.5	22.4	20.0	17.1	15.4	13.7	13.1	12.8
Credit to private sector in rials	30.7	16.7	17.3	18.2	17.5	16.0	15.7	14.5

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, which is does not fall under the definition of government used in Table 3 and 4.

Table 6. Islamic Republic of Iran: Medium-Term Scenario, 2013/14–2020/21[1/]

	2013/14	Est. 2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
	(Annual change, in percent, unless otherwise indicated)							
National accounts								
Nominal GDP at market prices (in billions of Iranian rials)	9,421,216	11,033,666	11,992,122	14,042,908	15,934,661	17,694,609	19,371,763	21,150,347
Real GDP at factor cost	-1.9	3.0	0.0	4.3	4.0	4.1	4.4	4.4
Real oil and gas GDP	-8.9	4.8	0.5	16.9	8.8	2.9	2.5	2.5
Real nonoil GDP	-1.1	2.8	-0.1	2.8	3.4	4.3	4.6	4.6
CPI inflation (average)	34.7	15.5	15.1	11.5	8.3	6.3	5.0	5.0
CPI inflation (end of period)	19.7	16.2	14.0	9.0	7.5	5.0	5.0	5.0
Unemployment rate (in percent of labor force)	10.4	10.6	11.9	12.5	12.6	12.4	12.2	11.9
	(In percent of GDP)							
Investment and savings								
Investment	32.1	31.1	30.9	31.3	31.1	30.9	30.8	30.7
Change in stocks	5.3	4.6	4.5	4.4	4.2	4.0	3.9	3.7
Total fixed capital investment	26.8	26.5	26.3	26.9	26.9	26.9	26.9	27.0
Gross national savings	39.9	35.2	32.1	33.3	33.8	33.7	33.2	32.9
Savings/investment balance	7.8	4.1	1.3	2.1	2.6	2.8	2.4	2.2
Budgetary operations								
Revenue	14.1	14.6	13.2	14.5	15.5	15.4	15.4	15.4
Of which: oil revenue	6.5	5.7	3.9	4.9	5.6	5.5	5.4	5.2
Expenditure	15.0	15.7	15.4	15.9	15.8	15.7	15.6	15.6
Expense	12.7	13.0	12.8	12.7	12.5	12.3	12.2	11.9
Net acquisition of nonfinancial assets	2.3	2.7	2.7	3.2	3.3	3.4	3.5	3.7
Net lending/borrowing (overall balance)	-2.2	-1.2	-2.5	-1.3	-0.3	-0.3	-0.2	-0.2
Net lending/borrowing (budget)	-0.9	-1.2	-2.2	-1.3	-0.3	-0.3	-0.2	-0.2
Balance of Targeted Subsidy Organization	-1.3	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
	(Annual change in percent, unless otherwise indicated)							
Monetary sector								
Credit to the private sector in rials	30.7	16.7	17.3	18.2	17.5	16.0	15.7	14.5
Broad money (M2)	39.5	22.4	20.0	17.1	15.4	13.7	13.1	12.8
	(In billions of U.S. dollars, unless otherwise indicated)							
External sector								
Current account balance	26.5	15.9	4.5	8.5	11.7	13.2	12.5	12.1
In percent of GDP at market prices	7.8	4.1	1.3	2.1	2.6	2.8	2.4	2.2
Gross official reserves	117.6	126.2	128.9	142.1	159.9	179.3	198.2	217.2
	(In U.S. dollars, unless otherwise indicated)							
Oil and gas sector								
Total oil and gas exports (billions)	64.9	55.4	35.3	48.6	59.8	65.3	68.6	71.2
Crude oil production (in millions of barrels/day)	2.8	3.1	3.1	3.7	4.0	4.2	4.3	4.4
Memorandum items:								
Average exchange rate (Iranian rials per U.S. dollar)	24,770	26,492	...	...	...	...	...	...

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

1/ The Iranian fiscal year ends March 20.

Table 7. Islamic Republic of Iran: Vulnerability Indicators, 2010/11–2014/15[1/]

	2010/11	2011/12	2012/13	2013/14	Est. 2014/15
External solvency indicators					
Real effective exchange rate (REER) (end of period; percent change)	8.4	2.0	-29.6	14.3	18.4
Total external debt (in billions of U.S. dollars)	22.6	17.3	7.7	6.7	5.1
(In percent of GDP)	4.9	3.4	1.9	2.0	1.3
Short-term external debt (in billions of U.S. dollars)	11.5	8.3	0.9	0.8	0.4
(In percent of GDP)	2.5	1.6	0.2	0.2	0.1
(In percent of exports of goods and services) [2/]	9.5	5.4	0.9	0.8	0.5
External debt service (in percent of exports of goods and services) [2/ 3/]	1.9	2.0	4.1	2.5	2.2
External liquidity indicators					
Gross official assets (in billions of U.S. dollars) [4/]	70.8	92.2	104.4	117.6	126.2
(In months of the following year's imports of goods and services) [2/]	8.9	13.4	16.7	17.6	20.9
(In percent of short-term external debt)	617	1,116	11,074	15,136	29,273
Commercial banks' net foreign assets (in billions of U.S. dollars)	48.4	49.5	51.2	53.2	44.9
Foreign assets [4/]	65.5	66.2	67.4	69.0	57.1
Foreign liabilities [4/]	17.2	16.7	16.2	15.8	12.2
Oil and oil-related exports (in percent of exports of goods)	80.0	81.6	70.0	69.7	64.0
Financial sector indicators					
Risk-weighted capital adequacy of banks (in percent)	8.4	7.9	8.6	8.7	...
Ratio of nonperforming loans of banks (in percent of total loans)	13.7	15.1	14.7	14.1	12.1
Loan provisions as a percentage of nonperforming loans	35.1	37.5	39.4	36.1	...
Return on assets (in percent)	1.0	0.9	1.0	...	...
Net domestic credit (percent change)	31.6	12.1	20.9	18.0	15.9
Net domestic credit (in percent of GDP)	69.6	59.6	63.3	56.7	56.1
Private sector credit in local currency (percent change)	37.1	20.1	17.7	30.7	16.7
Market assessment/financial market indicators					
Stock market price index (percent change; end-of-period)	89.2	11.2	46.8	107.7	-20.9
Stock market capitalization (in percent of GDP)	8.8	8.0	10.1	12.2	11.0

Sources: Iranian authorities; and Fund staff estimates.

1/ The Iranian fiscal year ends March 20.
2/ Excluding interest receipts and payments.
3/ Excluding service of short-term external debt.
4/ Including assets and liabilities in foreign exchange held by residents and contingent liabilities under letters of credit.

Appendix I. Fiscal and External Debt Sustainability

Iran, Islamic Republic of Public Sector Debt Sustainability Analysis (DSA) - Baseline Scenario

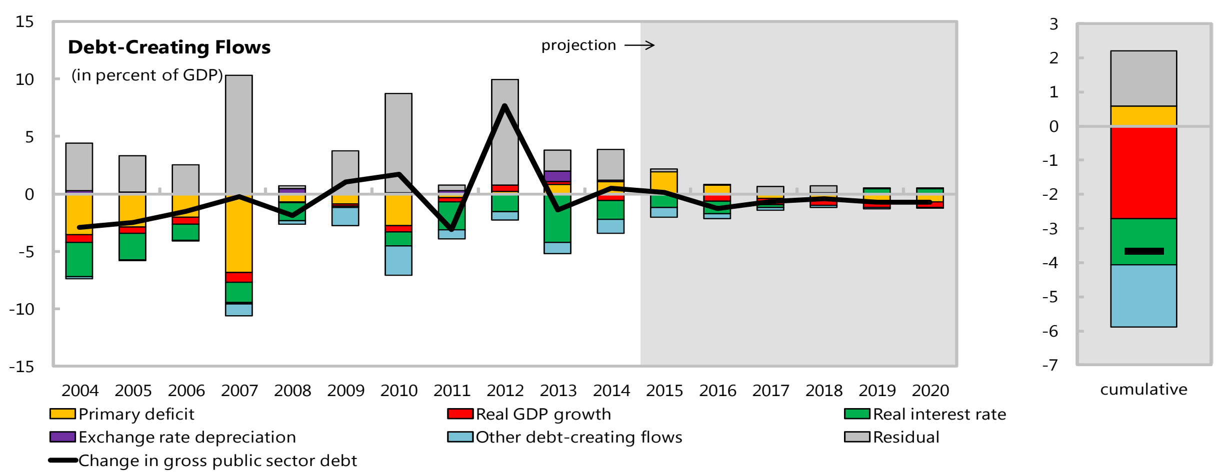
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of August 30, 2013		
	2004-2012 [2/]	2013	2014	2015	2016	2017	2018	2019	2020	Sovereign Spreads		
Nominal gross public debt	12.2	15.4	15.9	16.1	14.8	14.1	13.7	12.9	12.3	EMBIG (bp) 3/		n.a.
Public gross financing needs	-2.1	0.9	1.2	3.9	2.7	0.6	1.7	1.0	1.2	5Y CDS (bp)		n.a.
										Ratings	Foreign	Local
Real GDP growth (in percent)	3.4	-1.9	4.3	0.0	4.3	4.0	4.2	4.4	4.4	Moody's	n.a.	n.a.
Inflation (GDP deflator, in percent)	17.6	34.3	12.2	8.7	12.3	9.1	6.6	4.9	4.6	S&Ps	n.a.	n.a.
Nominal GDP growth (in percent)	21.6	31.8	17.1	8.7	17.1	13.5	11.0	9.5	9.2	Fitch	n.a.	n.a.
Effective interest rate (in percent) [4/]	1.6	0.7	0.7	0.8	4.8	7.7	7.8	9.0	9.1			

Contribution to Changes in Public Debt

	Actual			Projections							
	2004-2012	2013	2014	2015	2016	2017	2018	2019	2020	cumulative	debt-stabilizing
Change in gross public sector debt	-0.2	-1.4	0.5	0.1	-1.3	-0.7	-0.4	-0.7	-0.7	-3.7	primary
Identified debt-creating flows	-4.9	-3.2	-2.1	-0.1	-1.4	-1.4	-1.0	-0.8	-0.7	-5.3	balance [9/]
Primary deficit	-2.2	0.9	1.1	1.9	0.8	-0.4	-0.5	-0.6	-0.7	0.6	-0.1
Primary (noninterest) revenue and grant	22.1	14.1	14.6	13.2	14.5	15.5	15.4	15.4	15.4	89.5	
Primary (noninterest) expenditure	19.9	14.9	15.6	15.1	15.3	15.1	15.0	14.8	14.8	90.1	
Automatic debt dynamics [5/]	-1.9	-3.1	-2.0	-1.1	-1.7	-0.8	-0.4	-0.1	0.0	-4.1	
Interest rate/growth differential [6/]	-2.1	-4.0	-2.2	-1.1	-1.7	-0.8	-0.4	-0.1	0.0	-4.1	
Of which: real interest rate	-1.7	-4.2	-1.6	-1.1	-1.1	-0.2	0.1	0.5	0.5	-1.4	
Of which: real GDP growth	-0.4	0.2	-0.6	0.0	-0.6	-0.5	-0.5	-0.5	-0.5	-2.7	
Exchange rate depreciation [7/]	0.1	0.9	0.2	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.8	-1.0	-1.2	-0.9	-0.5	-0.2	-0.1	-0.1	0.0	-1.8	
Privatization (negative)	-0.8	-1.0	-1.2	-0.9	-0.5	-0.2	-0.1	-0.1	0.0	-1.8	
Contingent liabilities	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Please specify (2) (e.g., ESM and Euroa	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	
Residual, including asset changes [8/]	4.7	1.8	2.6	0.2	0.1	0.7	0.6	0.0	0.0	1.6	



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.

5/ Derived as [(r - π(1+g) - g + ae(1+r)]/(1+g+π+gπ)) times previous period debt ratio, with r = interest rate; π = 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 - π (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/ Includes asset changes and interest revenues (if any). For projections, includes exchange rate changes during the projection period.

9/ 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.

Islamic Republic of Iran: External Debt Sustainability Framework, 2010–20

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2010	2011	2012	2013	2014			2015	2016	2017	2018	2019	2020	Debt-stabilizing non-interest current account 6/
Baseline: External debt	4.9	3.4	1.9	2.0	1.6			**2.7**	**3.0**	**3.5**	**3.8**	**4.2**	**4.5**	**-0.6**
Change in external debt	-0.5	-1.5	-1.5	0.1	-0.4			1.1	0.4	0.4	0.4	0.3	0.3	
Identified external debt-creating flows (4+8+9)	-6.7	-11.9	-6.0	-6.8	-4.3			-0.4	-2.1	-3.0	-3.4	-3.8	-4.4	
Current account deficit, excluding interest payments	-6.2	-11.7	-6.0	-8.1	-4.4			-0.8	-1.9	-2.6	-2.8	-3.3	-3.9	
Deficit in balance of goods and services	-5.8	-11.3	-5.4	-7.3	-3.7			-0.5	-1.2	-1.6	-1.7	-1.4	-1.3	
Exports	26.3	29.9	25.6	29.4	24.6			20.5	23.8	25.5	25.5	25.0	24.6	
Imports	20.6	18.5	20.2	22.1	20.9			20.0	22.6	23.9	23.8	23.6	23.3	
Net non-debt creating capital inflows (negative)	0.0	0.5	0.0	-0.1	0.0			0.0	-0.5	-0.8	-1.1	-1.1	-1.1	
Automatic debt dynamics 1/	-0.5	-0.7	0.1	1.4	0.1			0.4	0.3	0.4	0.5	0.6	0.6	
Contribution from nominal interest rate	0.3	0.1	0.2	0.3	0.2			0.4	0.5	0.6	0.7	0.7	0.8	
Contribution from real GDP growth	-0.3	-0.2	0.2	0.1	-0.1			0.0	-0.1	-0.1	-0.1	-0.2	-0.2	
Contribution from price and exchange rate changes 2/	-0.5	-0.7	-0.3	0.9	-0.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	6.2	10.4	4.5	6.8	3.9			1.6	2.5	3.4	3.8	4.1	4.7	
External debt-to-exports ratio (in percent)	18.5	11.3	7.4	6.7	6.3			13.1	12.8	13.6	15.0	16.6	18.2	
Gross external financing need (in billions of US dollars) 4/	-17.0	-45.4	-11.9	-23.3	-13.4			0.6	0.9	-0.7	0.0	-0.7	-2.6	
in percent of GDP	-3.7	-8.8	-2.9	-6.8	-3.5	10-Year	10-Year	0.2	0.2	-0.2	0.0	-0.2	-0.5	
Scenario with key variables at their historical averages 5/								**2.7**	**-2.2**	**-6.0**	**-9.4**	**-12.6**	**-15.2**	**0.4**
Key Macroeconomic Assumptions Underlying Baseline						Historical Average	Standard Deviation							
Real GDP growth (in percent)	6.6	3.7	-6.6	-1.9	4.3	2.8	4.5	0.0	4.3	4.0	4.2	4.4	4.4	
GDP deflator in US dollars (change in percent)	9.7	17.3	10.6	-33.5	4.9	7.0	15.5	-5.5	0.5	3.3	3.2	2.9	2.9	
Nominal external interest rate (in percent)	5.8	3.4	6.2	12.1	12.4	7.4	2.8	23.1	17.7	19.6	20.2	20.2	19.5	
Growth of exports (US dollar terms, in percent)	26.4	25.9	-32.2	-4.0	-5.9	9.0	22.7	-21.1	21.8	15.0	7.5	5.3	5.7	
Growth of imports (US dollar terms, in percent)	9.3	0.0	-13.6	-8.8	6.6	5.6	11.2	-9.5	18.4	13.5	7.3	6.2	6.3	
Current account balance, excluding interest payments	6.2	11.7	6.0	8.1	4.4	7.2	2.7	0.8	1.9	2.6	2.8	3.3	3.9	
Net non-debt creating capital inflows	0.0	-0.5	0.0	0.1	0.0	0.0	0.3	0.0	0.5	0.8	1.1	1.1	1.1	

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.

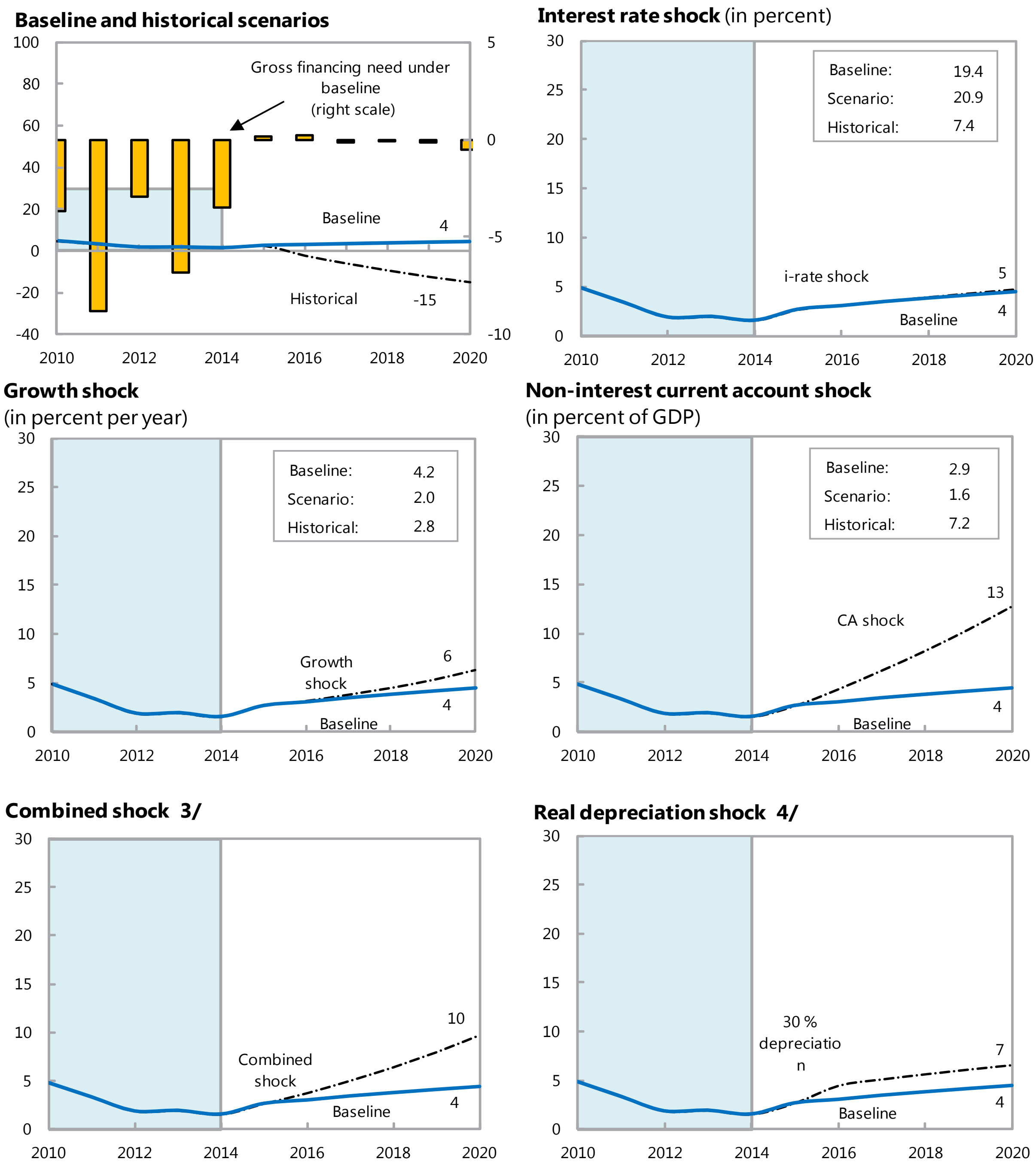
4/ Defined as current account deficit, plus amortization on medium- and long-term debt, plus short-term debt at end of previous period.

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.

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 2010.

Appendix II. External Sustainability Assessment for Iran

External Sector Vulnerabilities

Overall assessment: Iran's external position has been resilient in recent years. If removal of sanctions proceeds, current account surpluses and access to reserves should improve. Lower oil prices pose risks, including to exchange rate stability.	**Background**. Iran's external surpluses declined due to international restrictions on oil exports. The ensuing sharp real depreciation led to a significant compression of imports and a cumulative 9 percent decline in output. **Potential policy responses**. Fiscal consolidation and a tight monetary policy stance will help to protect macroeconomic stability. The (official) real exchange rate has climbed back towards pre-crisis levels and appears overvalued. But uncertainties over Iran's external environment cloud the assessment.
Current account: declining surpluses	**Background**. Current account surpluses have shrunk from 11 percent in 2011/12 to 4 percent in 2014/15 due to the sanctions-related decline in oil export volumes. Import compression and rising non-oil exports have cushioned the decline. **Assessment**. The current account remains in surplus. Further increase in non-oil exports will be crucial to reduce Iran's dependency on oil revenue and provide buffers against external shocks.
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 bureau market-determined rate for all other current account transactions. Uncertainty over Iran's external environment has led to bouts of volatility in the parallel rate. **Assessment**. Two of the three CGER methods suggest that the official exchange rate is overvalued. With the expected improvement in Iran's external environment, the bureau real exchange rate seems better aligned with fundamentals.
Capital and financial account: insignificant	**Background**. Iran's economy has been largely 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. **Assessment**. The balance of the capital account is small and has only a marginal impact on Iran's external assessment.
FX assets/reserves: large but not fully accessible	**Background**. Iran's foreign exchange assets/reserves stood at $127 billion at end-2014/15, equivalent to 20 months of imports. A significant share of the stock of reserve remains inaccessible due to sanctions. Technical external arrears have emerged because of Iran's difficulty in executing payments. **Assessment**. The level of gross foreign exchange assets appears comfortable.
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 the relief of sanctions. **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.

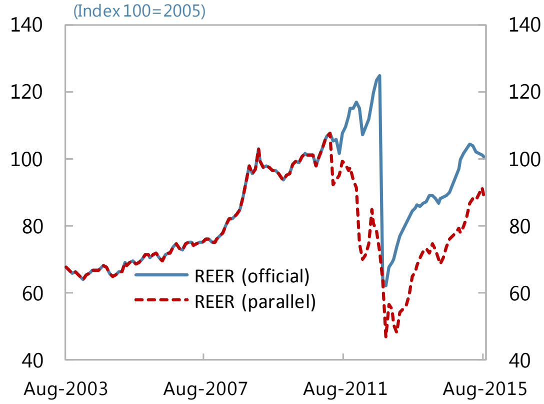
Source: IMF staff.

1. **Iran's current account surplus has declined markedly in recent years amid a deteriorating external environment**. Oil export receipts have declined by over 60 percent since mid-2012, reflecting the large decline in volumes and more recently the sharp drop in oil prices. Non-oil exports, on the other hand, have risen from 5 percent to 8 percent of GDP, precipitated by the real depreciation in 2012. Imports have declined by about $12 billion (3 percent of GDP) as a result of higher costs of conducting international business and the real depreciation. Overall, the current account surplus declined from 12 percent of GDP in 2011/12 to just over 4 percent of GDP in 2014/15.

2. **External buffers appear comfortable**. Gross foreign exchange assets stood at $126 billion, equivalent to 18 months of imports and 70 percent of broad money, at end-March 2015. However, difficulties in accessing the international payment system and making payments in convertible currencies following the intensification of international sanctions in 2012 have affected the liquidity and currency composition of foreign assets.

3. **After a sharp depreciation in 2012, Iran's real effective exchange rate has since regained more than half of the decline**. The Iranian authorities operate a two-tiered exchange rate system. Imports of a few basic necessities such a medicine and food staples can be imported at the official exchange rate, which the CBI determines and supplies with Iran's oil exports receipts. Importers of all other goods buy their foreign exchange in the bureau market, which is supplied mostly from non-oil exports. Since March 2014, the official rate has depreciated 18 percent against the U.S. dollar. However, because of U.S. dollar strength, the rial appreciated by 5 percent against the euro, for example, over the same time period. In addition, inflation differentials between Iran and its trading partners have remained high, although there is some uncertainty about the exact differential—the measured 12 percentage points are likely to be an upper bound as Iran's trade has recently shifted towards countries with slightly higher inflation rates (China and India). With this caveat in mind, these developments imply that the rial on a real effective basis has appreciated about 15 percent since March 2014. The appreciation is more pronounced when examining the bureau rate, as the rial was resilient in that market at a time of growing optimism about the nuclear negotiations between Iran and the P5+1.

Real Effective Exchange Rates
(Index 100=2005)



Source: IMF staff calculations.

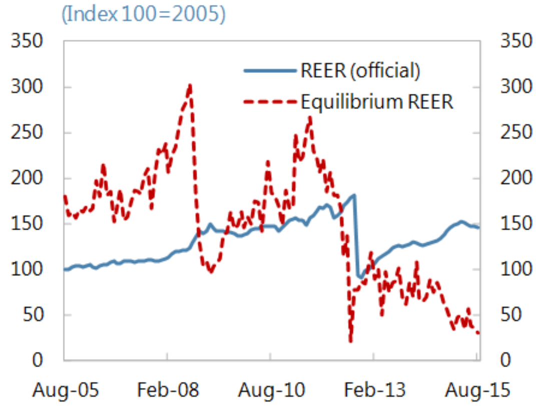
4. **Models based on high-frequency data suggest that the official exchange rate remains stronger than its estimated equilibrium level on a real effective basis**. Likewise, the macroeconomic balance approach for estimating current account norms of oil exporters also suggest that Iran's medium-term current account is slightly below its equilibrium level. In contrast, the external sustainability approach does not indicate a misalignment. However, the result of no misalignment hinges on the assumption of unified official and bureau market exchange rates. The

uncertainty about the timing of implementation of the JCPOA between Iran and the P5+1 and its repercussions on Iran's external environment complicates estimates of current account norms and equilibrium exchange rate levels, clouding the assessment of the exchange rate.

5. **The equilibrium real effective exchange rate approach analyzes the relationship between Iran's official exchange rate and economic fundamentals**. Using monthly data, a vector error-correction model is used to estimate the long-run relationship between Iran's real effective exchange rate (REER) and oil prices and oil export volumes. Given observed values of the fundamentals, the model predicts an equilibrium level of the REER in every period. In addition, the model can break down movements in the equilibrium into changes in the fundamentals.

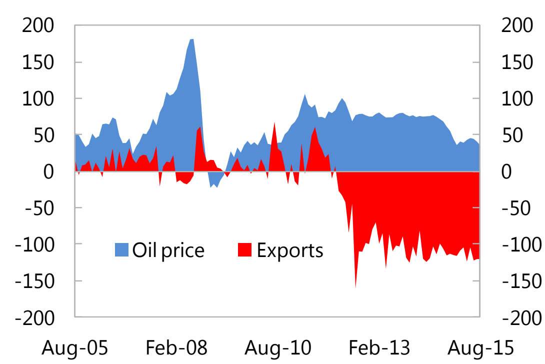
6. **The equilibrium approach suggests that the overvaluation of the official real effective exchange rate persisted over the past year**. The misalignment, based on high frequency data, has widened significantly since the devaluation in September 2012, which restored equilibrium at that time. The rial has continuously appreciated in real terms since the devaluation, mainly driven by high inflation differentials. The equilibrium rate, in contrast, has eased further due to lower international oil prices. Oil export volumes, the other determinant of the equilibrium, have stabilized at around 1.3 mbpd amid the interim agreement with the P5+1. These oil export volumes are well below pre-sanction levels. The model therefore suggests that economic fundamentals would have called for a depreciation of the real effective exchange rate; instead the rial appreciated on a real effective basis (see above). However, were oil export levels to return to the pre-crisis average of 2007–10, the gap between the equilibrium and actual REER would narrow significantly.

REER and EREER (official)
(Index 100=2005)



Source: Fund staff calculations.

Contribution to Changes in EREER (official)
(Index numbers; cumulative from 2005)

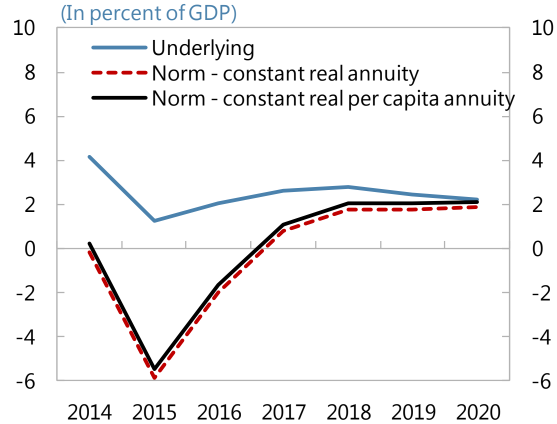


Source: Fund staff calculations.

7. **The external sustainability approach suggests no current account misalignment**. In Bems and de Carvalho Filho's (2009) methodology, Iran's current account norms are very close to its underlying current account in the medium term. Their approach is specifically designed for estimating external sustainability in resource-intensive countries. Achieving sustainability implies that import spending is no greater than the income stream derived from resource wealth. Applying this approach to Iran requires two steps. First, to estimate Iran's hydrocarbon wealth, staff assumes

that export volumes of crude oil remain constant from 2020 at a level that is equal to Iran's pre-crisis average export levels in 2007–11. Gas export volumes grow by 2.4 percent per year from 2020, consistent with the U.S. EIA 2014 annual report. Assumptions about export prices are consistent with the Fall 2015 WEO database. The discounted sum of all future hydrocarbon exports is then equal to \$1.34 trillion, an estimate of Iran's external hydrocarbon wealth. Second, to estimate the flow of income available for import expenditures, the stock of resource wealth has to be converted into annuities. Two common conversion methodologies exist—constant real per capita annuity and constant real annuity, although the differences are very small in the case of Iran, given low population growth. The results suggest that Iran's projected (or underlying) current account balance is close to its sustainable level of about +2 percent of GDP in the medium term. Note that the projected current surplus would be weaker, and therefore below the estimated norm, if the authorities fail to unify the official and parallel exchange rates at the more depreciated rate.

Current Account—Underlying and Norms
(In percent of GDP)



Source: Fund staff calculations.

8. **The current account norms of the external sustainability approach are sensitive to parameter choice**. For example, if the nominal rate of return that discounts future hydrocarbon export revenue increases from 6 to 8 percent, but real rates of return (at 4 percent) are unaffected, the current account norm under the constant real per capita rule increases to a surplus of 4.8 percent of GDP in 2020, compared to a surplus of 2.1 percent of GDP. Such an increase in the estimated current account norm would imply that the projected (underlying) current account would be significantly below the level consistent with economic fundamentals. The effect of trimming the assumption of gas export volume growth from 2.4 to 0 percent (because of higher domestic consumption, for example) on the current account norm has a similar magnitude.

9. **The macroeconomic balance approach finds that Iran's underlying current account is weaker than its norm**, unlike the external sustainability approach. This result suggests that the rial will need to depreciate on a real effective basis to bring the underlying current account to the level implied by the norm. Following Beidas-Strom and Cashin (2011), the macroeconomic balance approach estimates four main specifications of Iran's current account norm. The specifications differ as to whether they include a lagged dependent variable and how they proxy resource wealth (see text table). Specifications II and IV are the most appropriate for Iran as they capture the economic impact of Iran's significant oil and gas reserves. In contrast, specification I does not take into account that Iran's resource wealth surpasses current net foreign assets, and specification III carries a counterintuitive sign on the contribution of oil and gas wealth to the current account norm. The macroeconomic balance approach therefore puts the current account norm in the range of a surplus around 5 percent of GDP, above staff's projected current account surplus of 2.9 percent of GDP in 2020.

Current Account-GMM Estimation and Norm for Net-Oil Exporters: Iran 1/

(Dependent variable: current account balance, as a share of GDP)

	Specification I		Specification II		Specification III		Specification IV	
	GMM Coefficients	Contribution to CA Norm1	GMM Coefficients	Contribution to CA norm1	GMM Coefficients	Contribution to CA Norm1	GMM Coefficients	Contribution to CA Norm1
Core CGER regressors								
Constant	0.039	3.9%	0.350	3.5%	0.043	4.3%	0.044	4.4%
Lagged dependent	0.330	2.3%					0.383	2.6%
Fiscal balance/Non-oil fiscal balance GDP	0.851	-2.6%	0.385	-2.0%	0.363	-1.8%	0.391	-2.0%
Oil trade balance/GDP			0.454	3.0%	0.469	3.1%	0.459	3.0%
Old age dependency	-0.053	-0.4%	-0.059	-0.4%	-0.034	-0.2%	-0.034	-0.2%
Population growth	-0.693	-0.9%	-0.930	-1.2%	-0.632	-0.8%	-0.589	-0.8%
NFA/GDP	0.023	0.9%	0.022	0.8%				
Relative income	-0.017	-0.5%	0.044	1.2%	0.071	2.0%	0.073	2.0%
Economic growth	-0.053	-0.1%	-0.069	-0.1%	-0.064	-0.1%	-0.056	-0.1%
Net oil-exporter specific regressors								
Oil wealth			0.000	0.6%	0.001	1.8%	0.000	-1.2%
Degree of maturity in oil production					0.160	2.9%	0.170	-3.1%
Additional regressors								
REER growth	0.073	0.2%						
Terms of trade growth	4.269	-0.8%						
Estimated current account norm (2020)		**2.0%**		**5.4%**		**11.1%**		**4.7%**
Average current account norm					**5.1%**			

1/ Methodology based on Beidas-Strom and Cashin, 2011, "Are Middle Eastern Current Account Imbalances Excessive?", IMF Working Paper 11/195.

10. **The value of the rial in the bureau market provides another means of examining the degree of exchange rate misalignment**. The bureau market exchange rate is 10–15 percent weaker than the official rate. However, the premium in the bureau market has shrunk significantly from March last year, when it stood above 20 percent. Greater optimism about Iran's economic prospects has reportedly contained capital outflows and supported inflows through the bureau market. If Iran and the P5+1 successfully implement the JCPOA, the CBI has indicated it will move towards unifying the official and bureau market exchange. In an improved external environment without restrictions on oil exports, such a depreciation could significantly narrow the estimated overvaluation of the rial.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF IRAN

November 18, 2015

STAFF REPORT FOR THE 2015 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

Approved By

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

CONTENTS

FUND RELATIONS

(As of September 30, 2015)

Membership Status:

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

General Resources Account

	SDR Million	Percent Quota
Quota	1,497.20	100.00
Fund Holdings of Currency	1,497.23	100.00
Reserve Tranche Position	0.01	0.00

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	1,426.06	100.00
Holdings	1,536.62	107.75

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			
	2015	2016	2017	2018	2019
Principal					
Charges/Interest		0.02	0.02	0.02	0.02
Total		**0.02**	**0.02**	**0.02**	**0.02**

[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)

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

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, which also gives rise to 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 two percent from the rate used by foreign exchange bureaus.

A Multiple currency practice arises from the budget subsidies for foreign exchange purchases in connection with payments of certain 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 rate 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.

Last Article IV Consultation

The last Article IV consultation was concluded by the Executive Board on March 28, 2014.

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
LEG	FY 2009	Anti-Money Laundering/Combating Financing of Terrorism regulations
	FY 2015	Anti-Money Laundering/Combating Financing of Terrorism regulations
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
STA	FY 2011	GDDS: Metadata Development
	FY 2016	National Accounts

RELATIONS WITH THE WORLD BANK GROUP

The World Bank Group has no program in the Islamic Republic of Iran. The last Interim Assistance Strategy covered FY2002-2005, and the last IBRD project closed in 2012. 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 and is a donor to IDA16.

The Bank is in the process of preparing an Economic Monitoring Note that reviews recent economic developments and assesses the economic outlook with a focus on oil and gas exports and the financial sector.

STATISTICAL ISSUES

Assessment of Data Adequacy for Surveillance

General

Data provision has shortcomings, although it is broadly adequate for surveillance. However, the data tends to be reported with significant delays, notwithstanding recent improvement in timeliness.

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 and Labor Markets

National accounts statistics are broadly sound and released in a timely manner. There is scope for further progress, especially by extending the use annual surveys to all activities to ease data compilation. Also, the CBI and the Statistical Center of Iran (SCI) could make further progress to review and unify their respective GDP estimates. The Fund delivered TA in 2015 to assist the authorities to improve their national accounts statistics, advising strengthened cooperation between the CBI and SCI, and making specific recommendations to improve data compilation quality.

Data on labor force and unemployment are published regularly.

Price Statistics

Price statistics are methodologically sound and released in a timely manner. The official labor market statistics are released by the SCI, and are based on the definitions by the International Labor Organization (ILO). The data is based on an urban and rural population sample of about 60,000 households, and the threshold for considering a person employed is to have worked at least one hour during the reference week. Labor market statistics, however, could benefit from further improvement, particularly with regard to hours worked and wage data.

Government Finance Statistics

Government finance statistics only cover the central government. They are not released on a regular basis. Efforts are currently being made to improve the quality of data, by strengthening Treasury functions. Data are then expected to be updated and released on a regular basis. The Ministry of Finance has started to collect data on public debt to improve the quality of debt statistics. Higher frequency data on central government debt is derived from the monetary survey.

Data are compiled in accordance with the *Government Finance Statistics Manual 2001 (GFSM2001)* for central government operations. There is scope to improve coverage of fiscal reporting on general government by including the nonfinancial public corporations sector data, as well as other public agencies such as the National Development Fund of Iran, the Oil Stabilization Fund, and the Targeted Subsidy Organization.

The authorities plan to move from cash to accrual accounting in the context of their broad reform of their public financial management system, for which they have received Fund TA.

Monetary and Financial Statistics

Monthly monetary data are reported to STA for publication in IFS, but timeliness needs to be improved. Compilation of monetary statistics diverges from international standards in the application of the residency criterion and in the sectorization and classification of accounts. The authorities are undertaking improvements in each of these areas, in line with the recommendations of past STA missions. The measure of broad money employed by the CBI does not include deposits of public nonfinancial corporations, local governments, or foreign-currency deposits of residents.

Financial Sector

The authorities report quarterly statistics on nonperforming loans in domestic and foreign currency in the quarterly *Economic Trends*. NPL data is based on data submissions by banks to the CBI, widely believed to be inaccurate. The authorities do not publish other Financial Stability Indicators (FSIs).

External Sector Statistics

The accounting system for foreign exchange receipts and payments of the CBI and banks is being implemented in line with the methodological guidelines of the Fund's Balance of Payments Manual, fifth edition (BPM5).

Data on the international investment position are compiled, but not disseminated. In recent years, the compilation of data has been very difficult. Only data on public and publicly guaranteed debt are disseminated, but classifications do not fully accord with the guidelines of the External Debt Guide. The data template on international reserves and foreign currency liquidity is not compiled.

Data Standards and Quality

Participant in the General Data Dissemination System (GDDS) since 2012. Iran still needs to improve the timeliness of data dissemination to fully meet GDDS standards.	No data ROSC is available.

Islamic Republic of Iran: Common Indicator Required for Surveillance

(October 2015)

	Date of latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	October 20, 2015	October 20, 2015	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	June 2015	September 2015	M	I	I
Reserve/Base Money	July 2015	September 2015	M	Q	Q
Broad Money	July 2015	September 2015	M	Q	Q
Central Bank Balance Sheet	July 2015	September 2015	M	Q	I
Consolidated Balance Sheet of the Banking System	July 2015	September 2015	M	Q	Q
Interest Rates[2]	June 2015	September 2015	M	Q	Q
Consumer Price Index	September 2015	October 2015	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	August 2015	September 2015	M	I	I
Stocks of Central Government and Central Government-Guaranteed Debt[5]	June 2015	September 2015	Q	I	I
External Current Account Balance	June 2015	September 2015	M	Q	Q
Exports and Imports of Goods and Services	June 2015	September 2015	M	Q	Q
GDP/GNP	June 2015	September 2015	Q	Q	Q
Gross External Debt	June 2015	September 2015	M	Q	Q
International Investment Position[7]	Sept. 2010	May 2011	A	I	N/A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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
December 7, 2015

My authorities thank staff for its candid discussions and hard work in preparing this year's Article IV Consultation report and Selected Issues Paper, which provide a thorough assessment of Islamic Republic of Iran's recent economic developments and achievements, as well as policy options available to meet future challenges. They appreciate Fund's policy advice and technical assistance to support their efforts in safeguarding macroeconomic stability, strengthening the financial sector, and advancing structural reforms to enhance inclusive growth. My authorities are in broad agreement with staff analysis and policy recommendations, and look forward to continued close dialogue and engagement with the Fund in the period ahead.

Overview

Since taking office in August 2013, the current administration has firmly moved in the direction of easing external constraints and addressing the many economic, financial, and social challenges ahead through sound macroeconomic, financial, and structural policies. These, together with the signing of the Joint Comprehensive Plan of Action (JCPOA) between Iran and the P5+1 in July 2015 have helped restore macroeconomic stability, bolster public confidence, and improve investment and growth prospects. Notwithstanding lower global oil prices, the prospective lifting of economic sanctions in the coming months has set the stage for improved macroeconomic performance on account of expected higher oil production and exports, lower costs for trade and financial transactions, and restored access to Iran's frozen foreign assets.

The successful implementation of the JCPOA would also entail positive spillovers to the region and the rest of the world through increased global oil supply and new trade and investment opportunities. The October 2015 Regional Economic Outlook for the Middle East and Central Asia estimates a cumulative 15 percent increase in Iran's real GDP during the next 5 years relative to a baseline scenario of sustained sanctions, and substantial gains for Iran's regional trading partners. Iran's full return to the global oil market, and its further integration into the global economy, are estimated to lift global GDP growth by about 0.25 percent over the medium term, given the size of its economy (1.5 percent of global GDP), and its large oil and gas reserves (4^{th} and 2^{nd} largest in the world, respectively).

Recent Economic Developments and Outlook

After a cumulative contraction of around 9 percent over 2012/13–2013/14, growth rebounded to 3 percent in 2014/15. Average CPI inflation declined sharply from 35 to 15 percent, making interest rates positive in real terms, while unemployment remained below 11 percent. The overall fiscal deficit narrowed, reflecting increased domestic revenue and the implementation of the subsidy reform, and public debt remained low at around 15 percent of GDP. The external current account remained in surplus, albeit lower than in the previous year, and the exchange rate was relatively stable.

Notwithstanding continued prudent policies, the sharp decline in global oil prices and a wait-and-see attitude on the part of consumers and investors have weakened the growth momentum in 2015/16. Real GDP is projected to stagnate, with contraction in manufacturing and construction weighing down on overall economic activity. Consistent with the Central Bank of Iran (CBI)'s effort to contain the growth of base money, year-on-year inflation has lately declined to 10 percent, raising expectations for an average CPI inflation of 13 percent in 2015/16.

My authoritries are aware of the downside risks to the near- and medium-term outlook and are determined to continue their efforts to preserve macroeconomic stability and address structural issues. They recognize the need to strengthen the policy framework and garner public and political support for their reform agenda. They attach high priority to supporting growth and job creation, containing inflation, unifying the exchange rate, rebuilding fiscal buffers and improving fiscal management, repairing corporate and bank balance sheets, and advancing structural reforms to bolster productivity and resilience to external shocks, including by reducing the economy's dependence on hydrocarbons. Barring materialization of some of the downside risks highlighted in the report, the authorities believe that the sustained implementation of reforms could raise growth over the medium-term significantly beyond staff projections, including from higher oil output, lower cost of trade and financial transactions, and increased capital inflows and FDI.

The Economic Stimulus Package

To stimulate demand and activity, the authorities have recently announced a series of measures within the interim package of economic stimulus for the next six months. As documented in Box 1 of the staff report, reflecting the authorities' commitment to fiscal consolidation, most of the announced measures relate to monetary policy, to improving access to finance, and to easing financial bottlenecks. As a result, the interbank rate has declined from a high of 29 percent in March 2015 to 22 percent in recent days. The CBI would abandon the application of a uniform statutory reserve requirement rate for commercial banks and apply reduced and differentiated rates of 10 to 13 percent, based on the degree of compliance with regulations. My authorities emphasize that the stimulus measures, which include financing to clear accumulated inventory of manufactured goods, are temporary in nature, would be implemented prudently, and their inflationary impact monitored closely. Moreover, a pilot of about 0.5 percent of GDP worth of government securities at marketable terms was issued in October to clear government arrears linked to suppliers and guarantees on infrastructure projects. This should help partially clean the corporate and banking sectors balance sheets, while a market for these securities would enhance liquidity management and develop domestic capital markets.

Fiscal Policy

Gradual and growth-friendly fiscal consolidation will remain the centerpiece of macroeconomic stability, notwithstanding the sharp decline in oil prices. However, despite higher tax revenue and lower current expenditure, the fiscal deficit is expected to widen to 2.5 percent of GDP in 2015/16 on account of lower oil budget revenues that would also result in a deficit at the Targeted Subsidy Organization (TSO). The authorities remain focused on lowering the non-oil deficit to support disinflation while creating room for public investment through a combination of revenue and expenditure measures. This includes broadening the tax base by removing exemptions to large non-taxpayers, and strengthening the tax administration, including through implementation of an integrated tax system, as well as reducing fuel subsidies and containing other current spending. While recognizing that increases in VAT rates could potentially bring about significant additional revenue, my authorities believe that the current weak growth environment is not suitable for such an action.

Subsidy reform has continued by adjusting domestic prices, including the price of gasoline, which was raised by 40 percent to around 30 US cents per liter in November, and by improving the targeting of the cash transfer program. The budgetary cost of fuel subsidies is projected to decline to 4 percent of GDP in 2015/16 and efforts will be made to reduce it further. However, identification and means testing of beneficiaries with a view to removing less vulnerable households from the program have proved challenging. The authorities agree that automatic stabilizers would be allowed to play freely should downside risks materialize and growth further disappoints in 2015/16.

My authorities agree on the need to better articulate annual budgets around medium-term goals specified within the 5-year development plans, and build adequate fiscal buffers to smooth expenditure. They are working to improve public financial management, as well as strengthen the framework for the National Development Fund (NDF) to which a third of oil revenue would be allocated over the next 5 years. While no allocation to the Oil Stabilization Fund (OSF) is envisaged under the 6^{th} Five-Year Development Plan general guidelines, my authorities take note of staff recommendation to reinstate and replenish the OSF, and introduce fiscal rules built around a comprehensive medium-term fiscal framework targeting the non-oil balance. A debt management unit within the treasury was also established in early 2015 to identify all government debt and help incorporate debt sustainability risks into a medium-term fiscal strategy.

Monetary and Exchange Rate Policies

Monetary policy is guided by the disinflation strategy which seeks to achieve single-digit inflation by end 2016/17. While prioritizing price stability over output growth, my authorities are of the view that some temporary relief to the economy is needed at present, given sluggish growth, better-than-expected inflation outturns, benign inflation outlook, and tight fiscal stance. They are specifically concerned that the high level of real interest rates stemming from high NPLs and competition from unlicensed financial institutions (UFIs) could pose a threat to growth and financial stability. Accordingly, steps are being taken by the CBI to ease the tight liquidity conditions for banks, including by supplying resources in the interbank market and reducing statutory reserve requirements. The authorities expect that these steps would encourage lower levels of interest rates to prevail in the market. They note staff's views on the uncertainty in the underlying inflation dynamics and outlook, but are confident that prudent implementation of their policy package would support growth while helping their gradual disinflation strategy. The authorities also find merit in anchoring inflation expectations, including by announcing broad money and inflation targets for 2016/17.

Institutional reforms of the monetary policy framework would help refocus CBI's legal mandate on price stability and entrench macroeconomic stability. The draft Money and Banking law presented to the government would strengthen the decision making process and enhance the CBI's operational autonomy. The authorities remain open to examining all feasible options in this area, including ways to strengthen communication and transparency.

Notwithstanding relative calm in the foreign exchange market, difficulties in accessing foreign exchange have kept the bureau market rate at a large premium over the official exchange rate. My authorities remain committed to unifying the exchange rate and are ready to proceed with unification and returning to a managed float regime once account relationships with foreign correspondent banks are reestablished and full access to international reserves restored. Notwithstanding uncertainties over the external environment which complicate the assessment, they share the view that the official exchange rate appears somewhat overvalued.

Financial Sector

The banking system faces several challenges that are a legacy of past distortive credit policies, weak risk management, inadequate supervision, compounded by external shocks. Recognizing the important challenges and the need for comprehensive reform, my authorities are determined to strengthen supervision, promote bank restructuring and recapitalization, accelerate NPL resolution, and restore banks' profitability. The initial study on financial health of banks has been carried out, and a more detailed assessment of the largest banks is to follow. Higher provisions have been mandated, and dividend payments have been restricted to protect bank capital. While there is scope for improved supervision under the existing legal mandate, enactment of the planned new banking law would substantially enhance CBI's enforcement powers and extend them to all banks and UFIs. My authorities also remain committed to bolstering the AML/CFT framework, including by joining the Eurasian AML/CFT group, to help the domestic financial system reintegrate to the global economy, and will seek Fund assessment in this area.

Structural Reforms

Higher, more sustainable and inclusive growth, and lower unemployment require wide-ranging structural reforms to tap Iran's economic potential. The authorities share the view that reforms should focus on fostering competition and unlocking productivity gains by enhancing the functioning of the labor, product, and capital markets, restructuring the energy-intensive corporate sector, improving the business climate, and further developing the private sector. Lowering unemployment, including by boosting the job-intensity of growth and increasing the sectoral elasticity of labor demand, remains a key objective of the authorities' medium-term strategy in the face of a growing labor force. My authorities take note of staff view that increased employment, including for women, could be promoted by expanding childcare in-work facilities, reducing payroll taxes for youth and women, and establishing skill-matching and training programs. Strengthening the price signal in the product markets would also increase investment in high-productivity sectors and companies. The authorities have taken various initiatives to streamline administrative procedures, reduce the cost of doing business, and promote privatization. They also agree that there is scope to lift sectoral productivity through FDI and the ensuing transfer of modern technologies.

Conclusion

The agreement on Iran's nuclear program would create an opportunity to build on and broaden the achievements of the past two years. While my authorities work for the successful implementation of the JCPOA, they realize that the road towards achieving development objectives and economic prosperity will be long and arduous. They remain determined to persevere with sound macroeconomic and structural policies to realize the goal of becoming one of the fastest-growing emerging economies over the next decade.