INTERNATIONAL MONETARY FUND

IMF Country Report No. 17/62

ISLAMIC REPUBLIC OF IRAN

February 2017

2016 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 2016 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 February 24, 2017 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 February 24, 2017, following discussions that ended on December 14, 2016, 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 February 9, 2017.
- An **Informational Annex** prepared by the IMF staff.
- A **Statement by the Executive Director** for the Islamic Republic of Iran.

The documents listed below will be separately released.

Selected Issues

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

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INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 17/65
FOR IMMEDIATE RELEASE
February 27, 2017

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

IMF Executive Board Concludes 2016 Article IV Consultation with the Islamic Republic of Iran

On February 24, 2017, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with the Islamic Republic of Iran.

Economic growth rebounded over the course of 2016/17 on the back of higher oil production. Real GDP grew by 7.4 percent in the first half 2016/17, rebounding from recession in 2015/16. However, growth in the non-oil sector averaged 0.9 percent, despite the pick-up registered in the second quarter, reflecting continued difficulties in access to finance and domestic financial sector and structural weaknesses. Inflation declined to single digits and has hovered in the 9.5 percent range, year-on-year, since mid-2016. The foreign exchange market stabilized although it experienced some volatility towards end-2016 before recovering in January 2017. The spread between the official and the market rate has narrowed to about 15 percent.

Growth is projected to stabilize at 4.5 percent over the medium-term as the recovery broadens. Real GDP growth is expected to reach 6.6 percent in 2016/17 and to ease to 3.3 percent in 2017/18 as oil production remains at the OPEC target. Thereafter, higher FDI and a gradual improvement in domestic financial conditions drive investment and stronger non-oil sector growth. The current account is forecast to remain in surplus as higher exports offset the pick-up in imports related to investment. Inflation is expected to temporarily rise to 11.9 percent (year-on-year) by end-2017/18 reflecting recent liquidity growth and pass-through from exchange rate depreciation, but to return to single digits on the back of prudent fiscal and monetary policies. The pace of job creation lags that needed to absorb the large number of new entrants to the labor market and unemployment remains high.

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

Executive Board Assessment[2]

Directors commended the authorities for achieving an impressive recovery in economic growth after the lifting of nuclear sanctions in 2016, maintaining inflation in single digits, and stabilizing the foreign exchange market. Given the renewed uncertainty, Directors emphasized the importance of maintaining prudent macroeconomic policies and building buffers, strengthening the financial sector, and advancing reforms to lessen Iran's reliance on oil and develop the private sector. They welcomed the authorities' commitment in this regard and the thrust of their reform plans.

Directors saw an urgent need for financial sector reforms to sustain financial stability and finance growth. They recommended enhanced supervision of distressed banks and an asset quality review to identify viable banks that warrant recapitalization and nonviable banks to be resolved. They encouraged the authorities to support recapitalization of public banks with measures that improve their commercial viability and wind down directed credit schemes. They looked forward to the approval of the new banking bill that would give the Central Bank of Iran (CBI) the supervisory powers to implement reforms. Directors also encouraged quick passage of the central bank bill to modernize the monetary policy framework and provide greater operational independence to the CBI to pursue low and stable inflation.

Directors urged the authorities to implement a medium-term fiscal framework to underpin their commitment to prudent fiscal policy and ensure gradual fiscal adjustment while funding financial sector reform costs. Higher revenue collections, further fuel price adjustment, and better targeting of cash transfers would create space to support growth and equity through higher public investment and cash transfers to the poor. Directors encouraged the authorities to explore the scope to use oil revenues to fund bank recapitalization, and noted the importance of replenishing the Oil Stabilization Fund to provide the budget a buffer.

Directors welcomed recent steps to strengthen the AML/CFT framework, the introduction of IFRS reporting in banks, and the audit and securitization of government arrears, which will help unlock corporates' and banks' balance sheets and facilitate greater investment. They urged the authorities to fully implement the FATF action plan, further enhance the AML/CFT framework, and improve the transparency of corporate ownership to facilitate re-integration into the global financial system and restore correspondent banking relationships. They noted that reducing the role of the state and improving the business climate would foster foreign investment and aid job creation. Labor market reforms, including specific measures to facilitate youth and female employment, would ensure that more people have opportunities to work and make growth more inclusive.

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

Directors approved retention of the temporary exchange restriction and multiple currency practices, but underscored the authorities' commitment to unify the exchange rate and shift to a managed float by early 2018, in order to provide flexibility for managing shocks. Directors urged the authorities to improve the quality, timeliness, and availability of data, including by implementing the Enhanced General Data Dissemination System (e-GDDS).

Islamic Republic of Iran: Selected Macroeconomic Indicators, 2014/15–2021/22 1/

Quota: SDR 3,567.10 million
Population: 78 million, 2014/15
Per capita GDP: current US$5,288, PPP current US$17,366, 2014/15
Poverty rate: 9 percent, $5.5 2011 PPP
Main exports: oil, gas, chemical and petrochemical products, pistachios

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
			(Annual percentage change, unless otherwise indicated)					
National accounts								
Nominal GDP at market prices (trillions of Iranian rials)	11,036	11,096	13,045	15,146	17,379	19,884	22,624	25,639
Nominal GDP (billions of US$)	415	374	377	368	386	412	441	472
Real GDP at factor cost	4.0	-1.8	6.6	3.3	4.3	4.4	4.5	4.4
Real oil GDP	7.3	6.4	52.2	2.6	6.7	6.7	6.7	5.8
Real non-oil GDP	3.7	-2.7	0.8	3.4	3.8	4.0	4.0	4.1
CPI inflation (average)	15.6	11.9	8.9	11.2	11.0	10.2	9.5	9.0
CPI inflation (end of period)	16.2	8.3	10.5	11.9	10.7	9.8	9.2	8.8
GDP deflator at factor cost	12.6	2.2	10.3	12.4	10.1	9.5	8.9	8.5
Unemployment rate (percent of labor force)	10.6	11.0	12.5	12.5	12.5	12.3	12.2	12.2
			(Percent of GDP)					
Saving investment balance 2/								
Current account balance	3.8	2.4	6.3	5.3	5.3	4.3	4.3	3.3
Investment	37.7	32.1	31.2	31.1	31.4	32.1	32.9	33.7
Change in stocks	12.2	8.6	8.0	7.8	7.5	7.2	6.8	6.6
Total fixed capital investment	25.5	23.5	23.1	23.3	23.9	25.0	26.0	27.2
Public	2.7	2.5	2.2	2.0	2.4	2.4	2.4	2.4
Private	22.8	21.1	21.0	21.3	21.5	22.5	23.7	24.8
Gross national savings	41.5	34.5	37.5	36.4	36.7	36.4	37.2	37.1
Public	1.1	1.0	0.0	3.5	2.4	2.6	3.0	2.9
Private	40.4	33.5	37.5	33.0	34.4	33.8	34.1	34.1
Central government operations								
Revenue	14.6	16.2	15.1	18.5	17.5	17.8	18.1	18.1
Tax revenue	6.4	7.1	6.9	7.0	7.7	8.4	9.1	9.3
Nontax revenue	8.1	9.0	8.2	11.5	9.8	9.4	9.0	8.8
Of which: oil revenue	5.7	6.0	5.4	8.7	7.1	6.8	6.5	6.3
Expenditure	15.7	17.9	17.9	17.9	17.9	18.0	17.9	18.0
Net lending/borrowing (budget)	-1.2	-1.8	-2.8	0.7	-0.4	-0.2	0.3	0.2
Balance of Targeted Subsidy Organization	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing (including TSO)	-1.2	-1.8	-3.1	0.7	-0.4	-0.2	0.3	0.2
Non-oil net lending/borrowing (percent of non-oil GDP)	-8.2	-9.0	-10.6	-10.4	-9.7	-8.9	-8.0	-7.9
			(Annual percentage change, unless otherwise indicated)					
Monetary sector								
Net foreign assets	1.2	14.4	32.1	24.3	21.4	15.9	16.7	13.7
Net domestic assets	35.9	41.5	28.0	21.0	13.6	14.4	11.8	12.2
Credit to the private sector in rials	16.7	16.7	30.3	19.7	15.5	15.0	13.0	12.8
Base money	14.6	16.4	23.0	17.1	13.4	12.0	11.6	10.7
Narrow money (M1)	0.9	13.2	23.1	18.3	11.9	12.6	12.2	11.5
Broad money (M2)	22.3	30.0	29.5	22.3	16.6	15.0	13.8	12.8
			(Billions of US$, unless otherwise indicated)					
External sector								
Current account balance	15.9	9.0	23.8	19.6	20.6	17.7	18.8	15.7
Exports of goods and services	96.4	74.9	102.2	114.3	118.6	122.5	127.5	132.7
Imports of goods and services	-82.1	-67.2	-79.4	-96.0	-100.6	-107.6	-111.6	-120.1
External and publicly guaranteed debt	5.1	10.0	8.2	7.5	8.1	8.7	9.4	10.1
Of which: short-term debt	0.4	2.0	2.2	2.4	2.6	2.9	3.1	3.4
Gross official assets/reserves	126.2	128.4	132.3	148.0	166.4	182.5	200.3	215.2
Oil and gas sector								
Total oil and gas exports	55.4	33.6	57.4	65.3	67.7	69.8	72.2	74.9
Average oil export price (US$ per barrel)	79.1	45.6	48.1	55.4	55.7	55.7	56.0	56.5
Crude oil exports (millions of barrels/day)	1.2	1.4	2.4	2.5	2.6	2.7	2.8	2.9
Crude oil production (millions of barrels/day)	3.2	3.3	4.1	4.2	4.5	4.8	5.1	5.4
Memorandum items:								
Average exchange rate (Iranian rials per US$)	26,594	29,645	…	…	…	…	…	…
End-of-period exchange rate (Iranian rials per US$)	28,085	30,260	…	…	…	…	…	…

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

1/ The Iranian fiscal year ends March 20.
2/ Based on central government operations.

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF IRAN

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION

February 9, 2017

KEY ISSUES

Context. The lifting of nuclear sanctions under the Joint Comprehensive Plan of Action (JCPOA) has spurred growth, but banking system weaknesses, structural bottlenecks, and hesitation by foreign banks to re-establish financial links have held back expansion of non-oil activity.

Outlook and risks. Iran could grow by about 4½ percent over the medium-term with the implementation of reforms. Risks are to the downside, however, reflecting renewed external uncertainty and a demanding reform agenda that requires broad political support.

Policy discussions focused on the sequencing and implementation of the authorities' reform plan, and equipping the policy framework to support stability and address shocks:

Comprehensive banking sector reform is urgently needed. Banks should be restructured and recapitalized to safeguard financial stability, reduce high lending rates, and support growth. This would reduce banks' reliance on Central Bank funding and bolster capital levels.

Reforms to the monetary policy framework would anchor low and stable inflation. The central bank requires operational independence and instruments to safeguard low inflation and pave the way for exchange rate unification.

Fiscal policy needs to create space for reform costs and pro-growth spending. Public debt will rise as the government clears its liabilities and recapitalizes banks. A medium-term fiscal framework that targets a gradual reduction in the non-oil deficit and expansion in tax revenue would accommodate higher spending, support growth, and safeguard inflation and fiscal sustainability.

Structural reforms that facilitate foreign investment would ease domestic financing constraints while labor market reforms would foster job creation for all.

Approved By
Aasim M. Husain and Rupa Duttagupta

Discussions took place in Tehran during December 3–14, 2016. Staff representatives comprised C. Purfield (head), O. Basdevant (advance team lead), S. Cakir, G. Pierre (all MCD), C. El Khoury (LEG), and P. Austin (STA). Mr. Husain (MCD), Mr. Mojarrad and Mr. Nadali (all OED) also participated in some of the discussions. The mission met with Central Bank Governor (CBI) Seif, Vice-Presidents Nobakht (Plan and Budget Organization) and Molaverdi (Ministry of Women and Family Affairs), as well other senior government officials and private sector representatives. A. Sadeghi assisted the mission from headquarters and with the external DSA. M. Orihuela-Quintanilla assisted in the preparation of the report. A. Atamaou of the World Bank prepared the poverty estimates associated with better targeting. Box 1 was prepared by C. El Khoury; Box 2 by A. Aslam, C. Heady, and G. Michielse (all FAD); and Box 3 by G. Pierre.

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CONTEXT

1. **Higher oil production and exports, following the removal of nuclear sanctions in January 2016, is supporting a strong rebound in growth**. The prudent monetary and fiscal policies implemented in recent years paved the way for inflation to fall to single digits and stabilized the foreign exchange market. Progress was made in addressing Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) deficiencies, including passage of a CFT law. Foreign investors are planning sizeable investments in the hydrocarbon and manufacturing sectors.

2. **Still Iran faces considerable challenges in realizing its full potential**. The fall in oil prices since their 2014 peak further reduced fiscal space and buffers already eroded under sanctions. Limited access to correspondent banking relations (CBR) has constrained trade, investment inflows and access to international reserves (Box 1). More recently, renewed uncertainty regarding sanctions is dampening sentiment. Domestically, the banking system is fragile and unable to support the recovery. Unemployment remains high and private sector job creation is slow. With per capita incomes unchanged from a decade ago and poverty on the rise, pressure to realize rapid gains is high. Presidential elections are scheduled for May 2017.

3. **The authorities are putting in place the elements of an ambitious reform plan to address these challenges, consistent with past IMF advice**. They remain committed to prudent monetary and fiscal policies to underpin hard won economic stability. Under their Financial Sector Reform Plan, draft Central Bank and Banking bills aim to modernize the monetary policy framework and strengthen supervisory powers. The government has begun to clear its payment arrears, provided seed funds to recapitalize some banks, and plans to expand tax collections. The Sixth National Development Plan (NDP) aims to develop the private sector and reduce oil dependency. The challenge will be to prioritize and coordinate these complex reforms to definitively address structural weaknesses, sustain economic and financial stability, and secure higher, more inclusive growth.

Box 1. Impediments to Correspondent Banking with Iran

Despite the lifting of nuclear sanctions by the JCPOA—a multilateral agreement reached between Iran and the P5+1 which was ratified by the UN—on January 16, 2016, non-U.S. global banks are reluctant to re-engage Iranian banks because of remaining sanctions as well as AML/CFT concerns, including opacity of ownership of legal entities, and health of local banks.

Sanctions relief so far …

The JCPOA resulted in important relief. The oil embargo was lifted. E.U. and other countries' sanctions that targeted Iran's nuclear program ended. SWIFT reconnected Iranian banks to its payments system. Iranian banks have entered into CBRs with small and medium non-U.S. banks (around 238, but half 2006 levels) reducing financial transaction costs and improving the ease of cross-border trade. Access to foreign exchange reserves improved with some US$30 billion in blocked or frozen assets and oil receipts released.

But other sanctions remain in place….

U.S. primary sanctions remain in place and apply to U.S. financial institutions and companies, including non-U.S. branches (but not subsidiaries). U.S. dollar clearing restrictions have not been lifted and pose a significant challenge for larger non-U.S. global banks to re-establish CBRs. This in turn restricts access to corporate trade finance and limits access to reserves, foreign assets, and export earnings particularly from dollar-dominated oil sales. On December 15, 2016, the Iran Sanctions (10 years) extension Act became law. Other non-nuclear sanctions, including SDN list restrictions, which were broadened to cover new individuals and companies in February 2017, remain in place (see SIP, Chapter 1).

Status of Staff Recommendations from the 2015 Article IV Consultation

Recommendations	Status
	Fiscal Policy
Lowering the non-oil fiscal deficit.	The central government non-oil fiscal deficit reached 9 percent of non-oil GDP in 2015/16.
Building fiscal buffers.	Higher share of oil revenue (65.5 percent) allocated to the budget. Oil Stabilization Fund (OSF) not replenished.
Create space for growth-enhancing spending by mobilizing revenue.	Number of registered VAT taxpayers increased and tax administration strengthened. IMF technical assistance on tax administration and policy provided.
Deepen subsidy reform.	3 million high-income households removed from the cash transfer beneficiary list. Fuel prices last adjusted in May 2016.
	Monetary Policy
Reduce inflation and strengthen monetary framework.	Inflation < 10 percent. Draft central bank bill makes stable inflation core objective.
Address pressures on interest rates by Unlicensed Financial Institutions (UFIs)	Most UFIs are now under CBI supervision; problem UFIs closed/merged with banks.
	Banking Sector Reform
Strengthening supervisory powers.	Draft banking bill strengthens CBI's supervisory powers and makes unlicensed banking a criminal offense. IFRS reporting standards implemented.
Resolve non-performing loans (NPLs)	Audit of government arrears underway. New marketable government securities issued to settle payment arrears against tax obligations.
Bolster provisions and capital	Banks to retain profits and raise capital from shareholders. Budget approved use of part of CBI's FX revaluation gains to recapitalize some public banks.
Strengthening the AML/CFT framework	CFT Law approved in March 2016. In June 2016, the FATF suspended counter-measures for 12 months to monitor Iran's progress in implementing its action plan to address AML/CFT deficiencies. The authorities requested IMF assessment of the AML/CFT framework in 2018.
	Reforms to Promote Jobs and Growth
Improve business climate and address high unemployment	Iran's ranking in the World Bank Doing Business indicator has improved marginally from 57.1 percent in 2016 (distance to frontier, 100 percent = best) to 57.2 percent in 2017, while its global competitiveness index remained stable at 57.6 percent.

Source: IMF staff.

ECONOMIC DEVELOPMENTS, OUTLOOK, AND RISKS

A. Recent Developments

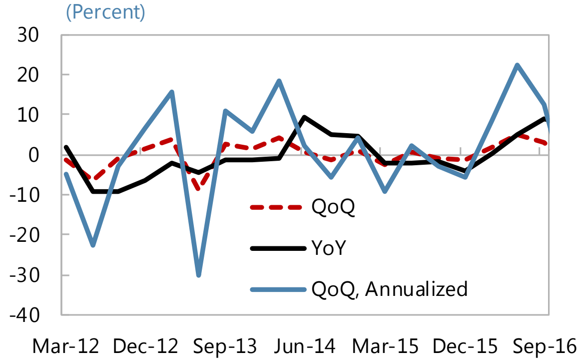
4. **Economic growth rebounded in 2016/17 on the back of higher oil production but non-oil activity remained weak** (Table 1, Figure 1). Boosted by the swift recovery in oil production and exports, real GDP grew by 7.4 percent in the first half 2016/17, recovering from recession in 2015/16. However, non-oil sector growth averaged just 0.9 percent reflecting continued difficulties in access to finance and depressed consumption. Unemployment had risen to 12.7 percent by the end-Q2 (Table 2).

Figure 1. Islamic Republic of Iran: Macroeconomic Indicators, 2011/12–2016/17

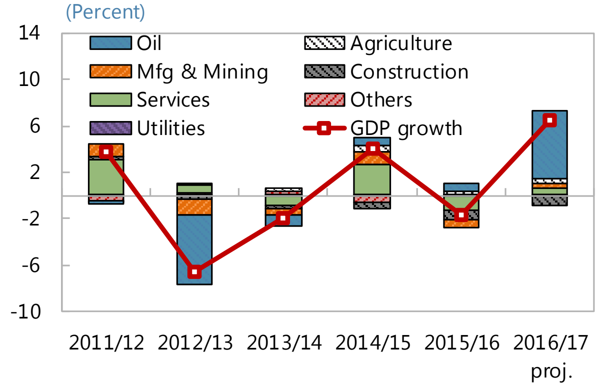
Growth has rebounded following the easing of economic sanctions…

…driven by the recovery in oil production,

Real GDP Growth
(Percent)



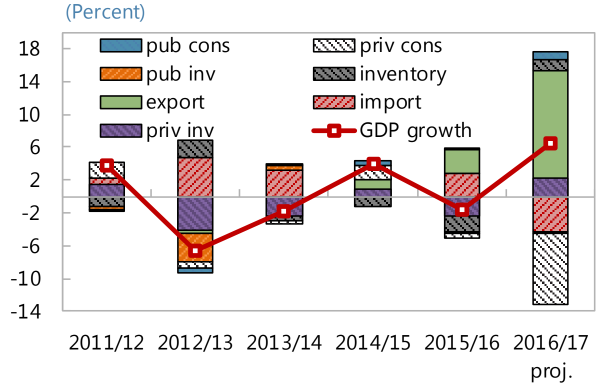
Contribution to Growth in supply-side GDP
(Percent)



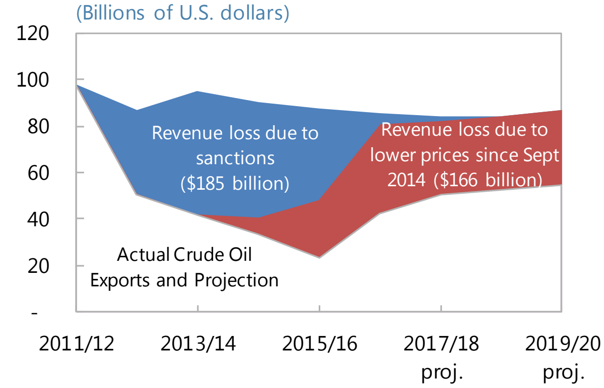
but consumption and investment remain weak…

hampered by the legacy of sanctions and oil price shocks, …

Contribution to Growth in demand-side GDP
(Percent)



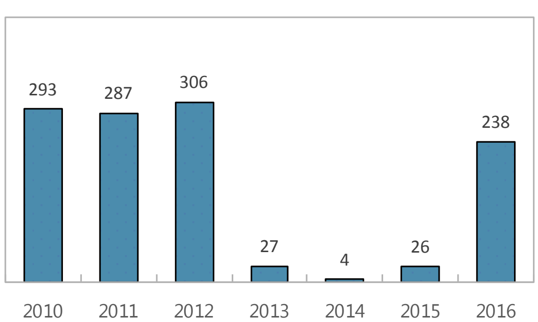
Twin Shocks of Sanctions and Low Oil Prices
(Billions of U.S. dollars)



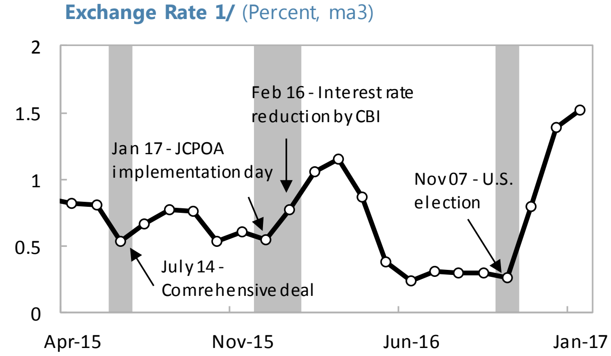
difficulties in reconnecting to the global financial system…

and heightened uncertainty.

Number of International Correspondent Banks



Coefficient of Variation, Free-Market IRR/USD Exchange Rate 1/ (Percent, ma3)



1/ Coefficient of Variation is calculated as monthly standard deviation divided by monthly average exchange rate.

Source: Iranian authorities, Bankers' almanac, and IMF staff calculations.

5. **Inflation declined to low and single digits** (Figure 2). Inflation fell to a multi-year low of 6.8 percent y/y in June 2016, down from a peak of 45 percent in June 2013 reflecting favorable food prices and prudent policies. Inflation has since hovered in the 9½ percent range on higher world food prices and faster liquidity growth. M2 had risen by 28.3 percent y/y by end-December 2016 driven by CBI support to banks and the government drawing on its revolving facility.

6. **Iran's external position strengthened** (Tables 3–4, Figure 3). The current account surplus reached a recent low of 2.4 percent of GDP in 2015/16 owing to low oil prices and curtailment of oil exports by sanctions. With the lifting of sanctions, higher oil exports and more favorable oil prices, the current account surplus is expected to rise to 6 percent of GDP in 2016/17. Renewed foreign investor inflows in the hydrocarbon, automobile and telecom industries are boosting FDI. The authorities are improving trade opportunities, by clearing arrears to export credit guarantee agencies and negotiating trade agreements with regional partners.

7. **The foreign exchange market experienced some volatility towards end-2016**. Through October 2016, the official exchange rate had depreciated by about 7 percent y/y from end-2015, whereas the market rate remained broadly steady. Over the remainder of 2016, the market rate depreciated sharply reflecting seasonal factors and the rise in sanctions-related uncertainty. It then recovered in January 2017 and the spread between the official and the market rate narrowed to 15 percent. Preparations for exchange rate unification have continued. Over half of all import categories have been shifted to the bureau market. Banks have been permitted to use non-oil export proceeds to fund imports to aid the re-creation of an interbank FX market.

8. **Monetary and fiscal policy have strived to support the recovery** (Tables 5–11). Interest rate caps on one-year deposits were cut from 18 to 15 percent, and lending rates from 20 to 18 percent. Banks were instructed to allocate at least 10 percent of their loans to small and medium-sized enterprises and manufacturing. Statutory reserves requirements were selectively reduced from 13 to 10 percent based on banks' asset quality and risk management. However, in the face of high nonperforming loans (NPLs), real interest rates remain high. The non-oil fiscal deficit of the central (general) government increased from 8.2 (11) percent of non-oil GDP in 2014/15 to 9.0 (11.5) percent in 2015/16 and is projected to rise to 10.6 (13.4) percent in 2016/17 as improved tax collections prove insufficient to fully offset higher current spending and transfers to the Targeted Subsidy Organization (TSO).[1] The overall central (general) government fiscal deficit is estimated to increase from 1.8 (2.9) percent of GDP in 2015/16 to 3.1 (3.2) percent of GDP by end-2016/17. However, the 2017/18 central government budget submitted to parliament targets a zero balance due to higher oil receipts.

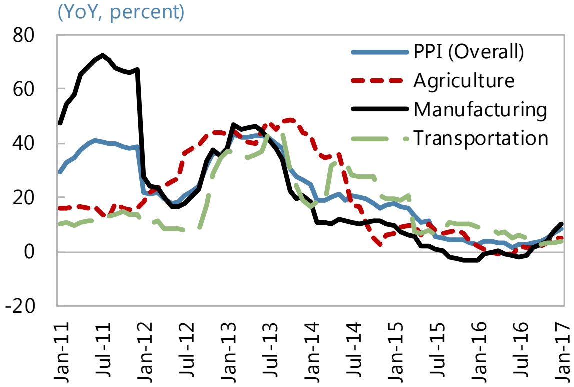
[1] The TSO administers revenues from domestic fuel sales to finance universal cash transfers.

Figure 2. Islamic Republic of Iran: Price Developments, 2011/12–2016/17

Notwithstanding the significant price adjustments in domestic energy prices since 2014...

Producer Inflation

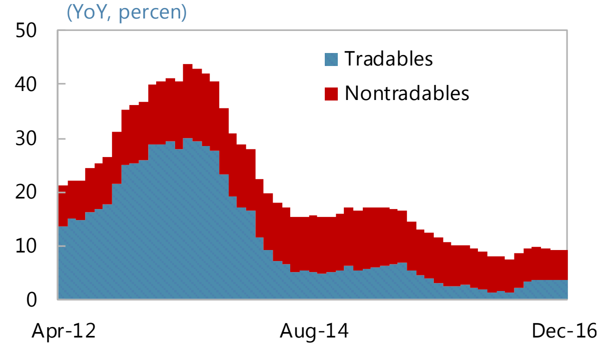
(YoY, percent)



annual inflation fell to single digits...

Contribution to Consumer Inflation

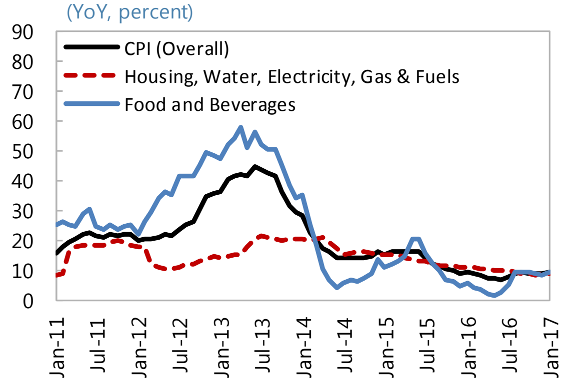
(YoY, percen)



...supported by macroeconomic policies, benign food prices and exchange rate stability, but in recent months...

Consumer Inflation

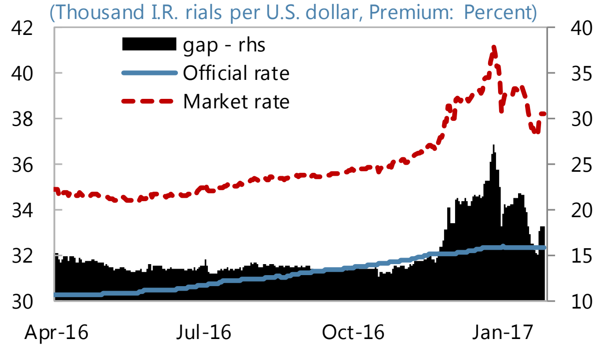
(YoY, percent)



...the gap between the official and bureau market widened as the market rate depreciated.

Exchange Rates and Premium

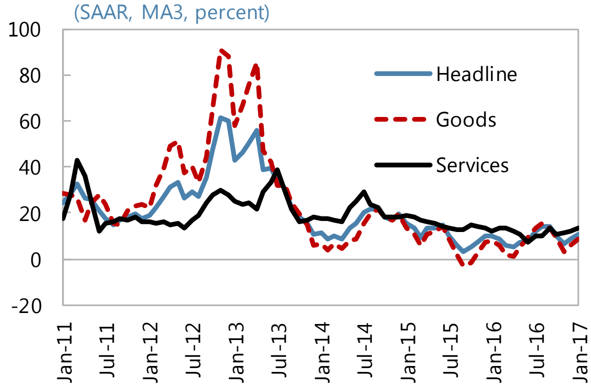
(Thousand I.R. rials per U.S. dollar, Premium: Percent)



As a result of monetary easing and depreciation pressures at end-2016, inflation is set to increase...

Consumer price inflation

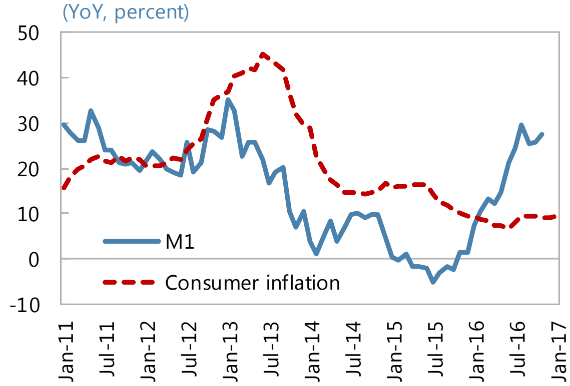
(SAAR, MA3, percent)



...and could reach double digits in the near term.

Money and Consumer Inflation

(YoY, percent)

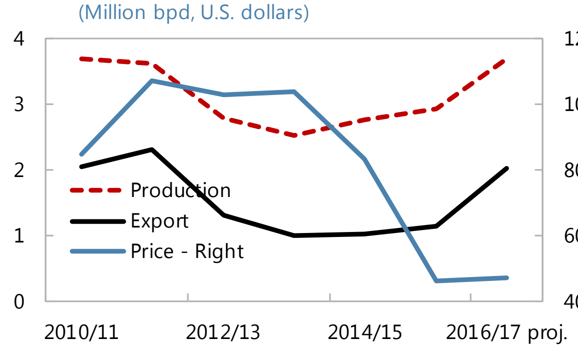


Source: IEA, Iranian authorities; and IMF staff calculations.

Figure 3. Islamic Republic of Iran: External Sector Developments

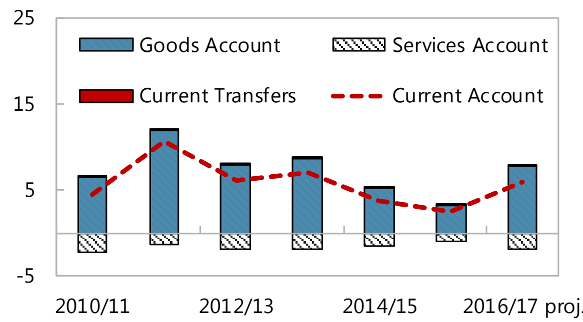
Despite low oil prices, the rise in oil production following the removal of sanctions...

Crude Oil Production, Export, and Price
(Million bpd, U.S. dollars)



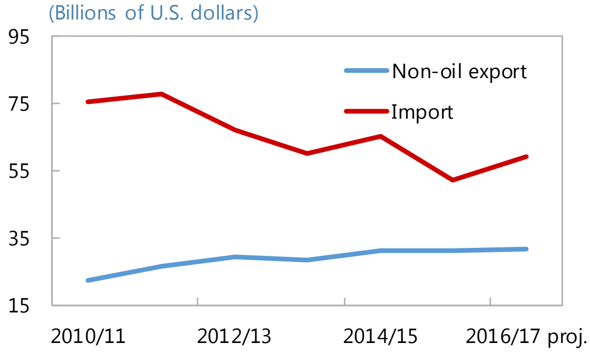
...led to an increase in the current account surplus in 2016/17.

Current account
(Percent of GDP)



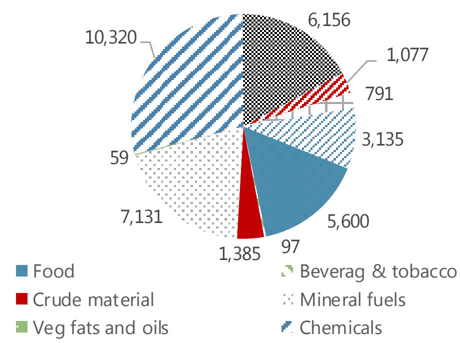
Economic activity slowed down during the sanctions era and imports declined whereas ...

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



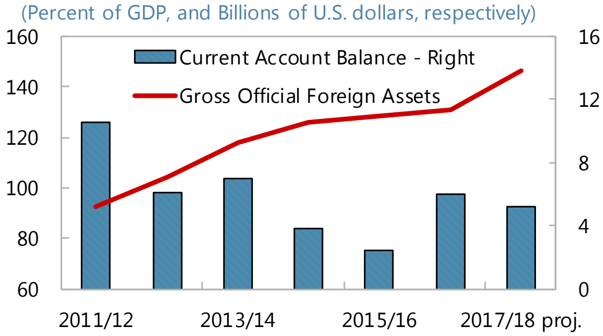
...non-oil exports maintained their rising trend in tandem with increasing export diversification.

Non-oil Export Breakdown by Sector, 2015/16
(Millions of U.S. dollars)



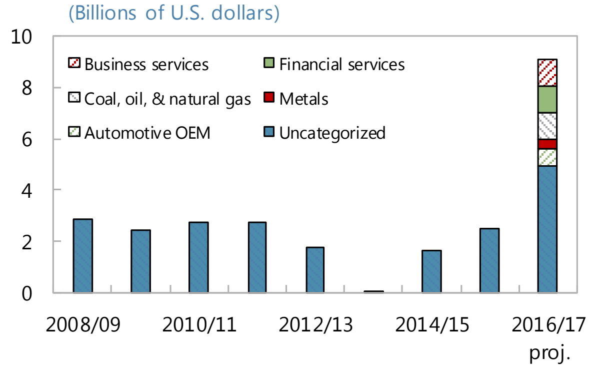
Going forward, pent-up demand on imports is expected to limit the recovery in the c/a surplus ...

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



...and a rebound in FDI is expected due to a sharp uptick in announced foreign investment projects.

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



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

9. The financial sector remains weak. NPLs are high (about 12 percent), but would be significantly higher were it not for recent regulations permitting the rollover of overdue loans into new loans contingent on a partial repayment. The implementation of International Financial Reporting Standards (IFRS) in banks in 2016 shows that the capital adequacy ratio (CAR) of the banking system has declined from 8.4 percent in March 2012 to 5.8 percent in March 2015. It also revealed substantial capital needs in state-owned banks (16 percent of total assets) where the average CAR is negative. Profitability remains constrained by the high cost of funds—some banks are competing aggressively for deposits by offering rates above the mandated caps and the interbank market rate remains at around 19 percent—and the lending rate cap.

10. The authorities are starting to address financial system weakness. Most notably, the CBI has restructured and brought most UFIs under its supervision, addressing an important source of financial instability. The CBI has requested banks to retain profits and raise capital. The proposed Banking Bill enhances the supervisory tool-kit by providing for consolidated supervision and an array of corrective measures. The government also started issuing market bonds to secure its payment arrears to banks, and approved the use of part of the CBI's foreign exchange revaluation gains to help settle banks' debt vis-à-vis the CBI.

Provisional Estimates for Government's Arrears to Banks and Settlements (Percent of GDP)

Government's arrears to banks 1/	10.6
Bond issuance for settlement of claims of banks on government 2/	0.8
Use of CBI's revaluation gains for settlement of banks' claims and recapitalization 2/	3.5

Sources: Iran authorities; and IMF staff estimates.

1/ Based on monetary survey data

2/ As provisioned in the Law on the Amendment of the 1395 State Budget Law

B. Outlook and Risks

11. Growth is projected to stabilize at 4½ percent over the medium-term as the recovery broadens. Real GDP growth is projected to reach 6.6 percent in 2016/17 reflecting the rebound in oil production and exports (up 25 and 75 percent, respectively), and to ease to 3½ percent in 2017/18 as oil production remains at the OPEC target. Thereafter, higher FDI and a gradual improvement in domestic credit conditions as financial reforms proceed drives investment, which combined with improved economic efficiency from updated production capacity, lifts non-oil sector growth. The current account is forecast to remain in surplus as higher exports offset the pick-up in imports related to investment and pent-up domestic demand. Inflation is expected to temporarily rise to 11.9 percent by end-2017/18 reflecting recent liquidity growth and pass-through from exchange rate depreciation, but returns to single digits with prudent fiscal and monetary policies. The pace of job creation lags that needed to absorb the large number of new entrants and unemployment remains high.

12. Risks are to the downside (see Risk Assessment Matrix). The renewed uncertainty surrounding the JCPOA, and especially relations with the U.S., could deter investment and trade with Iran and short-circuit the anticipated recovery. If the agreement is derailed, the economy could risk recession. Likewise, any challenges in implementing the FATF action plan could hamper CBRs, especially if counter-measures were re-imposed. Lower oil prices could increase pressure on export and budget revenues, reducing fiscal space. Domestically, failure to garner support for the ambitious reform program, especially banking sector reform, would see inflation rise, banking stress intensify, and growth slow. The complex, intertwined, reform agenda also demands careful coordination and sequencing.

Risk Assessment Matrix [1/]

Source of Risks	Relative Likelihood	Time Horizon	Potential Impact	Policy Response
Spillover Risks				
Rise in populism and nationalism in large economies affecting international trade liberalization; financial, and labor flows; weighing on global growth and exacerbating financial market volatility.	High	Short to Medium Term	High Measures that derail Iran's reintegration into the global trade and financial system could risk a recession.	Continue domestic reforms that enhance resilience to shocks and negotiate new trade agreements to improve trade prospects.
Heightened risk of fragmentation/security dislocation in part of the Middle East.	High	Short Term	High Regional conflicts could weigh negatively on Iran's trade development and regional integration.	Continue efforts to focus on domestic reforms to increase Iran's attractiveness to foreign investors.
Further loss of correspondent banking services significantly curtails cross-border payments, trade finance, and remittances in emerging and developing economies.	High	Short to Medium Term	Medium Iran already faces difficulties in reconnecting to the global financial system.	Continued improvements in Iran's AML/CFT framework and the health of its banking system remain essential to facilitate fuller reintegration into the global financial system.
Persistently lower energy prices, triggered by supply factors reversing more gradually than expected.	Low/Medium	Medium Term	Medium Negative impact on oil revenue, thus reducing scope for increasing growth-enhancing spending.	Improve fiscal planning by articulating fiscal priorities within a medium-term framework, and developing fiscal buffers. Continue to reduce oil dependency by increasing domestic tax revenue.
Significant China slowdown.	Low/Medium	Short to Medium Term	Medium China has become one of Iran's key trade partners in the recent past.	Continued efforts to diversify Iran's trade and to attract foreign investors.
Domestic Risks				
Financial strains from inadequate progress on banking sector recapitalization and restructuring.	High		High Continued banking system stress would see liquidity growth and inflation accelerate, real interest rates remain high, and growth slow.	Build broad-based consensus on a comprehensive restructuring and recapitalization strategy and how it is to be financed.
Limited progress in strengthening the monetary and fiscal policy frameworks.	High	Medium Term	Medium Without fiscal and monetary policy reform there is a risk of continued procyclical policies, persistent inflation, real exchange rate appreciation, and eroding competitiveness.	Reduce non-oil fiscal deficit to support disinflation, while mobilizing tax revenue to create space for growth-enhancing spending. Develop buffers to protect the economy against the consequences of adverse shocks. Develop a medium-term fiscal framework to anchor annual budgets.
Lack of broad-based support for reforms.	Medium	Short to Medium Term	High Difficulties in advancing reforms could hamper growth and job prospects, especially for the youth and women.	Improve transparency and outreach to the civil society, to build support for reforms. Strengthen administrative capacity through technical assistance.
Uncertainties related to the implementation of the nuclear-deal and the FATF action plan with related risks of AML/CFT.	Medium	Short to Medium Term	High Growth would be negatively affected by the re-imposition of sanctions or counter-measures that would lower direct investment and capital inflows, and disconnect Iran from the global financial system.	Continue reforms to strengthen domestic productive capacity, and improve the AML/CFT framework.

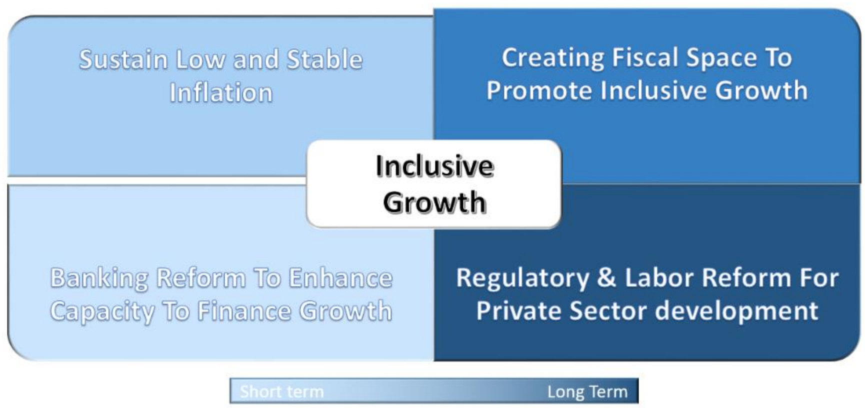
Source: IMF staff.

[1]The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. "Short term" and "medium term" are meant to indicate that the risk could materialize within 1 year and 3 years, respectively.

13. The authorities concurred with staff's assessment but stressed that with the envisaged reforms growth could be much stronger. The reforms anticipated under the Sixth NDP are expected to lift growth to 8 percent. The recent improvement in oil prices and unexploited potential in hydrocarbons—Iran's proven gas and oil reserves rank second and fourth in the world which alongside the revised oil contract model isattracting new investors—will continue to spur growth beyond 2017/18. The relatively diversified manufacturing and services sectors provide a good spring-board to expand the non-oil sector. As FDI is critical to their growth strategy, the authorities expressed concern that the inability to secure CBRs with large European banks is creating obstacles to investment and renewed uncertainty could deter investment.

POLICY DISCUSSIONS

A comprehensive and coordinated plan of action would focus in the next-year on (i) restructuring and recapitalizing banks to safeguard financial stability and support growth, and (ii) defending low and stable inflation by reducing liquidity growth while progressing to a market-based monetary policy framework. Casting fiscal policy in a medium-term framework would over time create space for reform costs and higher public investment. Within the structural reform agenda, priority should be given in the next year to reforms to laws and regulations that facilitate foreign investment to ease domestic financing constraints. Over the medium-term, labor market reforms would foster job creation.



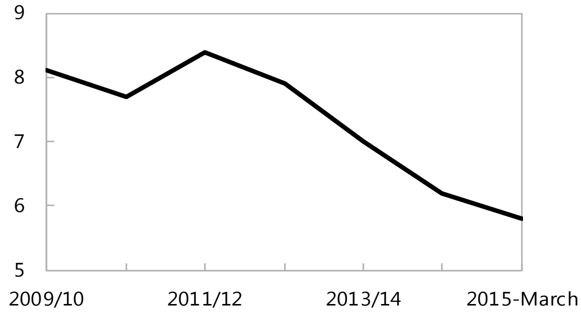
A. Strengthening the Financial System to Support Growth

14. The banking system is fragile. A legacy of government payment arrears, directed and connected lending, and poor risk management practices have left banks' balance sheets badly impaired and capital positions weak (Figure 4). The authorities' provisional estimates suggest that a large share of bank assets are frozen in NPLs or non-earning real estate or public enterprise assets. The fact that NPLs can only be written-off after 10 years and when they are 100 percent provisioned encourages banks to rollover loans and helps explain the rapid pace of headline credit growth despite high real interest rates and problems in access to finance (Section D).

Figure 4. Islamic Republic of Iran: Financial Sector Indicators, 2009/10–2016/17

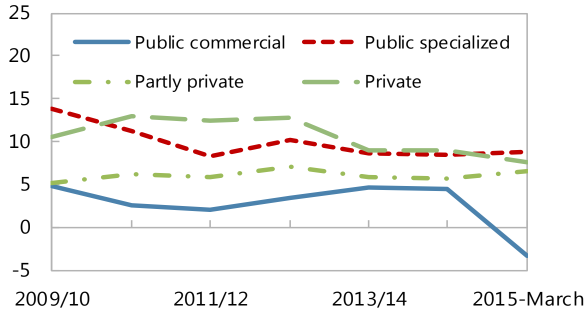
Banks are in urgent need of restructuring and recapitalization to safeguard financial stability.

Capital Adequacy Ratio, Banking System 1/
(Percent)



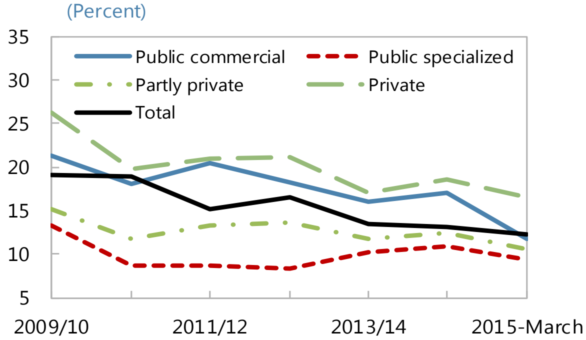
The capital shortage is more acute for state-owned banks.

Capital Adequacy Ratio, by Bank Type 1/
(Percent)



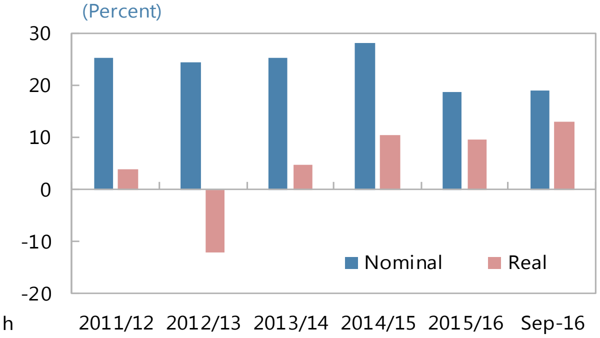
Uncertainty persists about the actual level of NPLs and the ultimate recapitalization need of the system.

Non-performing Loans/Gross Loans 1/
(Percent)



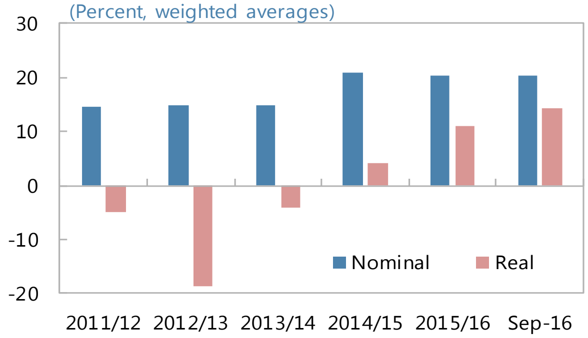
Distressed banks aggressively compete for funds, putting pressure on interbank and deposit rates, which in turn,...

Interbank Rate
(Percent)



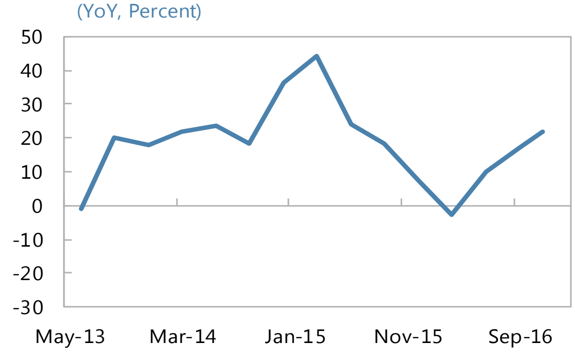
...keeps lending rates elevated and...

Lending Rate
(Percent, weighted averages)



...increases banks' reliance on CBI funding.

Central Bank Claims on Banks
(YoY, Percent)



Sources: Central Bank of Iran; and IMF staff calculations.

1/ Public commercial banks are fully owned by the government. Specialized banks are also state-owned supporting specific economic sectors (i.e. housing, agriculture, industry and mining, export promotion). Partly privatized banks are formerly state-owned banks. While the government is committed to reduce its ownership to 20 percent over time, the share of the government in these banks remains high at about 40 percent and the government maintains control over management. Private banks have no direct government involvement.

15. Banks' reliance on CBI funding is growing. So far the banking system has been shielded from systemic risks because of the banks' funding model that is virtually independent from external finance. State-owned, commercial and specialized banks, and partially privatized banks largely rely on central bank funding to implement government credit directives. Private banks raise funds largely from deposits or special purpose vehicles, and more recently from the new interbank market. Faced with increased balance-sheet pressures, some banks have begun to compete aggressively for deposits, pushing interest rates up for all banks despite caps, and keeping real interest rates high. Interbank market rates remain elevated. Some banks are now reliant on uncollateralized overnight liquidity support from the CBI. In this context, it is becoming increasingly difficult for the CBI to contain overall liquidity growth to sustain low inflation.

16. The mission recommended urgent action to restructure and recapitalize banks to safeguard financial stability and bring down high real interest rates. In particular,

- *Putting distressed banks under administration or intensified supervision.* This would prevent them from competing excessively for deposits in the short-term while allowing an assessment of their viability and determining an appropriate restructuring or resolution strategy.

- *An Asset Quality Review (AQR) of all banks and a forward-looking analysis of capital needs*. This would support the authorities' efforts to push for realistic, time-bound recapitalization of viable banks, and underpin the identification of nonviable institutions to be resolved.

- *Recapitalization of state-owned banks linked to measures to improve their long-term commercial viability and orientation.* Ultimately this would require the phasing out of government credit directives and interest subsidies on specialized bank credit facilities to be financed by the budget.

- *Stronger supervisory powers*. The draft Banking and CBI bills grant the CBI the power to supervise all deposit-taking institutions. The draft Resolution bill would enable the resolution of nonviable banks and provides the Deposit Guarantee Fund the ability to repay insured deposits in a timely manner. These draft laws significantly enhance the CBI's supervisory powers and could be further strengthened by stronger powers to intervene problem banks early and a broader range of resolution options. A new corporate insolvency framework would allow insolvent corporates to close and sell their assets. Quick passage of these bills, along with additional resources for financial supervision, would allow the restructuring strategy to proceed. It would also enable a transition to Basel capital standards, enhancing financial soundness and transparency.

- *Continued securitization of government arrears.* A rigorous audit of arrears is proceeding. The budget provided rials 480 trillion in new marketable government securities to settle arrears, which has aided the nascent domestic debt market. With a further rials 3,500 trillion in government liabilities to be cleared, the implications of new debt issuance for market interest rates, as well as for the maturity profile of public debt and the government's interest bill need to be factored into the budget and coordinated with monetary policy. Steps to develop the government bond market need to be expedited, including identifying state assets for the regular issuance of Sharia compliant government securities.

17. A stronger AML/CFT framework is essential to facilitate banks' re-connection to the global financial system and expand CBRs. It also enables better detection of proceeds from tax crimes and corruption. Since 2015/16, the authorities have adopted a high level action plan with the FATF and gained affiliation to the Eurasian AML/CFT group as an observer. Dedicated AML/CFT units have been created in all banks. Cash courier and remittance laws, and the by-laws for the CFT law have been drafted. Staff stresses the importance of fully implementing the FATF action plan, enhancing the effectiveness of the framework by improving understanding of ML/TF risks, improving identification of beneficial owners of accounts and legal entities,[2] enhancing measures to identify politically exposed persons, and moving to risk-based AML/CFT supervision.

18. The authorities agreed on the need for swift action. They are working on a detailed road map to implement banking reform, and have requested IMF technical assistance. The Banking and CBI Bills should be approved by parliament by mid-2017. They underscored the need for broad political consensus to tackle problem banks and alleviate banks from the burden of fiscal activities. The authorities attach high priority to sustainably reducing high real interest rates, which have risen as inflation moderated, through banking reform. They reiterated their strong commitment to strengthen the AML/CFT framework which they see as essential for transparency and access to the international financial system. Nonetheless, they stressed that their continued problems in establishing CBRs with larger banks requires greater attention and international support.

B. Anchoring Low and Stable Inflation: Strengthening the Monetary Policy Framework

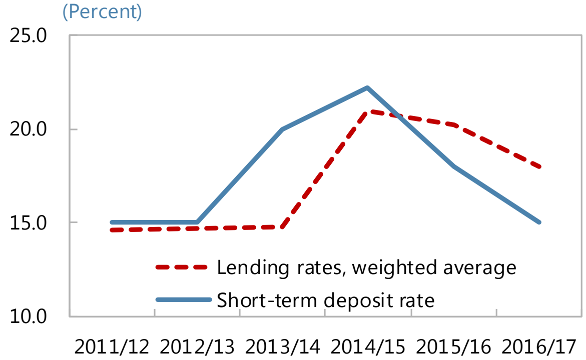
19. Iran's monetary policy framework does not provide the CBI adequate tools to keep inflation low and stable. In the presence of underdeveloped financial markets, weak transmission mechanisms and 'quasi-fiscal' credit directives, it is difficult for the CBI to align liquidity growth with the production potential of the economy. Injection and withdrawal of liquidity is controlled by rationing. The CBI balance sheet is primarily driven by its loans to banks given the policy of credit support to specific sectors, the government's overdraft facility, and liquidity support to distressed banks (Figure 5). In the near term, the government should sharply reduce its directed credit schemes and adjust regulated prices to curb liquidity pressures and contain the risk of pass-through from recent exchange rate deprecation. This would also free-up credit available for more productive firms.

[2] Access to beneficial ownership information would allow correspondent banks to lower their compliance costs in ensuring they do not conduct business with Iranian entities or persons on the sanctions list.

Figure 5. Islamic Republic of Iran: Monetary Indicators, 2011/12–2016/17

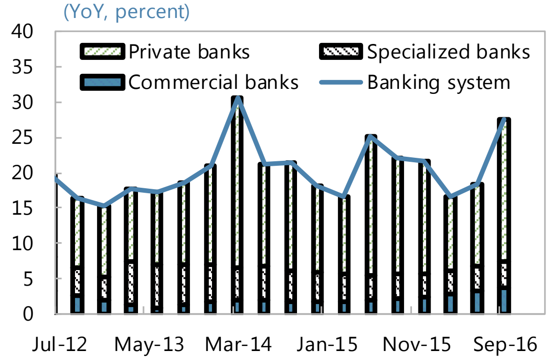
CBI's decision to reduce deposit rates improved the spread of the banks to some extent.

Nominal Interest Rates
(Percent)



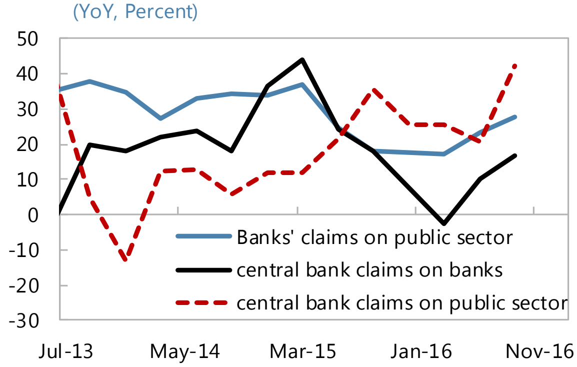
Credit growth picked up in 2016 as a result of rolling over of existing loans and…

Private-sector Credit Growth contributions
(YoY, percent)



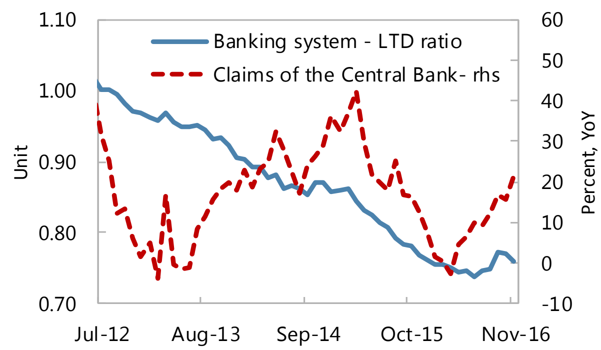
…looser fiscal and monetary policies in response to the slowdown in non-oil activity.

Banking System & Central Bank Credit Growth
(YoY, Percent)



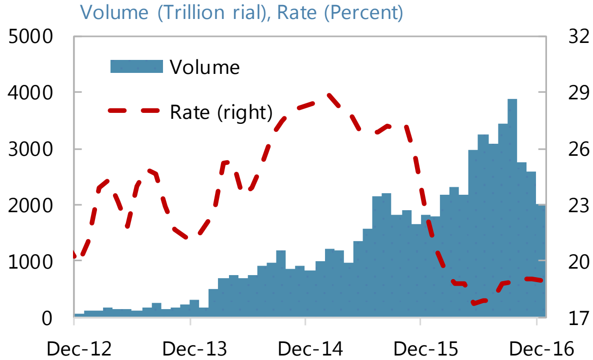
Banks' reliance on CBI funding increased as a result of directed credits and funding of distressed banks

Loan-to-Deposit Ratio and Central Bank Claims on Banks



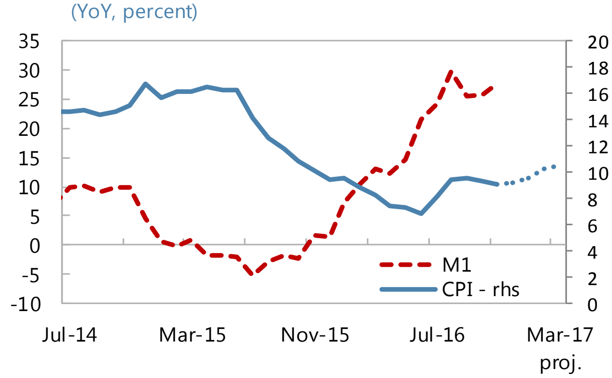
CBI's injection of liquidity through the interbank market has increased with a view to reduce interbank rates.

Interbank Market
Volume (Trillion rial), Rate (Percent)



The rise in liquidity as a result of these policies risks reinvigorating inflationary pressures.

Money Growth and Inflation
(YoY, percent)



Source: Iranian authorities; and IMF staff calculations.

20. The CBI requires greater independence and market-based instruments to sustain low and stable inflation. The draft Central Bank Bill overhauls the monetary policy framework, making low and stable inflation the CBI's main objective. However, to bolster CBI independence to achieve its new mandate, the bill should eliminate the positions for government representatives and nonexperts on the central bank's governing committees. A lender of last resort framework also needs to be clearly defined—with the CBI's liquidity facilities collateralized to minimize risks to its balance sheet—and targeted to solvent banks. A target inflation range—the authorities' objective is to keep inflation below 10 percent—tools to manage liquidity such as central bank participation or government paper, and a clear communication plan will all have to be developed to build the CBI's credibility to manage interest rates and control inflation (SIP, chapter 2).

21. The mission recommends an early move to unify the exchange rate and shift to a managed float given the need for flexibility to manage external shocks. Staff analysis suggests the market rate is better aligned with fundamentals (Appendix I). The official rate subsidizes select imports and does little to insulate inflation given pass-through from the depreciation in the market rate. Unification would increase the value of oil proceeds in domestic currency terms and improve the budget balance. It would also eliminate the economic distortions and potential rent-seeking that arise under the dual rate system, promote competitiveness and non-oil exports, and afford the CBI somewhat greater space to smooth pressures on the market rate. Stronger monetary and fiscal policies would underpin credibility and support a stable exchange rate under the new regime. The exact timing of unification has to be cognizant of FX market conditions and the extent of access to international reserves.

22. The authorities see the new central bank bill as key to sustaining low inflation especially as they move to a unified exchange rate regime. Parliamentary committees are working to build political consensus for greater operational independence for the CBI. They noted that the success of the new system hinges on prudent fiscal policy. The securitization of government arrears offered an opportunity to create monetary policy instruments. The authorities saw the market rate as having overshot somewhat in the wake of seasonal factors and increased uncertainty. They remain committed to the unification of the exchange rate. They continue to shift goods to the bureau market, albeit at a slower pace due to recent FX volatility, and are encouraging FX transactions to move to banks through tighter regulation of FX bureaus. However, because CBRs constrain access to reserves, the CBI's ability to intervene in the foreign exchange market is curtailed. Against this backdrop, the authorities express their commitment to unify the exchange rate by end-February 2018 as access to reserves improves.

C. Fiscal Policy Reform to Promote Faster Inclusive Growth

23. Fiscal policy has to adapt to the spending pressures arising from balance sheet repair while finding space to support growth. Interest payments are set to rise from 0.9 percent of GDP in 2016/17 to about 3 percent over the medium-term reflecting securitization of government arrears. However, the bonds required for bank recapitalization—the amount and terms of which will only be determined once an AQR is conducted—will add further pressure to the debt burden and interest bill. Additional budgetary investment spending of about 1½ percent of GDP a year would help upgrade infrastructure and support growth. Pressure on the social security system is also rising despite the young population. At the same time, the overall level of the fiscal deficit and the fiscal stance needs to be prudent to support low inflation and rebuild buffers.

24. A medium-term fiscal framework (MTFF) that targets a gradual adjustment in the non-oil fiscal deficit by creating space, primarily via domestic revenue mobilization, balances these needs (SIP, chapter 3). Although public debt is set to rise above 40 percent of GDP as new debt is issued to clear government liabilities, it remains sustainable and robust to shocks (Appendix II). With ample, long-lasting oil resources, Iran has some space to target a gradual adjustment in the non-oil fiscal deficit to the Permanent Income Hypothesis (PIH) norm of 5.6 percent of non-oil GDP over the long-term (Figure 6). This balances the need to support growth and keeps debt manageable and in-line with the capacity of the nascent domestic debt market (Iran lacks access to international debt markets). However, given the additional spending pressures discussed above, including arrears clearance and potential costs of bank recapitalization, additional measures of about 7¼ percent of non-oil GDP should be identified over the next five years to contain the non-oil deficit in the range of 12 percent of non-oil GDP to support low inflation and underpin the credibility of the monetary policy framework. After 2021/22 further measures would be needed to reduce the non-oil deficit to the PIH norm to create savings for future generations. A comprehensive financing plan and improved cash management would avoid arrears and recourse to CBI's and banks' balance sheets to implement off-budget fiscal initiatives.

Staff's Assessment of Fiscal Space and Spending Pressures, 2014/15-2021/22

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	(percent of non-oil GDP)							
PIH norm on the non-oil fiscal balance	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6	-5.6
Non-oil balance as a result of spending pressures	-11.0	-11.5	-13.4	-14.8	-16.2	-17.4	-18.1	-18.8
Key contributors	6.2	12.3	13.2	14.0	14.7	15.4	15.7	16.1
Interest payment	0.1	0.1	0.9	1.6	1.7	2.1	2.4	2.5
Investment spending (including NDFI)	6.1	5.5	5.6	5.7	6.3	6.6	6.7	6.9
Staff assessment on non-oil balance to support disinflation and a gradual adjustment to the PIH norm	-11.0	-11.5	-13.4	-13.4	-12.8	-12.3	-11.5	-11.6
Options to create fiscal space 1/	...	...	...	1.5	1.9	1.7	1.5	0.6
Tax revenue	...	...	...	-0.2	0.9	0.9	0.9	0.3
Primary current spending	...	...	...	1.0	0.5	0.4	0.3	0.1
Subsidies reform	...	...	...	0.7	0.6	0.5	0.4	0.3
Other measures	...	...	...	-0.1	-0.1	-0.1	-0.1	-0.1
Cumulated impact	...	...	...	1.5	3.3	5.1	6.6	7.2

Source: Iran authorities, and IMF staff projections.

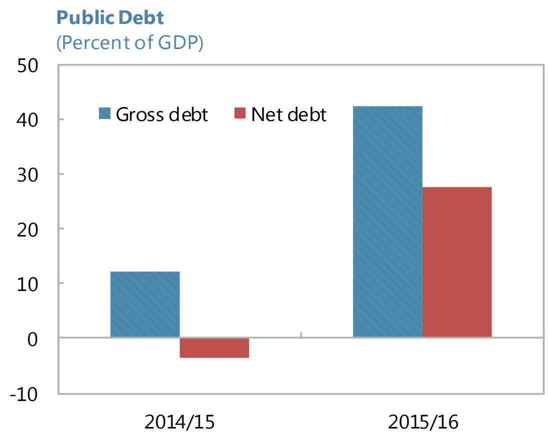
1/ Staff estimates of permanent measures to be taken every year.

25. The government should revisit its oil revenue management strategy, with the view of funding banking sector reform and creating buffers. Currently, 65 percent of oil revenue goes to the central government's budget while one-fifth goes the National Development Fund of Iran (NDFI) that on-lends these funds to banks to fund private sector investment.[3] Directing a greater proportion of oil revenues to the budget could help fund the prospective additional interest burden arising from bank recapitalization. Using a portion of NDFI assets (10 percent of GDP) to replenish the Oil Stabilization Fund (OSF) would provide the budget a buffer to safeguard spending levels in the event of a shock.

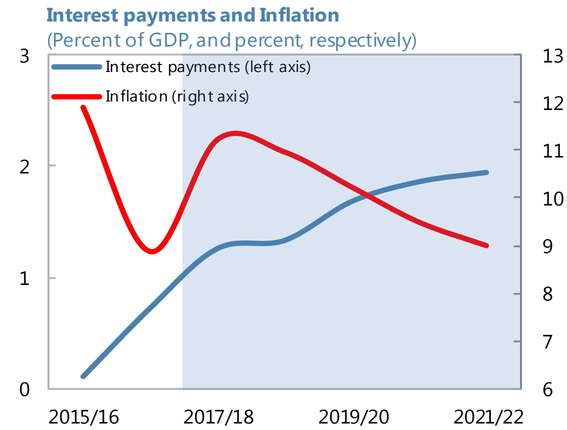
[3] The remainder is kept by the NIOC for exploration and operating costs.

Figure 6. Islamic Republic of Iran: Fiscal Developments and Prospects

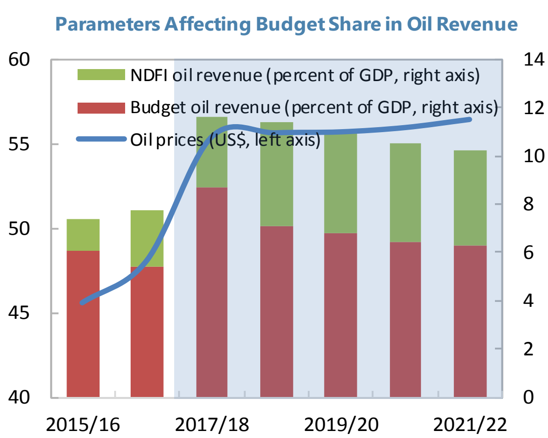
With the recognition of government arrears, debt has increased substantially in 2015/16.



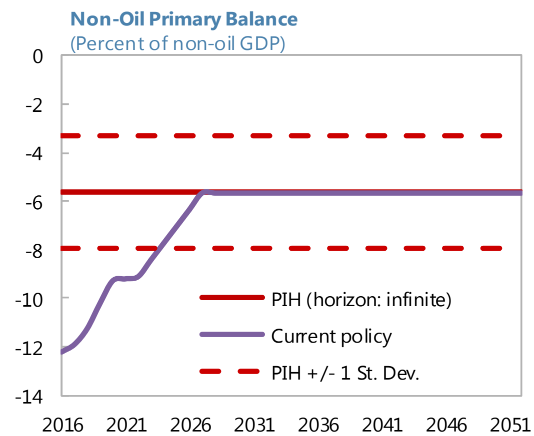
Fiscal consolidation is needed to create room for higher debt payments and to support low inflation.



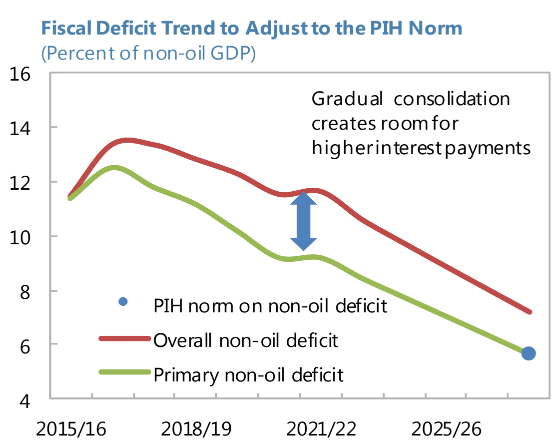
The expected rebound in oil revenue aided by favorable oil prices...



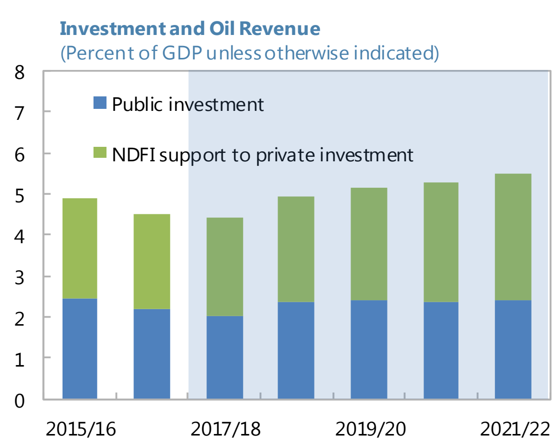
... together with ample oil resources warrant a gradual adjustment in the non-oil deficit towards the PIH norm.



Measures of 7.2 percent of GDP over the next five years would...



...create space for a gradual increase in growth-enhancing investment spending.

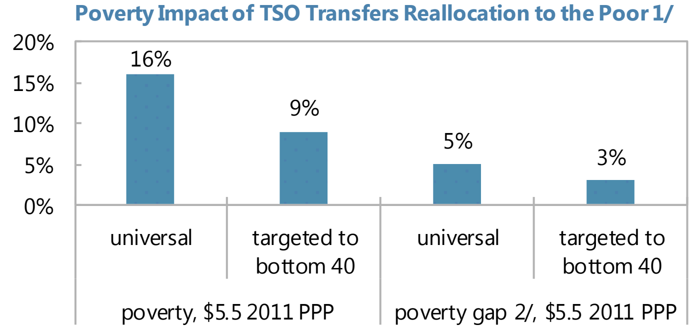


Sources: Iran authorities, and IMF staff estimates and projections.

26. Expanding domestic revenues and improving the composition and efficiency of spending would ensure the adjustment is growth-friendly and protects the poor (Figure 7). The government aims to increase tax revenue from 7 to 10 percent of GDP. This will require a broader tax base (Box 2) and improved administration. Raising the VAT rate—which is less distortive to investment and savings than personal or corporate income taxes—can compensate for the revenue lost from the corporate tax incentives and the cut in personal income tax rates approved in 2016/17. Generous tax incentives and exemptions can be rationalized and steps taken to revised the income tax code to safeguard against the risk of base erosion (SIP, Chapter 4). Re-organizing the Iran National Tax Authority by taxpayer groups and creating within it a risk management unit would bolster taxpayer compliance.

27. Better targeting of cash transfers would create space for growth-supporting investment spending and improve equity.[4] Fuel subsidies have been eliminated on gasoline owing to recent domestic price adjustments and favorable movements in international prices. Adopting an automatic adjustment mechanism would prevent their re-emergence and allow the diesel subsidy to be phased-out. Better targeting of cash transfers by removing the richest 20 percent of households from the beneficiary list would save 0.6 percent of GDP. This could be used to raise the cash transfer to the poorest households—which has halved in real terms since 2011 and contributed to higher poverty—and halve the poverty rate (measured at $5.5 per day, PPP adjusted) and improve equity.

Poverty Impact of TSO Transfers Reallocation to the Poor 1/



Sources: HIES 2011, authors' calculation.

1/ Poverty is measured using reported per capita incomes in the household survey and shows a higher rate of poverty than measured on reported consumption. Per capita income is spatially and intertemporally adjusted as per Policy Research working paper; no. WPS 7836. Washington, D.C.: World Bank Group.

2/ The poverty gap estimates the depth of poverty by considering how far, on average, the poor fall below the poverty line.

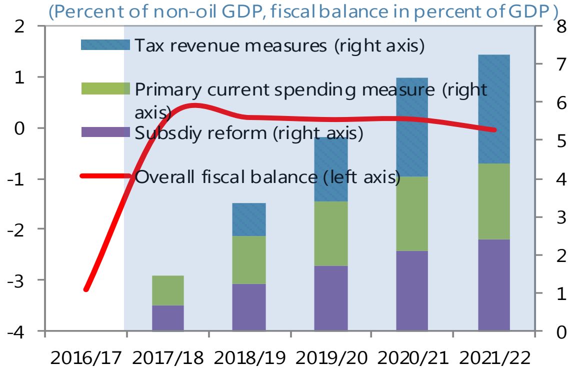
28. The authorities emphasized their commitment to prudent fiscal policy. Their ultimate aim is to ensure that current government spending is fully funded by non-oil revenue and that oil resources are used for investment or saved. Although they have not reinstated the OSF, in the wake of low oil prices they have reduced the share of oil receipts going to the NDFI to allow the budget's share to rise. If the oil price were to rise above the budgeted amount of $55 per bbl., the additional revenues would be saved. While the authorities have yet to formulate a MTFF, they aim to mobilize domestic revenue through improved tax administration. Administrative difficulties in identifying rich households has prevented their quick removal from the cash transfer system.

[4] Multiplier estimates suggest higher investment spending of 1.5 percent of GDP per year would offset the negative growth impact of the authorities' plan to increase tax collections to 10 percent of GDP.

Figure 7. Islamic Republic of Iran: Options for Fiscal Measures

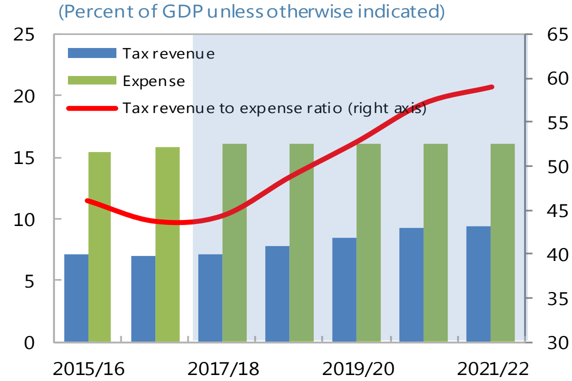
Fiscal measures will support a reduction of the non-oil deficit while bringing the general government deficit to balance.

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



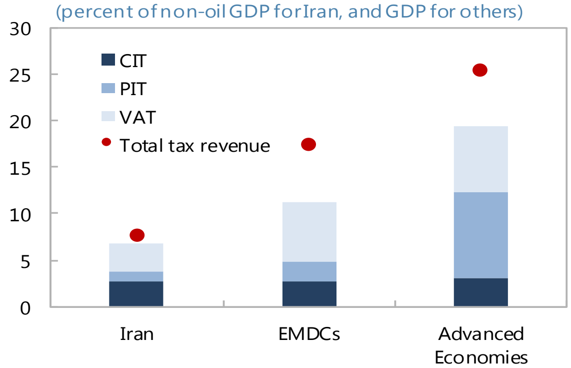
Mobilizing domestic revenue would create space for higher investment.

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

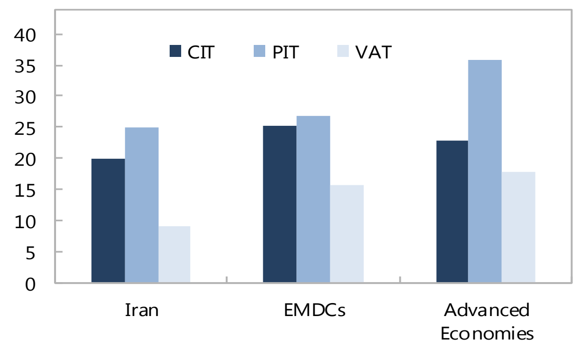


More streamlined exemptions, higher tax rates, and on-going improvements in tax administration would raise revenue. Statutory tax rates and tax collection are below comparable international benchmarks.

Tax Revenue Collection
(percent of non-oil GDP for Iran, and GDP for others)

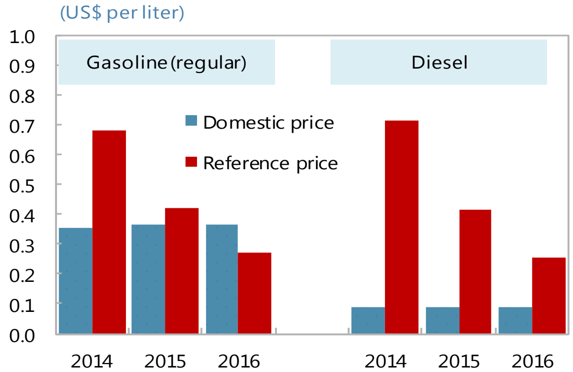


Statutory Tax Rates
(Percent)



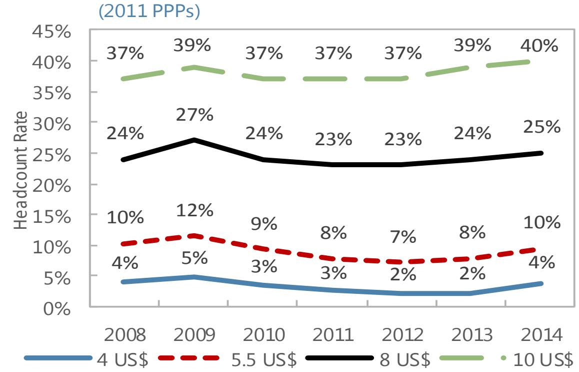
Further adjustments in domestic fuel prices would reduce distortions and create fiscal space.

Fuel Prices
(US$ per liter)



Removing the top quintile of the TSO beneficiary list and redistributing these resources to the bottom 40 percent, would reduce poverty which has been rising since 2012.

Poverty Rate, 2008-14 in Iran
(2011 PPPs)

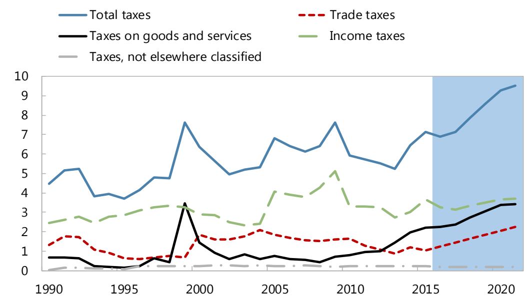


Sources: countries authorities, IEA, World Bank, and IMF staff estimates and projections.

Box 2. Improving Revenue Mobilization in Iran

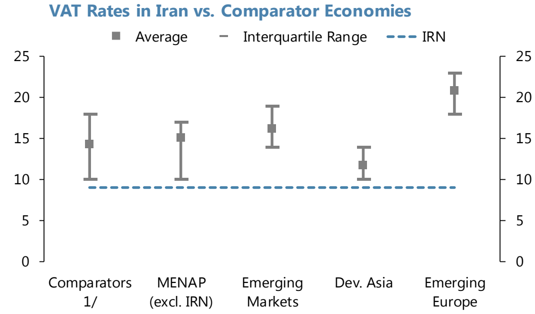
With the introduction of VAT in 2008, the development of a modern tax system is underway. Indirect taxes are growing but direct taxes still account for almost half of total tax revenues, with corporate income taxes (CIT) accounting for 36 percent. A number of changes can bring the tax system in-line with international practice and mobilize revenue:

Tax-to-GDP Ratio, by Type of Tax



Source: IMF, World Economic Outlook and IMF staff calculations.

VAT Rates in Iran vs. Comparator Economies



Sources: IMF staff calculations.
1/ Comparator economies: Colombia, Egypt, Philippines, Poland, South Africa, Thailand, and Turkey.

- **Gradually raise VAT rates and rationalize the system**. The VAT rate remains low despite its increase from 3 to 9 percent. The integrity of the VAT can be strengthened by (i) removing the large number of exemptions (e.g. immovable property); (ii) re-introducing a VAT threshold that excludes small businesses who yield little revenue and capture them under a simple turnover tax; and (iii) bringing agriculture—which comprises for one-tenth of GDP but is outside all tax nets—under the VAT by introducing a sector-specific threshold. This would help capture sales by larger agribusinesses.

- **Separate the top VAT rates into an excise and VAT component and apply the VAT to excise-inclusive prices**. At present, the 9 percent VAT rate is supplemented by higher rates on cigarettes and tobacco (12 percent) and vehicle fuels (20 percent). The latter mimics excises for consumers but when these goods are used as a production input their prices do not include these taxes because they are refunded under the VAT, leading to significant revenue loss.

- **Increase and broaden excises**. Excise rates are low by international standards. There is scope to raise rates, shift to easier-to-administer specific rates, and introduce new excises, e.g., on beverages and telecommunications. Introducing ad-valorem excises on motor vehicles would address environmental goals, supplement revenue, and enhance tax progressivity.

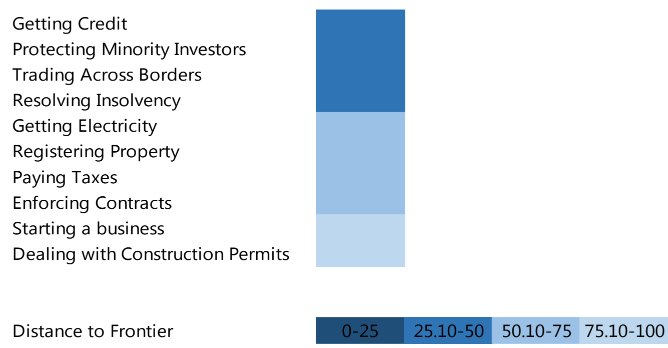
- **Shift investment incentives from profit to cost-based measures**. Profit-based investment tax incentives—income exemptions, reduced rates, tax holidays—have proliferated under the CIT and are often open-ended. Specific investment allowances—accelerated depreciation schemes and investment tax deductions or credits—would lower the cost of capital for more investments, encouraging greater investment with less revenue loss.

- **Continue moving closer to a global income tax system**. The rationalization of personal income tax rates for public and private sector wage income in 2015/16 was an important step forward. Nonetheless, income taxes are mostly "schedular" with different income—wages, self-employed income, rents—taxed under separate schedules. Moving closer to a global income tax system that combines taxpayers' incomes from all sources, and applying a single, progressive rate schedule would increase equity and limit incentives for tax planning.

D. Promoting Private Sector Development and Job Opportunities for All

29. Private sector development is hampered by limited access to finance and connectedness to the global economy (Figure 8, SIP Chapter 5). World Bank business climate indicators show Iran performing poorly in access to credit, protecting minority investors, governance, trading across borders, and resolving insolvency. Global Competitiveness indicators shows shortfalls in financial market development, labor market efficiency, and technological readiness. These constraints, combined with the large role of the state, result in a low employment elasticity of non-oil growth (just 0.2). The labor market is unable to absorb new entrants—which average half a million annually over the next five years—with youth and women facing the greatest challenges. The unemployment rate exceeds 12 percent, with female and youth unemployment at 21 and almost 30 percent, respectively. Nearly one-fifth of university graduates are unemployed and one-third of the youth are neither economically active nor in education.

Iran Business Environment



Source: Doing business 2017.

Note: the distance to frontier score benchmarks economies with respect to regulatory best practice, showing the absolute distance to the best performance on each Doing Business indicator. The indicator goes from 0 to 100, with 100 being the frontier.

30. Structural reforms can spur private sector growth, mitigate the effects of fiscal adjustment, and provide opportunities to improve living standards durably. In particular:

- *Refocusing the role and resources of the state would facilitate private sector development.* Higher infrastructure investment, reducing the large role of the state in the economy, the removal of government-imposed constraints such as excessive red tape, administered prices, and greater commercial orientation of state-owned firms would help level the playing field for new and smaller firms to enter markets, grow and create jobs.

- *Regulatory reforms can attract foreign investors to ease financing constraints as the banking reform proceeds while bringing technical know-how and innovation.* A registry of corporate beneficial ownership would complement AML/CFT reforms, addressing concerns that have made some investors and correspondent banks hesitant to enter or deal with Iran. Establishing an independent anti-corruption agency, actively pursuing cases, and enhancing the system of declaration of assets of high-level public officials in line with international standards would bolster accountability, transparency, and improve the business climate.

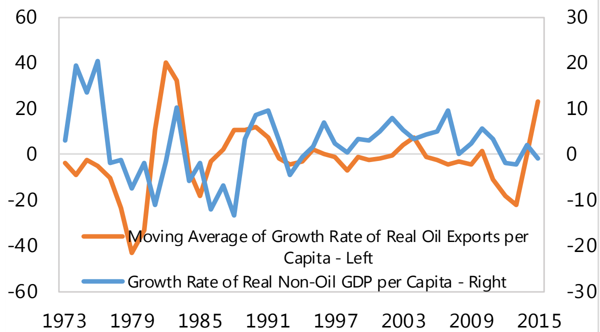
- *Higher female participation and employment can boost growth (Box 3).* Female labor force participation has improved slightly and over 4 million women work outside the home. Over half of university students are female where they comprise over 70 percent of science, and over half

Figure 8. Islamic Republic of Iran: Structural Reforms

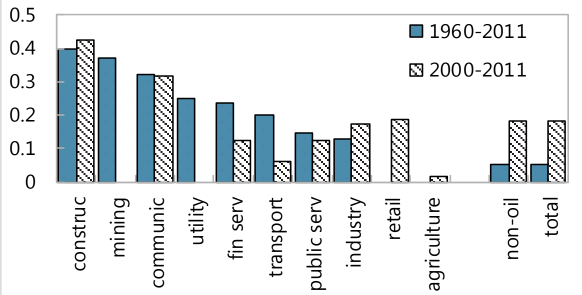
Growth in the non-oil sector is still largely driven by the oil sector.

And non-oil growth has not generated sufficient jobs.

Oil Exports and Non-Oil Activity
(Percent)



Employment Elasticities, Non-oil GDP 1/

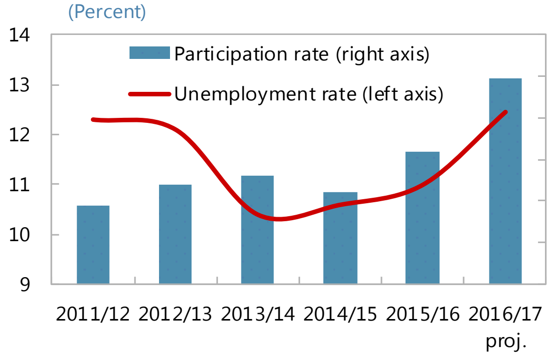


1/ Elasticities are estimated using linear regression. Non-negativity constraints are imposed on elasticity coefficients.

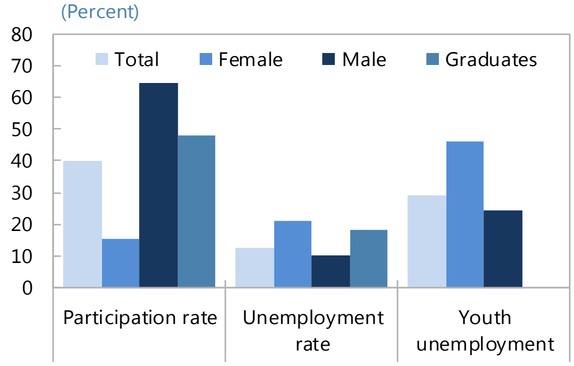
Unemployment and participation are rising, stressing the need for higher growth and job creation...

especially for females and university graduates.

Unemployment and Participation Rate
(Percent)



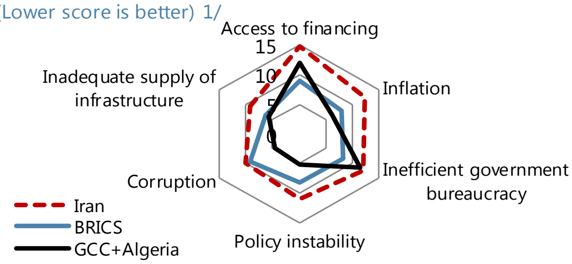
Labor Market Performance, 2016
(Percent)



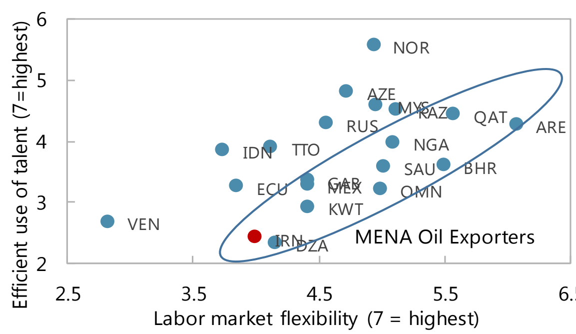
Addressing institutional and market inefficiencies would help private sector development.

Structural reforms, including in the labor market, can also improve the allocation of resources to more productive uses.

The Most Problematic Factors for Doing Business
(Lower score is better) 1/



Labor Market Efficiency, 2016



1/ From a list of 16 factors, respondents were asked to select the five most problematic for doing business in their country and to rank them between 1 (most problematic) and 5. The score corresponds to the responses weighted according to their rankings.

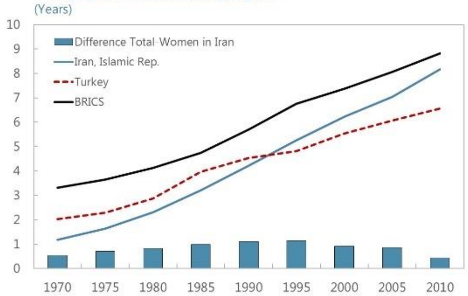
Sources: Iran authorities; Global Competitiveness, and IMF staff calculations.

Box 3. Unlocking Growth and Improving Female Labor Market Outcomes

Iran is working on improving women's labor market outcomes…

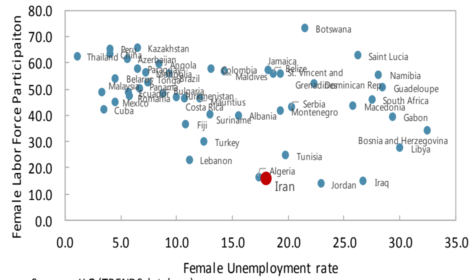
Despite significant improvements in educational attainment and gender parity in education, Iran has not achieved commensurate improvements in women's labor market outcomes.

Average years of total schooling, age 25+
(Years)



Source: Barro-Lee database.

Women's outcomes in sample of upper middle income countries, 2015
(Percent)



Sources: ILO (TRENDS database)

In a context of evolving social norms and greater need for two-earner households, the government has sought to better understand women's participation by measuring the value of domestic work in the national accounts and fostering economic diversification and job creation in sectors where women work. The Vice-Presidency for Women's Affairs has taken action to increase employment opportunities, in part through a review of gender quotas; ready women for promotion in the public sector via training; enforce non-discrimination in hiring; and promote more affordable child-care near or at work. As they address NPLs, they have provided a longer grace period on loans owed by women.

Higher economic growth is correlated with greater female labor force participation (FLFP)…

By enlarging talents available to employers, better female labor market outcomes enhance growth. Recent studies estimate that bringing the female employment rate to male levels could raise GDP in Japan by 9 percent, the United Arab Emirates by 12 percent, and Egypt by 34 percent. Under similar assumptions, we estimate the GDP boost in Iran would be around 40 percent.

But often to realize this potential measures targeted at women are needed….

Even as Ireland's economic development accelerated in the 1970s, FLFP remained around 30 percent. Only the evolution of social norms and the removal of institutional barriers to women's participation—such as restrictions on married women's employment, night work and pay discrimination—eventually enabled firms to employ more workers, especially in traditionally female sectors such as textiles, thereby supporting Ireland's export-led growth strategy.

A recent World Bank report on Women, Business and the Law shows 65 economies made 94 reforms to improve gender parity during 2013–15, and identified 23 gender-based legal restrictions in Iran. Fiscal policy can be designed to avoid work disincentives for women for example by shifting from family to individual income taxation; tax credits or other benefits for low-wage earners (e.g., Belgium, Finland); family allowances that help parents reconcile work and family care; or pension reforms that address retirement age gaps. Broader regulatory reforms that support flexible work, improve the quality and quantity of child and elderly care, and ensure safe transport, can help.

of the medical student populations. The government can enhance women's opportunities and boost growth by hiring more women and ensuring non-discrimination in all job advertisements, hiring, and pay. Active labor market policies that offer business skills, management and entrepreneurship training, and affordable child-care can aid greater female participation.

- *Active labor market policies to tackle youth unemployment.* Better coordination with the private sector would better align the education and training system to the skills needs of employers. Revisions to the labor code can address the rigidities in regulations—such as high job protection and benefits to those who are employed for more than a year—that deter job creation and longer-term work contracts. Consideration could be given to offering firms a temporary tax credit (or reduction in payroll taxes) for new hires funded by new budgetary resources or savings, pending a pension reform that tackles high social security contribution rates.

31. Job creation is at the heart of the authorities' growth strategy. The NDP bill in parliament anticipates concrete steps—e.g., permitting the public sector companies to procure services from the private sector—to improve the regulatory environment for private firms. The authorities noted that discussions have started on the broad reform of the labor code anticipated under the NDP to remove constraints to hiring and firing for permanent contracts. To improve the match between labor supply and demand, they are seeking to improve the quality and relevance of education and training through greater private sector involvement and the introduction of entrepreneurship courses in the education curriculum. As in many countries in the region, social norms and legal barriers have hampered female participation but economic necessity means that more women are working.

E. Other Issues

32. More timely and comprehensive data will support the modernization of the fiscal and monetary frameworks and foreign investment. Data in most sectors is infrequent (Informational Annex) and suffers shortcomings. The mission encourages the authorities to participate in the e-GDDS by developing a national summary data page to disseminate key macroeconomic data, and to develop a program to strengthen data quality, availability, and timeliness.

33. The exchange rate regime gives rise to several multiple currency practices (MCPs) and an exchange restriction subject to Fund approval under Article VIII, Sections 2(a) and 3. A MCP and exchange restriction arise from the establishment of an official exchange rate for use in some exchange transactions, which differs by more than two percent from the rate used by foreign exchange bureaus. Two other MCPs arise from the differences of more than two percent between the current official and bureau market rates, and the preferential rates for certain imports for which foreign exchange payment commitments were made through letters of credits or bank drafts prior to March 21, 2002 and July 24, 2012.[5]

[5] The MCP related to the pre-March 21, 2002 letters of credit are expected to be removed once the commitments under these letters mature. The authorities are committed to eliminate the MCP related to letters of credits or banks drafts prior to July 2012 by end-February 2018.

STAFF APPRAISAL

34. **The economy is staging an impressive recovery after the lifting of nuclear sanctions in 2016**. Oil production rebounded quicker than expected but the recovery in the non-oil sector is still nascent. Staff commends the achievement under difficult conditions of single digit inflation and stabilization of the foreign exchange market. Staff welcomes recent steps to strengthen the AML/CFT framework, the introduction of IFRS reporting standards in banks, and audit and securitization of government liabilities which will help unlock corporates' and banks' balance sheets and facilitate greater investment.

35. **The challenge now is to create the conditions for sustained stability and growth**. Renewed uncertainty underscores the importance of advancing reforms to lessen Iran's reliance on oil, develop the private sector, and build buffers. Rapid and resolute implementation of the authorities' comprehensive reform plan would help meet these goals. Priority should be given to the restructuring and recapitalization of banks to sustain financial stability and fund growth. This would also alleviate liquidity pressures, help safeguard low and stable inflation, and facilitate the transition to a new monetary policy framework and managed float. Fiscal policy needs to create space to fund these reforms and support growth. Structural reforms that facilitate foreign investment such as improvements in the transparency of corporate ownership would ease domestic financing constraints as banking reform proceed. Reducing the role of the state and improving the business climate would aid job creation.

36. **Banking reform is now urgent to sustain financial stability and reduce high lending rates**. Distressed banks require enhanced supervision. An AQR would identify viable banks that warrant recapitalization and nonviable banks to be resolved. Recapitalization of state-owned banks should be linked to measures that improve their commercial viability. The government should continue the securitization of its arrears. Quick approval of the new banking and resolution bills would give the CBI the supervisory powers to implement the reform and help it safeguard financial soundness.

37. **Prudent fiscal policy and liquidity growth are critical to keep inflation well anchored and permit exchange rate unification**. The government should recapitalize public banks, wind down its directed credit schemes, and reform regulated prices to reduce banks' and public enterprises' need for CBI liquidity. Staff urges quick passage of the Central Bank bill to modernize the monetary policy framework and provide greater operational independence to the CBI to pursue low and stable inflation. Staff recommends an early move to unify the exchange rate and shift to a managed float to have flexibility to manage external shocks. It also acknowledges the need for expanded CBRs to enhance growth prospects and ensure better access to foreign reserves.

38. **Staff urge the authorities to move to a MTFF to accommodate reform needs and underpin their commitment to prudent fiscal policy**. A MTFF that takes advantage of the sizeable oil resources and moderate debt burden would ensure a gradual adjustment to the additional fiscal costs from banking system reform. Higher revenue collections, further fuel price adjustment, and

better targeting of cash transfers would create space to support growth and equity through higher public investment spending and cash transfers for the poor. Replenishing the OSF would provide the budget a buffer. The authorities should explore the scope to use oil revenues to fund bank recapitalization.

39. Fostering private non-oil sector development and job creation calls for comprehensive legal and regulatory reform. Enhancing the AML/CFT framework will facilitate re-integration to the global financial system and tackle proceeds of crimes including corruption and tax evasion. Improved labor market regulations, with specific measures to facilitate youth and female employment, would ensure more people have opportunities to work and make growth more inclusive.

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

41. Staff recommends Executive Board approval of the retention of the MCP and exchange restriction arising from the greater than the two percent deviation between the official and bureau exchange rates, since they are maintained for balance of payments reasons, are non-discriminatory, and are temporary in light of the authorities' commitment to unify the exchange rate regime by end-February 2018. Staff also recommends Executive Board approval of the retention of the two MCPs relating to the use of preferential exchange rates for certain imports, as referred to in paragraph 33, through end-February 2018. 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.

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

Table 1. Islamic Republic of Iran: Selected Macroeconomic Indicators, 2014/15–2021/22 1/

Quota: SDR 3,567.10 million
Population: 78 million, 2014/15
Per capita GDP: current US$5,288, PPP current US$17,366, 2014/15
Poverty rate: 9 percent, $5.5 2011 PPP
Main exports: oil, gas, chemical and petrochemical products, pistachios

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
			(Annual percentage change, unless otherwise indicated)					
National accounts								
Nominal GDP at market prices (trillions of Iranian rials)	11,036	11,096	13,045	15,146	17,379	19,884	22,624	25,639
Nominal GDP (billions of US$)	415	374	377	368	386	412	441	472
Real GDP at factor cost	4.0	-1.8	6.6	3.3	4.3	4.4	4.5	4.4
Real oil GDP	7.3	6.4	52.2	2.6	6.7	6.7	6.7	5.8
Real non-oil GDP	3.7	-2.7	0.8	3.4	3.8	4.0	4.0	4.1
CPI inflation (average)	15.6	11.9	8.9	11.2	11.0	10.2	9.5	9.0
CPI inflation (end of period)	16.2	8.3	10.5	11.9	10.7	9.8	9.2	8.8
GDP deflator at factor cost	12.6	2.2	10.3	12.4	10.1	9.5	8.9	8.5
Unemployment rate (percent of labor force)	10.6	11.0	12.5	12.5	12.5	12.3	12.2	12.2
			(Percent of GDP)					
Saving investment balance 2/								
Current account balance	3.8	2.4	6.3	5.3	5.3	4.3	4.3	3.3
Investment	37.7	32.1	31.2	31.1	31.4	32.1	32.9	33.7
Change in stocks	12.2	8.6	8.0	7.8	7.5	7.2	6.8	6.6
Total fixed capital investment	25.5	23.5	23.1	23.3	23.9	25.0	26.0	27.2
Public	2.7	2.5	2.2	2.0	2.4	2.4	2.4	2.4
Private	22.8	21.1	21.0	21.3	21.5	22.5	23.7	24.8
Gross national savings	41.5	34.5	37.5	36.4	36.7	36.4	37.2	37.1
Public	1.1	1.0	0.0	3.5	2.4	2.6	3.0	2.9
Private	40.4	33.5	37.5	33.0	34.4	33.8	34.1	34.1
Central government operations								
Revenue	14.6	16.2	15.1	18.5	17.5	17.8	18.1	18.1
Tax revenue	6.4	7.1	6.9	7.0	7.7	8.4	9.1	9.3
Nontax revenue	8.1	9.0	8.2	11.5	9.8	9.4	9.0	8.8
Of which : oil revenue	5.7	6.0	5.4	8.7	7.1	6.8	6.5	6.3
Expenditure	15.7	17.9	17.9	17.9	17.9	18.0	17.9	18.0
Net lending/borrowing (budget)	-1.2	-1.8	-2.8	0.7	-0.4	-0.2	0.3	0.2
Balance of Targeted Subsidy Organization	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Net lending/borrowing (including TSO)	-1.2	-1.8	-3.1	0.7	-0.4	-0.2	0.3	0.2
Non-oil net lending/borrowing (percent of non-oil GDP)	-8.2	-9.0	-10.6	-10.4	-9.7	-8.9	-8.0	-7.9
			(Annual percentage change, unless otherwise indicated)					
Monetary sector								
Net foreign assets	1.2	14.4	32.1	24.3	21.4	15.9	16.7	13.7
Net domestic assets	35.9	41.5	28.0	21.0	13.6	14.4	11.8	12.2
Credit to the private sector in rials	16.7	16.7	30.3	19.7	15.5	15.0	13.0	12.8
Base money	14.6	16.4	23.0	17.1	13.4	12.0	11.6	10.7
Narrow money (M1)	0.9	13.2	23.1	18.3	11.9	12.6	12.2	11.5
Broad money (M2)	22.3	30.0	29.5	22.3	16.6	15.0	13.8	12.8
			(Billions of US$, unless otherwise indicated)					
External sector								
Current account balance	15.9	9.0	23.8	19.6	20.6	17.7	18.8	15.7
Exports of goods and services	96.4	74.9	102.2	114.3	118.6	122.5	127.5	132.7
Imports of goods and services	-82.1	-67.2	-79.4	-96.0	-100.6	-107.6	-111.6	-120.1
External and publicly guaranteed debt	5.1	10.0	8.2	7.5	8.1	8.7	9.4	10.1
Of which: short-term debt	0.4	2.0	2.2	2.4	2.6	2.9	3.1	3.4
Gross official assets/reserves	126.2	128.4	132.3	148.0	166.4	182.5	200.3	215.2
Oil and gas sector								
Total oil and gas exports	55.4	33.6	57.4	65.3	67.7	69.8	72.2	74.9
Average oil export price (US$ per barrel)	79.1	45.6	48.1	55.4	55.7	55.7	56.0	56.5
Crude oil exports (millions of barrels/day)	1.2	1.4	2.4	2.5	2.6	2.7	2.8	2.9
Crude oil production (millions of barrels/day)	3.2	3.3	4.1	4.2	4.5	4.8	5.1	5.4
Memorandum items:								
Average exchange rate (Iranian rials per US$)	26,594	29,645	…	…	…	…	…	…
End-of-period exchange rate (Iranian rials per US$)	28,085	30,260	…	…	…	…	…	…

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

Table 2. Islamic Republic of Iran: Labor and Population Data, 2014/15–2021/22 1/

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	(Millions of people, unless otherwise indicated))							
Population	78.5	79.5	80.5	81.4	82.4	83.3	84.1	85.0
Working age population		64.6	65.2	65.7	66.3	66.8	67.3	67.9
Labor force	23.8	24.7	26.1	26.4	26.8	27.2	27.6	28.0
Employment	21.3	22.0	22.8	23.1	23.5	23.8	24.2	24.6
Unemployment	2.5	2.7	3.2	3.3	3.3	3.4	3.4	3.4
Nominal GDP per capita (US$)	5,288	4,710	4,682	4,519	4,685	4,945	5,240	5,558
	(Percent)							
Participation rate	30.4	38.2	40.0	40.2	40.5	40.7	41.0	41.2
Male		63.2	64.5	...	...	...	...	...
Female		13.3	15.6	...	...	...	...	...
Unemployment rate	10.6	11.0	12.5	12.5	12.5	12.3	12.2	12.2
Male		9.3	10.4	...	...	...	...	...
Female		19.4	21.1	...	...	...	...	...
Youth		26.1	29.0	...	...	...	...	...
	(Annual percentage change)							
Nominal GDP per capita	14.9	-0.7	16.1	14.7	13.4	13.2	12.6	12.2
Real GDP per capita	2.0	-2.9	5.2	2.1	3.1	3.3	3.4	3.4
Population	2.0	1.3	1.2	1.2	1.2	1.1	1.1	1.0
Labor force	0.0	3.6	5.5	1.4	1.4	1.4	1.4	1.6
Employment	-0.2	3.1	3.8	1.3	1.5	1.5	1.6	1.6
Unemployment	2.0	7.5	19.5	2.0	1.0	0.4	0.3	1.4

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

1/ The Iranian fiscal year ends March 20.

Table 3. Islamic Republic of Iran: Balance of Payments, 2014/15–2021/22 1/

(In millions of US$, unless otherwise indicated)

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Current account balance	15,861	9,019	23,766	19,602	20,624	17,703	18,808	15,670
(in percent of GDP at market prices)	3.8	2.4	6.3	5.3	5.3	4.3	4.3	3.3
Trade balance	21,392	12,178	29,979	29,416	29,818	28,068	28,918	27,182
Exports	86,471	64,597	89,265	100,380	104,194	107,602	111,390	115,971
Oil and gas	55,352	33,569	57,429	65,274	67,704	69,812	72,212	74,884
Crude oil	33,458	23,630	42,423	50,550	52,639	54,622	56,892	59,404
Petroleum products and natural gas	21,894	9,939	15,005	14,724	15,065	15,190	15,320	15,480
Non-oil and gas	31,119	31,028	31,836	35,106	36,490	37,790	39,177	41,087
Imports	-65,079	-52,419	-59,286	-70,964	-74,376	-79,534	-82,471	-88,789
Services and Income (net)	-6,042	-3,706	-6,803	-10,458	-9,895	-11,130	-10,945	-12,420
Credits	11,884	12,309	15,709	16,985	17,634	18,222	19,483	20,296
Debits	-17,926	-16,015	-22,512	-27,443	-27,529	-29,352	-30,428	-32,717
Transfers (net)	511	547	591	644	702	765	834	909
Capital and financial account balance	-1,665	-2,514	-14,801	-3,899	-2,276	-1,602	-982	-794
Foreign direct investment and portfolio equity	1,360	799	2,000	5,000	5,244	5,595	5,992	5,953
Medium- and long-term debt	57	65	-1,043	-860	300	400	400	400
Trade credit	634	1,173	-8,319	-4,801	-4,781	-4,759	-4,735	-4,709
Other capital 2/	-3,716	-4,551	-7,438	-3,238	-3,038	-2,838	-2,638	-2,438
Errors and omissions	-5,634	-4,272	0	0	0	0	0	0
Overall balance	8,562	2,233	8,966	15,703	18,349	16,100	17,826	14,876
Change in gross official assets/reserves (– = increase)	-8,562	-2,233	-8,966	-15,703	-18,349	-16,100	-17,826	-14,876
Memorandum items:								
Net official reserves	117,489	120,378	123,524	138,786	156,671	170,826	188,652	203,528
Gross official assets/reserves	126,166	128,399	132,347	148,050	166,398	182,498	200,324	215,201
(in months of the following year's imports)	22.5	19.4	16.5	17.7	18.6	18.6	18.6	18.6
Gross foreign liabilities of the Central Bank of Iran	8,676	8,020	8,823	9,264	9,727	11,672	11,672	11,672
External debt service (percent of exports)	0.0	0.6	1.6	1.2	0.9	0.8	0.8	0.8
External debt (percent of GDP)	1.2	2.7	2.2	2.0	2.1	2.1	2.1	2.1

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 4. Islamic Republic of Iran: Balance of Payments, 2014/15–2021/22 1/

(In percent of GDP)

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Current account balance	3.8	2.4	6.3	5.3	5.3	4.3	4.3	3.3
Trade balance	5.2	3.3	8.0	8.0	7.7	6.8	6.6	5.8
Exports	20.8	17.3	23.7	27.3	27.0	26.1	25.3	24.5
Oil and gas	13.3	9.0	15.2	17.7	17.5	17.0	16.4	15.9
Crude oil	8.1	6.3	11.3	13.7	13.6	13.3	12.9	12.6
Petroleum products and natural gas	5.3	2.7	4.0	4.0	3.9	3.7	3.5	3.3
Non-oil and gas	7.5	8.3	8.5	9.5	9.5	9.2	8.9	8.7
Imports	-15.7	-14.0	-15.7	-19.3	-19.3	-19.3	-18.7	-18.8
Services and Income (net)	-1.5	-1.0	-1.8	-2.8	-2.6	-2.7	-2.5	-2.6
Credits	2.9	3.3	4.2	4.6	4.6	4.4	4.4	4.3
Debits	-4.3	-4.3	-6.0	-7.5	-7.1	-7.1	-6.9	-6.9
Transfers (net)	0.1	0.1	0.2	0.2	0.2	0.2	0.2	0.2
Capital and financial account balance	-0.4	-0.7	-3.9	-1.1	-0.6	-0.4	-0.2	-0.2
Foreign direct investment and portfolio equity	0.3	0.2	0.5	1.4	1.4	1.4	1.4	1.3
Medium- and long-term debt	0.0	0.0	-0.3	-0.2	0.1	0.1	0.1	0.1
Trade credit	0.2	0.3	-2.2	-1.3	-1.2	-1.2	-1.1	-1.0
Other capital 2/	-0.9	-1.2	-2.0	-0.9	-0.8	-0.7	-0.6	-0.5
Errors and omissions	-1.4	-1.1	0.0	0.0	0.0	0.0	0.0	0.0
Overall balance	2.1	0.6	2.4	4.3	4.8	3.9	4.0	3.1
Change in gross official assets/reserves (– = increase)	-2.1	-0.6	-2.4	-4.3	-4.8	-3.9	-4.0	-3.1
Memorandum items:								
Net official reserves	28.3	32.2	32.8	37.7	40.6	41.5	42.8	43.1
Gross official assets/reserves	30.4	34.3	35.1	40.2	43.1	44.3	45.4	45.6
Gross foreign liabilities of the Central Bank of Iran	2.1	2.1	2.3	2.5	2.5	2.8	2.6	2.5
External debt	1.2	2.7	2.2	2.0	2.1	2.1	2.1	2.1

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 5. Islamic Republic of Iran: Central Bank Balance Sheet, 2014/15–2021/22 1/

	2014/15	2015/16	Projections 2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	(Billions of rials, unless otherwise indicated)							
Net foreign assets (NFA)	2,867,544	3,259,700	4,323,887	5,464,873	6,733,268	7,882,257	9,290,588	10,641,804
In millions of U.S. dollars	*102,102*	*107,723*	*110,869*	*126,131*	*144,016*	*158,171*	*175,997*	*190,887*
Foreign assets	3,111,222	3,502,400	4,667,966	5,866,240	7,188,032	8,463,927	9,906,744	11,292,522
In millions of U.S. dollars	*110,779*	*115,744*	*119,691*	*135,394*	*153,743*	*169,843*	*187,669*	*202,559*
Foreign liabilities 2/	243,678	242,700	344,079	401,367	454,765	581,670	616,156	650,718
In millions of U.S. dollars	*8,676*	*8,020*	*8,823*	*9,264*	*9,727*	*11,672*	*11,672*	*11,672*
Net domestic assets (NDA)	-1,507,047	-1,673,600	-2,152,098	-2,614,241	-3,096,278	-3,679,818	-4,508,544	-5,200,682
Net domestic credit	-369,355	-276,300	-284,565	-389,680	-762,664	-1,164,332	-1,575,435	-1,978,889
Central government, net	-1,469,486	-1,388,800	-1,575,142	-1,809,315	-2,253,280	-2,688,853	-3,111,595	-3,515,050
Claims	117,126	175,400	195,400	215,400	235,400	255,400	275,400	295,400
Deposits	1,586,613	1,564,200	1,770,542	2,024,715	2,488,680	2,944,253	3,386,995	3,810,450
Claims on banks	858,049	836,300	978,471	1,076,318	1,130,134	1,164,038	1,175,678	1,175,678
Claims on nonfinancial public enterprises (NFPEs)	242,083	276,200	312,106	343,317	360,482	360,482	360,482	360,482
Other items net, excluding central bank participation papers (CPPs)	-1,137,692	-1,397,300	-1,867,533	-2,224,561	-2,333,615	-2,515,486	-2,933,109	-3,221,793
Base money	1,353,109	1,575,100	1,937,690	2,269,342	2,573,782	2,881,722	3,214,572	3,557,347
Currency	421,792	457,000	523,176	549,335	576,802	605,642	635,924	667,720
Currency in circulation	351,673	371,900	434,236	455,948	478,746	502,683	527,817	554,208
Cash in vaults	70,118	85,100	88,940	93,387	98,056	102,959	108,107	113,512
Reserves	889,688	1,076,000	1,372,414	1,677,907	1,954,881	2,233,980	2,536,548	2,847,527
Required reserves	850,360	1,019,000	1,324,792	1,627,795	1,903,678	2,194,832	2,501,900	2,827,268
Excess reserves	39,327	57,000	47,622	50,112	51,203	39,148	34,648	20,259
Deposits of NFPE and municipalities	41,629	42,100	42,100	42,100	42,100	42,100	42,100	42,100
Other liabilities	7,388	10,400	234,099	581,290	1,063,207	1,320,717	1,567,472	1,883,775
Memorandum items:								
End-period change (in percent of base money)								
Base money	14.6	16.4	23.0	17.1	13.4	12.0	11.6	10.7
NFA	-3.8	29.0	67.6	58.9	55.9	44.6	48.9	42.0
NDA (net of other liabilities)	6.5	-12.5	-44.6	-41.8	-42.5	-32.7	-37.3	-31.4

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

1/ The Iranian fiscal year ends March 20.

2/ Includes liabilities in foreign currency to residents.

Table 6. Islamic Republic of Iran: Monetary Survey, 2014/15–2021/22 1/

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
			Projections					
			(Billions of rials, unless otherwise indicated)					
Net foreign assets (NFA)	3,309,567	3,787,600	5,004,261	6,220,733	7,548,905	8,751,630	10,211,504	11,613,630
(Millions of US$)	117,841	125,169	128,314	143,576	161,462	175,617	193,443	208,319
Foreign assets	5,020,296	5,807,900	7,639,364	9,167,313	10,750,169	12,260,745	13,928,667	15,539,299
(Millions of US$)	178,754	191,933	195,881	211,584	229,933	246,033	263,859	278,735
Foreign liabilities 2/	1,710,729	2,020,300	2,635,103	2,946,580	3,201,264	3,509,115	3,717,163	3,925,668
(Millions of US$)	60,913	66,765	67,567	68,008	68,471	70,416	70,416	70,416
Net domestic assets (NDA)	4,521,670	6,396,200	8,185,434	9,906,487	11,255,775	12,878,411	14,398,114	16,152,839
Net domestic credit	5,744,253	7,170,500	9,037,164	10,800,804	12,230,580	13,862,964	15,402,358	17,177,168
Net credit to government 3/	-842,428	-494,900	-899,673	-1,064,008	-1,436,236	-1,799,341	-2,249,351	-2,680,087
Claims on nonfinancial public enterprises (NFPEs)	277,628	303,200	347,077	386,077	410,342	417,833	425,733	434,103
Claims on the private sector	6,309,054	7,362,200	9,589,760	11,478,735	13,256,475	15,244,472	17,225,977	19,423,152
Other items, net, excluding CPPs	-1,222,583	-774,300	-851,730	-894,317	-974,805	-984,553	-1,004,244	-1,024,329
Broad money (M3)	7,831,236	10,183,200	13,189,695	16,127,221	18,804,680	21,630,040	24,609,618	27,766,469
M2	7,823,848	10,172,800	13,176,292	16,112,330	18,788,612	21,612,913	24,591,476	27,747,308
Cash	351,673	371,900	434,236	455,948	478,746	502,683	527,817	554,208
Deposits	7,472,175	9,800,900	12,742,055	15,656,382	18,309,866	21,110,230	24,063,659	27,193,101
Demand deposits	855,886	995,100	1,249,123	1,534,818	1,749,169	2,006,137	2,286,805	2,584,201
Time deposits	6,616,289	8,805,800	11,492,933	14,121,563	16,560,697	19,104,094	21,776,853	24,608,900
CPPs held by nonbanks	0	0	0	0	0	0	0	0
Foreign currency deposits	7,388	10,400	13,404	14,891	16,069	17,127	18,143	19,160
Memorandum items:								
Net credit to government (without valuation effect) 3/	-842,428	-494,900	-899,673	-1,064,008	-1,436,236	-1,799,341	-2,249,351	-2,680,087
Base money	1,353,109	1,575,100	1,937,690	2,269,342	2,573,782	2,881,722	3,214,572	3,557,347
M1	1,207,559	1,367,000	1,683,359	1,990,767	2,227,914	2,508,820	2,814,622	3,138,409
Multiplier (M2/base money)	5.8	6.5	6.8	7.1	7.3	7.5	7.7	7.8
Velocity of M2	1.4	1.1	1.0	0.9	0.9	0.9	0.9	0.9
GDP	11,035,525	11,096,457	13,044,529	15,145,590	17,379,466	19,883,880	22,624,158	25,638,513
			(Annual change, in percent)					
NFA	1.2	14.4	32.1	24.3	21.4	15.9	16.7	13.7
NDA	35.9	41.5	28.0	21.0	13.6	14.4	11.8	12.2
Base money	14.6	16.4	23.0	17.1	13.4	12.0	11.6	10.7
M1	0.9	13.2	23.1	18.3	11.9	12.6	12.2	11.5
M2	22.3	30.0	29.5	22.3	16.6	15.0	13.8	12.8
Credit to private sector in rials	16.7	16.7	30.3	19.7	15.5	15.0	13.0	12.8

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.

Table 7. Islamic Republic of Iran: Central Government Operations, 2014/15–2021/22 1/ 2/

(Billions of rials, unless otherwise indicated)

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Revenue	1,606,800	1,794,100	1,971,466	2,803,648	3,044,777	3,543,118	4,103,006	4,650,083
Tax revenue	709,652	791,890	900,202	1,062,852	1,342,665	1,671,710	2,056,831	2,384,627
Taxes on income, profits and capital gains	334,085	405,448	419,809	464,233	559,667	672,926	801,921	910,177
Taxes on property	25,115	24,153	25,636	28,958	33,210	38,075	43,358	49,211
Taxes on goods and services	217,026	246,747	292,842	351,374	464,547	594,596	749,736	850,615
Of which : value added tax	167,040	197,416	209,535	248,584	331,909	435,784	560,797	636,502
Taxes on international trade and transactions	133,426	115,542	161,916	218,286	285,241	366,113	461,816	574,624
Other revenue	897,148	1,002,209	1,071,263	1,740,796	1,702,112	1,871,409	2,046,175	2,265,456
Property income	748,003	817,743	875,473	1,519,631	1,448,477	1,580,620	1,715,034	1,889,612
Of which : rents (oil revenue)	628,837	670,354	702,209	1,322,739	1,233,841	1,347,332	1,462,868	1,618,137
Other	149,145	184,466	195,790	221,164	253,634	290,789	331,141	375,844
Expenditure	1,735,115	1,990,403	2,335,239	2,704,282	3,115,385	3,576,438	4,042,399	4,604,250
Expense	1,438,316	1,716,637	2,051,411	2,397,457	2,702,477	3,094,087	3,504,884	3,982,300
Of which : Interest payments	9,924	11,845	94,520	190,762	231,624	334,813	421,006	498,469
Net acquisition of nonfinancial assets	296,799	273,766	283,828	306,826	412,909	482,352	537,514	621,950
Gross operating balance	168,484	77,463	-79,945	406,191	342,300	449,031	598,122	667,784
Net lending/borrowing (including TSO)	-128,115	-196,260	-402,918	99,366	-70,609	-33,320	60,608	45,834
Net lending/borrowing (budget, excluding TSO)	-128,315	-196,303	-363,773	99,366	-70,609	-33,320	60,608	45,834
Balance of Targeted Subsidy Organization	200	43	-39,145	0	0	0	0	0
Financial assets	-32,369	-221,685	-488,300	-12,980	2,212	11,327	16,796	20,078
Financial liabilities	95,746	-25,425	-85,382	-112,346	72,821	44,647	-43,812	-25,756
Memorandum items:								
Non-oil net lending/borrowing	-756,952	-866,614	-1,105,127	-1,223,373	-1,304,450	-1,380,652	-1,402,260	-1,572,303
Oil prices (US$ per barrel)	79	46	48	55	56	56	56	56
Oil exports (millions of barrels per day)	1.2	1.4	2.4	2.5	2.6	2.7	2.8	2.9

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

1/ The Iranian fiscal year ends March 20.

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

Table 8. Islamic Republic of Iran: Central Government Operations, 2014/15–2021/22 1/ 2/
(Percent of GDP)

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
Revenue	14.6	16.2	15.1	18.5	17.5	17.8	18.1	18.1
Tax revenue	6.4	7.1	6.9	7.0	7.7	8.4	9.1	9.3
Taxes on income, profits and capital gains	3.0	3.7	3.2	3.1	3.2	3.4	3.5	3.6
Taxes on property	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Taxes on goods and services	2.0	2.2	2.2	2.3	2.7	3.0	3.3	3.3
Of which : value added tax	1.5	1.8	1.6	1.6	1.9	2.2	2.5	2.5
Taxes on international trade and transactions	1.2	1.0	1.2	1.4	1.6	1.8	2.0	2.2
Other revenue, of which	8.1	9.0	8.2	11.5	9.8	9.4	9.0	8.8
Property Income	6.8	7.4	6.7	10.0	8.3	7.9	7.6	7.4
Of which : rents (oil revenue)	5.7	6.0	5.4	8.7	7.1	6.8	6.5	6.3
Other	1.4	1.7	1.5	1.5	1.5	1.5	1.5	1.5
Expenditure	15.7	17.9	17.9	17.9	17.9	18.0	17.9	18.0
Expense	13.0	15.5	15.7	15.8	15.5	15.6	15.5	15.5
Of which : Interest payments	0.1	0.1	0.7	1.3	1.3	1.7	1.9	1.9
Net acquisition of nonfinancial assets	2.7	2.5	2.2	2.0	2.4	2.4	2.4	2.4
Gross operating balance	1.5	0.7	-0.6	2.7	2.0	2.3	2.6	2.6
Net lending/borrowing (including TSO)	-1.2	-1.8	-3.1	0.7	-0.4	-0.2	0.3	0.2
Net lending/borrowing (budget, excluding TSO)	-1.2	-1.8	-2.8	0.7	-0.4	-0.2	0.3	0.2
Balance of Targeted Subsidy Organization	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0
Financial assets	-0.3	-2.0	-3.7	-0.1	0.0	0.1	0.1	0.1
Financial liabilities	0.9	-0.2	-0.7	-0.7	0.4	0.2	-0.2	-0.1
Memorandum items:			(Percent of non-oil GDP)					
Tax revenue	7.7	8.2	8.6	9.0	9.9	10.8	11.7	11.9
Income tax	3.6	4.2	4.0	3.9	4.1	4.3	4.5	4.5
VAT	1.8	2.0	2.0	2.1	2.5	2.8	3.2	3.2
Non-oil net lending/borrowing	-8.2	-9.0	-10.6	-10.4	-9.7	-8.9	-8.0	-7.9
Change in nonoil net lending (+ = tightening)	2.3	-0.7	-1.6	0.2	0.7	0.7	1.0	0.1

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

1/ The Iranian fiscal year ends March 20.

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

Table 9. Islamic Republic of Iran: General Government Operations, 2014/15–2021/22 1/

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
				(Billions of rials)				
Revenue	2,299,509	2,278,085	2,555,216	3,584,862	4,101,117	4,660,586	5,286,842	5,908,178
Tax revenue	709,652	791,890	900,202	1,062,852	1,342,665	1,671,710	2,056,831	2,384,627
Budget	709,652	791,890	900,202	1,062,852	1,342,665	1,671,710	2,056,831	2,384,627
Nontax revenue	1,589,857	1,486,194	1,655,014	2,522,010	2,758,452	2,988,877	3,230,011	3,523,551
Budget (excluding oil revenue)	268,311	331,855	369,054	418,057	468,271	524,077	583,307	647,319
TSO (excluding transfer from budget)	355,000	334,016	289,928	365,049	345,076	326,102	308,077	290,952
Oil revenue	966,546	820,323	996,032	1,738,904	1,945,105	2,138,698	2,338,627	2,585,279
Expenditure	2,365,503	2,595,396	2,966,739	3,434,574	3,906,313	4,444,624	5,002,993	5,675,765
Expense	1,793,116	2,050,610	2,380,484	2,762,506	3,047,553	3,420,189	3,812,961	4,273,252
Budget (excluding transfer to TSO)	1,325,316	1,615,111	1,937,411	2,340,457	2,645,477	3,037,087	3,447,884	3,925,300
TSO	467,800	435,499	443,073	422,049	402,076	383,102	365,077	347,952
Net acquisition of nonfinancial assets	572,387	544,786	586,255	672,069	858,761	1,024,436	1,190,032	1,402,513
Budget	296,799	273,766	283,828	306,826	412,909	482,352	537,514	621,950
NDFI (onlending)	275,588	271,020	302,426	365,243	445,852	542,084	652,518	780,563
Overall balance	-65,994	-317,311	-411,522	150,288	194,803	215,962	283,850	232,413
Net acquisition of financial assets	29,752	-342,735	-496,904	37,942	267,624	260,609	240,038	206,657
Budget	-32,369	-221,685	-488,300	-12,980	2,212	11,327	16,796	20,078
NDFI & OSF	62,121	-121,051	-8,604	50,922	265,412	249,282	223,242	186,579
Deposit at the central bank	62,121	-121,051	-8,604	50,922	265,412	249,282	223,242	186,579
Net acquisition of financial liabilities	95,746	-25,425	-85,382	-112,346	72,821	44,647	-43,812	-25,756
Budget	95,746	-25,425	-85,382	-112,346	72,821	44,647	-43,812	-25,756
				(percent of GDP, unless otherwise indicated)				
Revenue	20.8	20.5	19.6	23.7	23.6	23.4	23.4	23.0
Tax revenue	6.4	7.1	6.9	7.0	7.7	8.4	9.1	9.3
Budget	6.4	7.1	6.9	7.0	7.7	8.4	9.1	9.3
Nontax revenue	14.4	13.4	12.7	16.7	15.9	15.0	14.3	13.7
Budget (excluding oil revenue)	2.4	3.0	2.8	2.8	2.7	2.6	2.6	2.5
TSO (excluding transfer from budget)	3.2	3.0	2.2	2.4	2.0	1.6	1.4	1.1
Oil revenue	8.8	7.4	7.6	11.5	11.2	10.8	10.3	10.1
Expenditure	21.4	23.4	22.7	22.7	22.5	22.4	22.1	22.1
Expense	16.2	18.5	18.2	18.2	17.5	17.2	16.9	16.7
Budget (excluding transfer to TSO)	12.0	14.6	14.9	15.5	15.2	15.3	15.2	15.3
TSO	4.2	3.9	3.4	2.8	2.3	1.9	1.6	1.4
Net acquisition of nonfinancial assets	5.2	4.9	4.5	4.4	4.9	5.2	5.3	5.5
Budget	2.7	2.5	2.2	2.0	2.4	2.4	2.4	2.4
NDFI (onlending)	2.5	2.4	2.3	2.4	2.6	2.7	2.9	3.0
Overall balance	-0.6	-2.9	-3.2	1.0	1.1	1.1	1.3	0.9
Net acquisition of financial assets	0.3	-3.1	-3.8	0.3	1.5	1.3	1.1	0.8
Budget	-0.3	-2.0	-3.7	-0.1	0.0	0.1	0.1	0.1
NDFI & OSF	0.6	-1.1	-0.1	0.3	1.5	1.3	1.0	0.7
Deposit at the central bank	0.6	-1.1	-0.1	0.3	1.5	1.3	1.0	0.7
Net acquisition of financial liabilities	0.9	-0.2	-0.7	-0.7	0.4	0.2	-0.2	-0.1
Budget	0.9	-0.2	-0.7	-0.7	0.4	0.2	-0.2	-0.1
Memorandum item:								
Non-oil balance (percent of nonoil GDP)	-11.0	-11.5	-13.4	-13.4	-12.8	-12.3	-11.5	-11.6
Non-oil primary balance (percent of nonoil GDP)	-11.1	-11.6	-12.6	-11.9	-11.2	-10.3	-9.3	-9.3
Nominal GDP (billions of rials)	11,035,525	11,096,457	13,044,529	15,145,590	17,379,466	19,883,880	22,624,158	25,638,513

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

1/ The Iranian fiscal year ends March 20.

Table 10. Islamic Republic of Iran: Government Oil Revenues and Funds, 2014/15–2021/22 1/

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
	(Billions of rials, unless otherwise indicated)							
Crude oil exports, total	889,773	700,513	1,469,113	2,080,825	2,370,880	2,637,887	2,919,197	3,223,806
Oil exports (millions of barrels per day)	1.16	1.42	2.42	2.50	2.59	2.69	2.78	2.88
Average oil exports price (US$ per barrel)	79.1	45.6	48.1	55.4	55.7	55.7	56.0	56.5
Exchange rate (rial per US$)	26,594	29,645	...	...	...	...	...	...
Allocation of oil revenue								
Total	1,095,563	929,051	1,209,053	2,080,825	2,370,880	2,637,887	2,919,197	3,223,806
Budget 2/	628,837	670,354	702,209	1,322,739	1,233,841	1,347,332	1,462,868	1,618,137
National Development Fund (NDFI)	337,709	149,969	293,823	416,165	711,264	791,366	875,759	967,142
Oil Stabilization Fund (OSF)	0	0	0	40,201	81,997	116,695	157,287	171,076
NIOC	129,017	108,727	213,021	301,720	343,778	382,494	423,284	467,452
Shares of annual oil revenue proceeds								
Budget	54.5	65.5	65.5	63.6	52.0	51.1	50.1	50.2
NDFI	31.0	20.0	20.0	20.0	30.0	30.0	30.0	30.0
OSF	0.0	0.0	0.0	1.9	3.5	4.4	5.4	5.3
NIOC	14.5	14.5	14.5	14.5	14.5	14.5	14.5	14.5
	(Billions of US$, unless otherwise indicated)							
NDFI								
Flows								
Oil revenue	12.7	5.1	8.5	10.1	15.8	16.4	17.1	17.8
Expenditure (earmarked/disbursed) 3/	10.4	9.1	8.7	8.9	9.9	11.2	12.7	14.4
Balance	2.3	-4.1	-0.2	1.2	5.9	5.2	4.4	3.4
Assets								
Earmarked, cumulative	32.5	41.6	50.3	59.2	69.1	80.3	93.1	107.4
Asset under management	73.7	78.8	87.3	97.4	113.2	129.5	146.6	164.4
Deposit available 4/	41.3	37.2	36.9	38.2	44.1	49.2	53.6	57.0
OSF								
Flows								
Oil revenue	0.0	0.0	0.0	1.0	1.8	2.4	3.1	3.2
Expenditure (transfers to the budget)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Balance	0.0	0.0	0.0	1.0	1.8	2.4	3.1	3.2
Assets								
Deposit available	0.0	0.0	0.0	1.0	2.8	5.2	8.3	11.4
Memorandum items								
NDFI expenditure (percent of nonoil GDP)	3.0	2.8	2.9	3.1	3.3	3.5	3.7	3.9
NDFI and OSF deposits (percent of GDP)	9.9	9.9	9.8	10.6	12.1	13.2	14.0	14.5
Central government deposits at the CBI 5/	59.7	52.8	51.1	49.2	55.3	61.0	66.0	70.2
Break even oil price (US$ per barrel)	100	60	73	51	59	57	54	55
WEO price (US$ per barrel)	79	46	48	55	56	56	56	56

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

1/ The Iranian fiscal year ends March 20.

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

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

4/ Including currency adjustments and government bonus payback.

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

Table 11. Islamic Republic of Iran: Targeted Subsidy Organization Accounts, 2014/15–2021/22 1/

			Projections					
	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21	2021/22
				(Billions of rials)				
Revenue	468,000	435,542	403,928	422,049	402,076	383,102	365,077	347,952
Price Adjustments	355,000	334,016	289,928	365,049	345,076	326,102	308,077	290,952
Budget Appropriations	113,000	101,526	114,000	57,000	57,000	57,000	57,000	57,000
Expense	467,800	435,499	443,073	422,049	402,076	383,102	365,077	347,952
Cash Transfers	421,000	412,906	420,480	399,456	379,483	360,509	342,484	325,359
Social Security/health	34,000	8,725	8,725	8,725	8,725	8,725	8,725	8,725
Enterprises (Cash and noncash)	5,500	5,770	5,770	5,770	5,770	5,770	5,770	5,770
Other	7,300	8,098	8,098	8,098	8,098	8,098	8,098	8,098
Operating balance	200	43	-39,145	0	0	0	0	0
Debt	59,800	59,800	59,800	59,800	59,800	59,800	59,800	59,800
CBI	57,000	57,000	57,000	57,000	57,000	57,000	57,000	57,000
Treasury	2,800	2,800	2,800	2,800	2,800	2,800	2,800	2,800
				(Percent of GDP)				
Revenue	4.2	3.9	3.1	2.8	2.3	1.9	1.6	1.4
Price Adjustments	3.2	3.0	2.2	2.4	2.0	1.6	1.4	1.1
Budget Appropriations	1.0	0.9	0.9	0.4	0.3	0.3	0.3	0.2
Expense	4.2	3.9	3.4	2.8	2.3	1.9	1.6	1.4
Cash Transfers	3.8	3.7	3.2	2.6	2.2	1.8	1.5	1.3
Social Security/health	0.3	0.1	0.1	0.1	0.1	0.0	0.0	0.0
Enterprises (Cash and noncash)	0.0	0.1	0.0	0.0	0.0	0.0	0.0	0.0
Other	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Operating balance	0.0	0.0	-0.3	0.0	0.0	0.0	0.0	0.0

Sources: Iran authorities and IMF staff estimates and projections.

1/ The Iranian fiscal year ends March 20.

Appendix I. External Sector Assessment

Iran's external position is characterized by low external debt, high reserves and a current account surplus. The official exchange rate is moderately overvalued. The bureau rate is 15 percent more depreciated than the official rate. The unification of the exchange rate is expected to result in the exchange rate settling between the current official and market rates, which in turn, would likely make the unified rate more closely in line with fundamentals.

F. Overview

1. The current account position has remained in surplus, despite the sharp drop in oil prices, due to the rapid rebound in oil exports, and strengthening non-oil exports (e.g., automobiles and petrochemicals) following the lifting of sanctions (Table 1). The current account surplus is expected to decline over the medium-term but remain in modest surplus, reflecting the increase in imports to meet investment needs and consumer demand.[1] The financial account is poised to improve, reflecting large FDI commitments and Iran's gradual reconnection to the global financial system. Prudent monetary and fiscal policies are expected to preserve external stability by avoiding excessive exchange rate fluctuations and containing real appreciation pressures from higher oil exports and increasing private sector demand.

2. External buffers are adequate but limited CBRs hamper reserve management. To address the latter, Iran has reached agreements with some countries to convert its dollar reserves and export earnings into other currencies and is increasingly denominating its oil sales contracts in euros. The uncertain outlook for oil prices, the impact of remaining sanctions, and risk of snap-back sanctions under the JCOPA pose risks to Iran's external position.

[1] Iran will import new aircrafts to replace its aged commercial fleet and is investing in the modernization of oil refining, petrochemical and manufacturing production capacity,

Appendix Table 1. External Sector Vulnerabilities

Current account: Higher surplus driven by rebound in oil exports	**Background**. Current account surpluses shrunk from just over 6 percent of GDP in 2012/13 to 2.4 percent in 2015/16 due to the decline in oil exports and sanctions. However, oil exports have now recovered to pre-sanctions levels and non-oil exports grew by $21.6 billion in the first eight months of FY 2016/17. The main exported items apart from oil include gas condensates, liquefied gas and autos. **Assessment**. The current account remains in surplus. Expanding non-oil exports will be crucial to reduce Iran's dependency on oil revenue, contain the impact of rising imports, and build external buffers.
Real exchange rate: overvalued	**Background**. Iran has a dual exchange rate system: an official rate for imports of select priority goods, and a bureau, market-determined rate for all other transactions. The CBI has shifted about half of goods categories and all services from the official to bureau market, most recently moving imports of wheat and food products to the bureau market. **Assessment**. The real effective exchange rate calculated using the official rate is overvalued. However, uncertainty around oil prices and sanctions complicate the assessment. The government plans to unify the exchange rate and move to a managed float which could eliminate the overvaluation.
Capital and financial account: insignificant	**Background**. Iran's economy was cut-off from global financial markets due to international sanctions until January 2016. However, FDI flows are returning, mostly in oil and gas sectors and automotives. **Assessment**. The capital account is small. One major challenge hampering the development of the capital account is the reconnection of Iranian banks to the international financial system reflecting both the impact of remaining sanctions and need to strengthen the AML/CFT framework and weak domestic banks.
FX assets/reserves: large but some problems in access	**Background**. Iran's foreign exchange assets/reserves stood at $128 billion at end-March 16, equivalent to 19 months of imports and 40 percent of broad money. Post JCPOA implementation, Iran has been able to access more of its reserves, but challenges remain. Iran is increasingly settling its trade in euros (notably for oil) and converting its reserves to currencies other than the US dollar. **Assessment**. The level of gross foreign exchange assets is comfortable.
Foreign assets and liabilities position: no detailed information available	**Background**. Gross external debt is low, around 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 are reported to be frozen or encumbered even after sanctions relief. **Assessment**. IIP data are not disseminated. In recent years, the compilation of data has been very difficult owing to challenges in tracking foreign assets. (see informational annex)

Source: IMF staff.

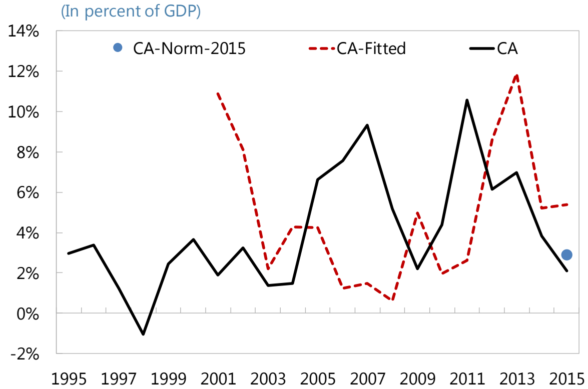
G. Exchange Rate Assessment

3. The exchange rate assessment points to a moderate overvaluation in the official exchange rate of about 5–7 percent. The bureau rate is 15 percent more depreciated than the official rate. The unification of the exchange rate would be expected to result in the exchange rate settling between the current official and market rates, which in turn, would likely make the unified rate broadly in line with fundamentals.

- **Current account approach**. The REER is moderately overvalued by 5.7 percent. The current account balance (CA) in 2015 of 2.1 percent of GDP is below the norm of 2.9 percent of GDP. The two main drivers of the CA norm in Iran are labor productivity and the fiscal position. A widening fiscal deficit and comparatively low productivity has left the CA surplus weaker than the norm. Prudent fiscal and monetary policies would contain inflation and aid competitiveness. Reforms to improve the business climate and labor market would address Iran's productivity gap.

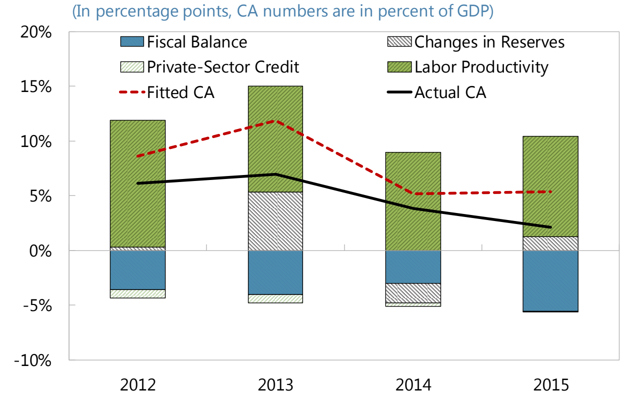
- **Real effective exchange rate approach**. The REER is moderately overvalued by 7 percent. The overvaluation is mostly driven by the positive real interest rate differential and decline in terms of trade. Exchange rate unification and transition to a managed float would allow the economy to better manage terms of trade shocks.

Current Account: Actual, Fitted, and Norm
(In percent of GDP)



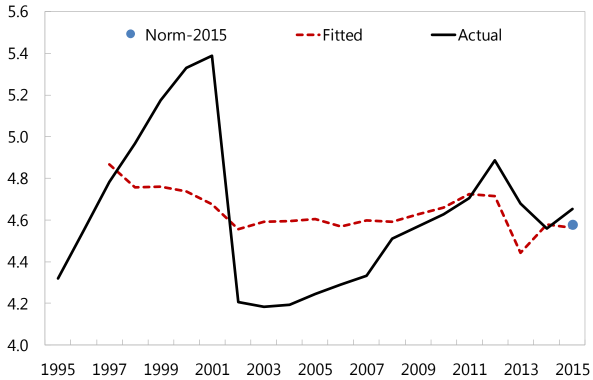
Source: IMF staff.

Current Account: Contributions of Fitted Values
(In percentage points, CA numbers are in percent of GDP)



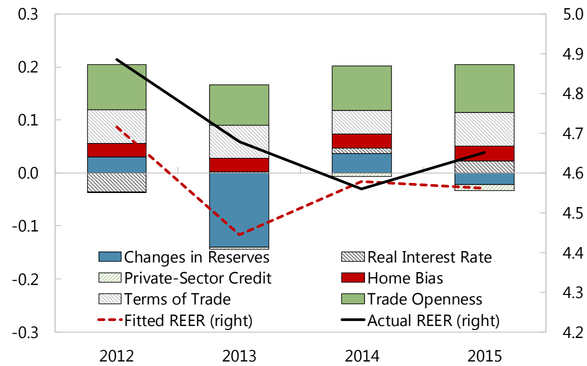
Source: IMF staff.

Ln(REER): Actual, Fitted, and Norm



Source: IMF staff.

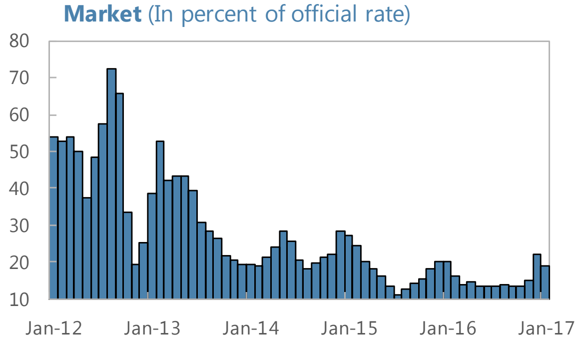
Ln(REER): Contributions of Fitted Values
(In percentage points, REER numbers are unit index)



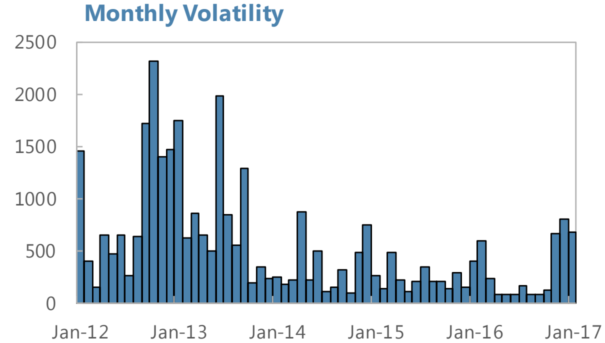
Source: IMF staff.

4. Iran's bureau or market exchange rate also suggests the official rate is overvalued. The premium between the parallel rate and the official rate declined to about 14 percent over the course of 2016, but widened to 20 percent towards to end-2016 amid dollar strength before falling to 15 percent in early 2017. The authorities have moved 53 percent of categories of goods imports from the priority list of imports that are valued at the official exchange rate to the bureau market.

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



Free-Market IRR/USD Exchange Rate, Avg. Monthly Volatility



H. External Sustainability

5. Iran's external position suggests no significant misalignment, or sustainability risk. External debt is low and forecast to remain stable at around 2 percent of GDP. Data on the international investment position are not available reflecting shortcomings in compilation of private sector external assets (see Statistical Annex).

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

(In percent of GDP, unless otherwise indicated)

	Actual							Projections						
	2011	2012	2013	2014	2015	10-Year Historical Average	10-Year Standard Deviation	2016	2017	2018	2019	2020	2021	Debt-stabilizing non-interest current account 6/
Baseline: External debt	3.4	2.0	1.8	1.2	2.7			**2.2**	**2.0**	**2.1**	**2.1**	**2.1**	**2.1**	**-1.1**
Change in external debt	-1.5	-1.4	-0.3	-0.5	1.4			-0.5	-0.1	0.0	0.0	0.0	0.0	
Identified external debt-creating flows (4+8+9)	-11.0	-4.3	-7.7	-4.2	-2.7			-6.7	-6.7	-6.3	-5.2	-5.1	-4.1	
Current account deficit, excluding interest payments	-10.8	-6.4	-7.2	-4.0	-2.9			-6.6	-5.9	-5.2	-4.0	-4.0	-3.0	
Deficit in balance of goods and services	-10.4	-5.7	-6.6	-3.5	-2.1			-6.1	-5.0	-4.7	-3.6	-3.6	-2.7	
Exports	27.2	27.3	26.4	23.2	20.0			27.1	31.1	30.7	29.8	28.9	28.1	
Imports	16.7	21.6	19.8	19.8	18.0			21.1	26.1	26.1	26.1	25.3	25.4	
Net non-debt creating capital inflows (negative)	0.5	0.2	-0.7	-0.3	-0.4			-0.5	-1.4	-1.4	-1.4	-1.4	-1.3	
Automatic debt dynamics 1/	-0.7	1.9	0.3	0.0	0.6			0.5	0.6	0.3	0.2	0.2	0.2	
Contribution from nominal interest rate	0.2	0.3	0.2	0.2	0.5			0.6	0.7	0.3	0.3	0.3	0.3	
Contribution from real GDP growth	-0.1	0.3	0.0	-0.1	0.0			-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	
Contribution from price and exchange rate changes 2/	-0.8	1.3	0.0	-0.1	0.1			...	...	...	...	...	...	
Residual, incl. change in gross foreign assets (2-3) 3/	9.5	2.9	7.4	3.7	4.1			6.2	6.5	6.3	5.2	5.2	4.1	
External debt-to-exports ratio (in percent)	12.4	7.4	6.7	5.3	13.3			8.0	6.6	6.8	7.1	7.3	7.6	
Gross external financing need (in billions of US dollars) 4/	-47.0	-9.8	-23.3	-15.1	-8.1			-18.9	-15.7	-16.2	-12.6	-13.4	-9.7	
in percent of GDP	-8.3	-2.6	-6.1	-3.6	-2.2			-5.0	-4.3	-4.2	-3.1	-3.0	-2.0	
Scenario with key variables at their historical averages 5/								**2.2**	**1.9**	**1.4**	**0.0**	**-1.5**	**-4.0**	**-0.1**
Key Macroeconomic Assumptions Underlying Baseline														
Real GDP growth (in percent)	3.7	-6.6	-1.9	4.0	-1.6	2.2	4.7	6.5	3.3	4.3	4.5	4.5	4.4	
GDP deflator in US dollars (change in percent)	18.5	-28.2	1.3	5.1	-8.3	4.4	14.5	-5.5	-5.4	0.6	2.2	2.5	2.6	
Nominal external interest rate (in percent)	5.5	5.6	12.1	12.4	35.2	10.5	9.0	24.4	29.4	17.2	16.1	15.4	14.9	
Growth of exports (US dollar terms, in percent)	34.3	-32.6	-4.0	-3.6	-22.3	3.0	21.9	36.5	11.8	3.8	3.3	4.0	4.1	
Growth of imports (US dollar terms, in percent)	0.0	-13.6	-8.8	9.2	-18.1	2.9	13.4	18.0	21.0	4.8	6.9	3.7	7.7	
Current account balance, excluding interest payments	10.8	6.4	7.2	4.0	2.9	6.2	2.8	6.6	5.9	5.2	4.0	4.0	3.0	
Net non-debt creating capital inflows	-0.5	-0.2	0.7	0.3	0.4	0.0	0.4	0.5	1.4	1.4	1.4	1.4	1.3	

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

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

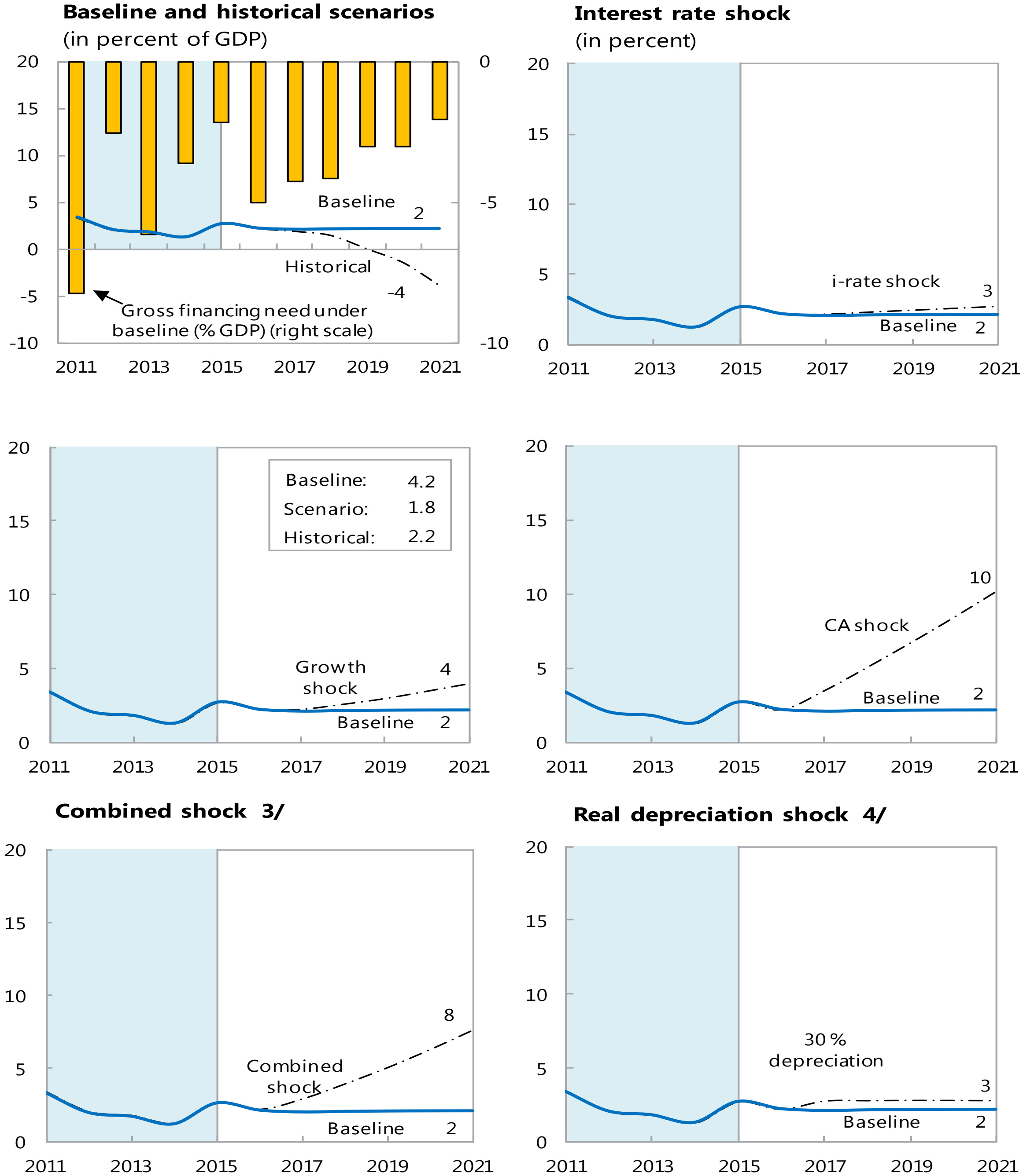
3/ For projection, line includes the impact of price and exchange rate changes.

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

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

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

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



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

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

Appendix II. Public DSA[1]

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

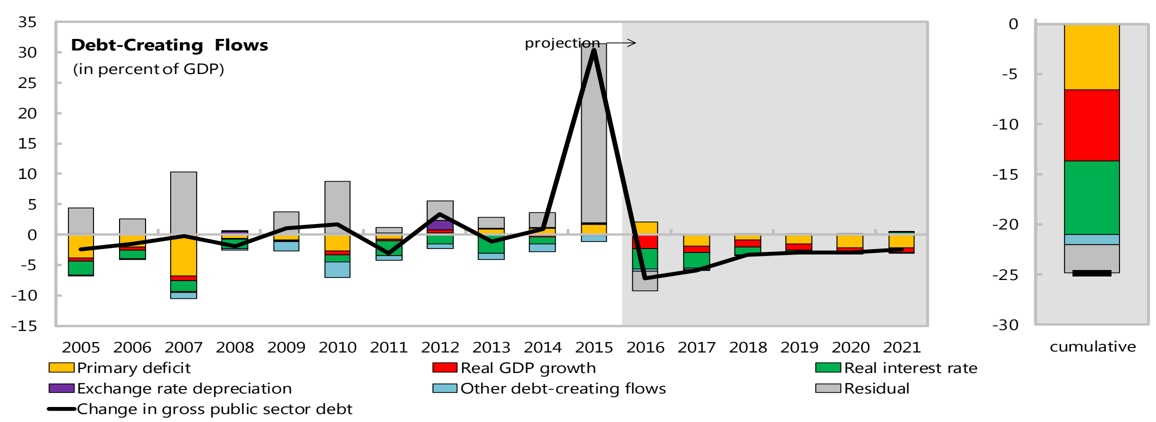
(In percent of GDP unless otherwise indicated)

Debt, Economic and Market Indicators [1/]

	Actual			Projections						As of March 21, 2016		
	2005-2013 [2/]	2014	2015	2016	2017	2018	2019	2020	2021	Sovereign Spreads		
Nominal gross public debt	11.2	12.1	42.5	35.2	29.3	26.0	23.0	20.0	17.6	EMBIG (bp) 3/		n.a.
Public gross financing needs	-1.8	1.2	1.8	7.7	4.6	4.5	3.8	3.4	2.3	5Y CDS (bp)		n.a.
Real GDP growth (in percent)	2.7	4.0	-1.6	6.5	3.3	4.3	4.5	4.5	4.4	Ratings	Foreign	Local
Inflation (GDP deflator, in percent)	19.2	12.6	2.2	10.3	12.4	10.1	9.5	8.9	8.5	Moody's	n.a.	n.a.
Nominal GDP growth (in percent)	22.2	17.1	0.6	17.6	16.1	14.7	14.4	13.8	13.3	S&Ps	n.a.	n.a.
Effective interest rate (in percent) [4/]	1.6	0.9	0.9	2.0	4.1	5.1	7.5	9.6	11.4	Fitch	n.a.	n.a.

Contribution to Changes in Public Debt

	Actual			Projections							
	2005-2013	2014	2015	2016	2017	2018	2019	2020	2021	cumulative	debt-stabilizing primary balance [9/]
Change in gross public sector debt	-0.5	0.9	30.4	-7.2	-5.9	-3.3	-3.0	-2.9	-2.4	-24.8	
Identified debt-creating flows	-4.4	-1.6	0.8	-4.0	-5.8	-3.5	-3.2	-3.0	-2.5	-22.0	
Primary deficit	-1.8	1.1	1.7	2.1	-1.9	-0.9	-1.5	-2.1	-2.1	-6.5	-0.4
Primary (noninterest) revenue and gra	21.2	14.6	16.2	15.1	18.5	17.5	17.8	18.1	18.1	105.2	
Primary (noninterest) expenditure	19.3	15.6	17.8	17.2	16.6	16.6	16.3	16.0	16.0	98.7	
Automatic debt dynamics [5/]	-1.7	-1.4	0.1	-5.6	-3.6	-2.5	-1.6	-0.9	-0.3	-14.5	
Interest rate/growth differential [6/]	-2.0	-1.5	0.0	-5.6	-3.6	-2.5	-1.6	-0.9	-0.3	-14.5	
Of which: real interest rate	-1.7	-1.2	-0.2	-3.3	-2.6	-1.4	-0.6	0.1	0.5	-7.3	
Of which: real GDP growth	-0.3	-0.4	0.2	-2.4	-1.0	-1.1	-1.0	-0.9	-0.8	-7.1	
Exchange rate depreciation [7/]	0.3	0.1	0.1	…	…	…	…	…	…	…	
Other identified debt-creating flows	-0.9	-1.2	-1.0	-0.5	-0.3	-0.1	-0.1	0.0	0.0	-1.0	
Privatization (negative)	-0.9	-1.2	-1.0	-0.5	-0.3	-0.1	-0.1	0.0	0.0	-1.0	
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 Euro	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/]	3.9	2.4	29.5	-3.2	-0.1	0.2	0.1	0.1	0.1	-2.8	



Source: IMF staff.

1/ Public sector is defined as general government.

2/ Based on available data.

3/ Long-term bond spread over German bonds.

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

5/ Derived as [(r - 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. The large residual in 2015 corresponds to the recognition of government arrears.

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.

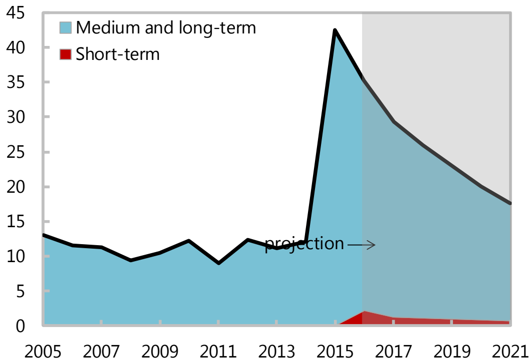
[1] The DSA excludes the cost of bank recapitalization because the AQR has not been completed to inform the restructuring and recapitalization strategy.

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

Composition of Public Debt

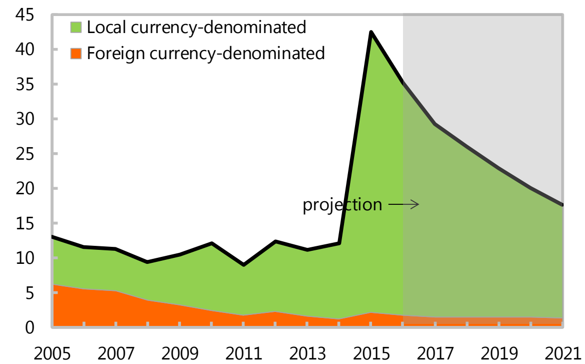
By Maturity

(in percent of GDP)



By Currency

(in percent of GDP)

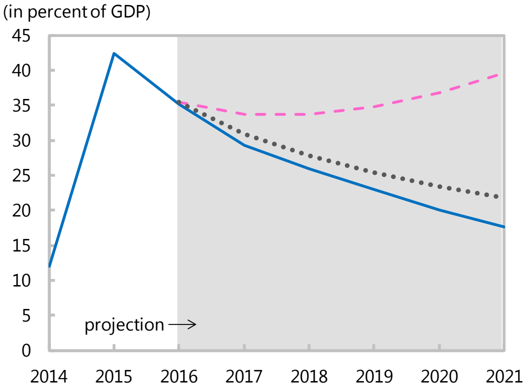


Alternative Scenarios

Baseline ······· Historical – – Constant Primary Balance

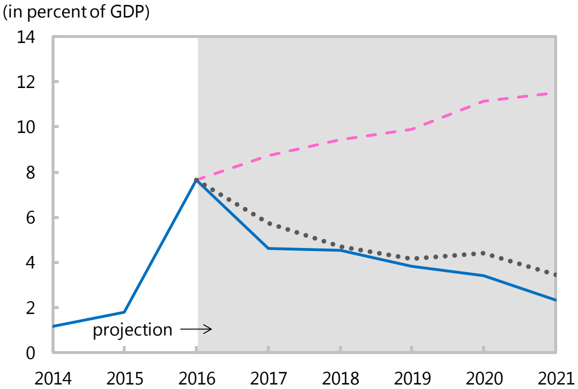
Gross Nominal Public Debt

(in percent of GDP)



Public Gross Financing Needs

(in percent of GDP)



Underlying Assumptions

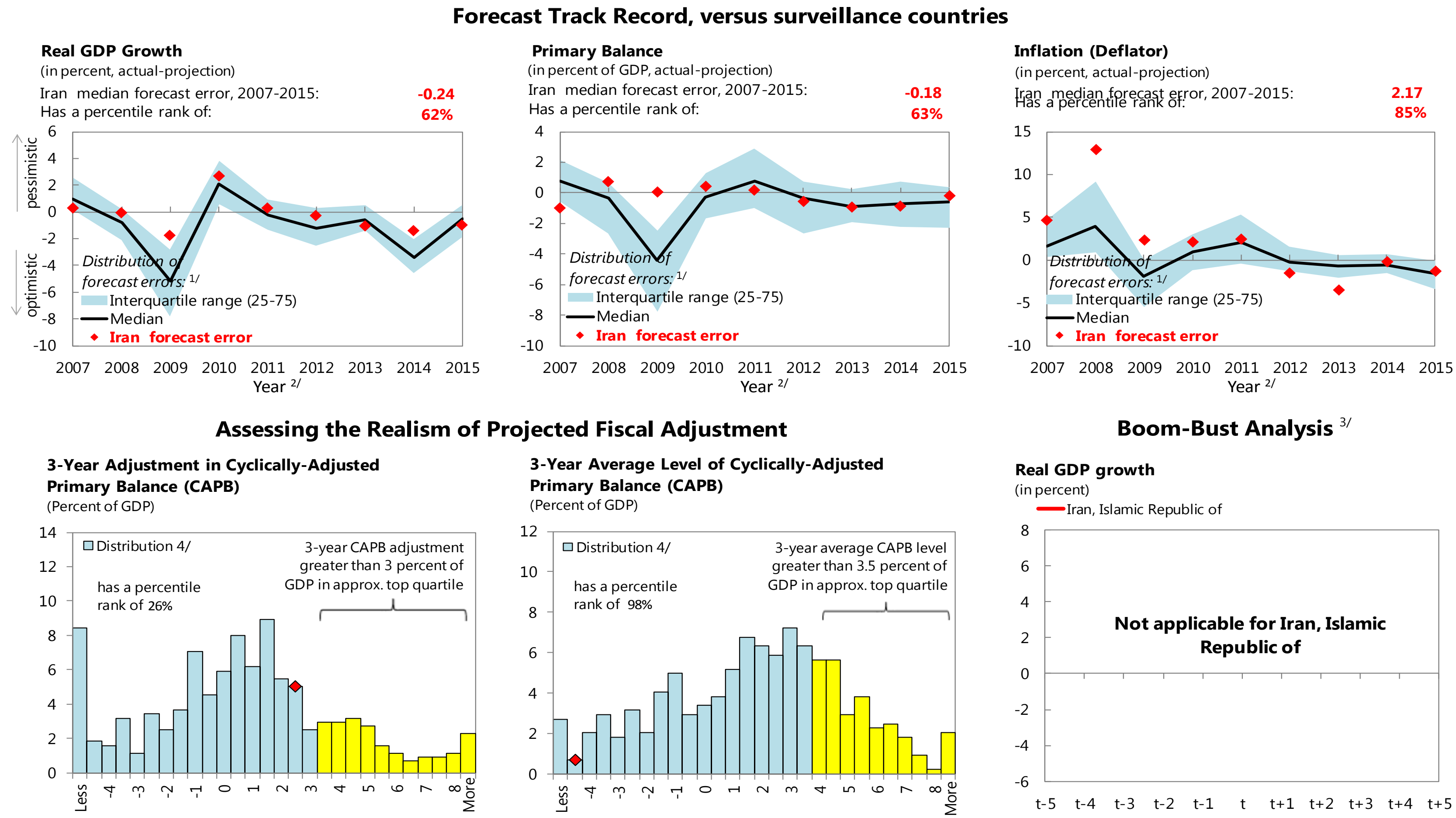
(in percent)

Baseline Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.5	3.3	4.3	4.5	4.5	4.4
Inflation	10.3	12.4	10.1	9.5	8.9	8.5
Primary Balance	-2.1	1.9	0.9	1.5	2.1	2.1
Effective interest rate	2.0	4.1	5.1	7.5	9.6	11.4
Constant Primary Balance Scenario						
Real GDP growth	6.5	3.3	4.3	4.5	4.5	4.4
Inflation	10.3	12.4	10.1	9.5	8.9	8.5
Primary Balance	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1
Effective interest rate	2.0	4.2	7.1	10.3	12.9	14.7

Historical Scenario	2016	2017	2018	2019	2020	2021
Real GDP growth	6.5	2.2	2.2	2.2	2.2	2.2
Inflation	10.3	12.4	10.1	9.5	8.9	8.5
Primary Balance	-2.1	1.0	1.0	1.0	1.0	1.0
Effective interest rate	2.0	4.2	4.0	5.1	6.1	6.8

Source: IMF staff.

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



Source : IMF Staff.

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

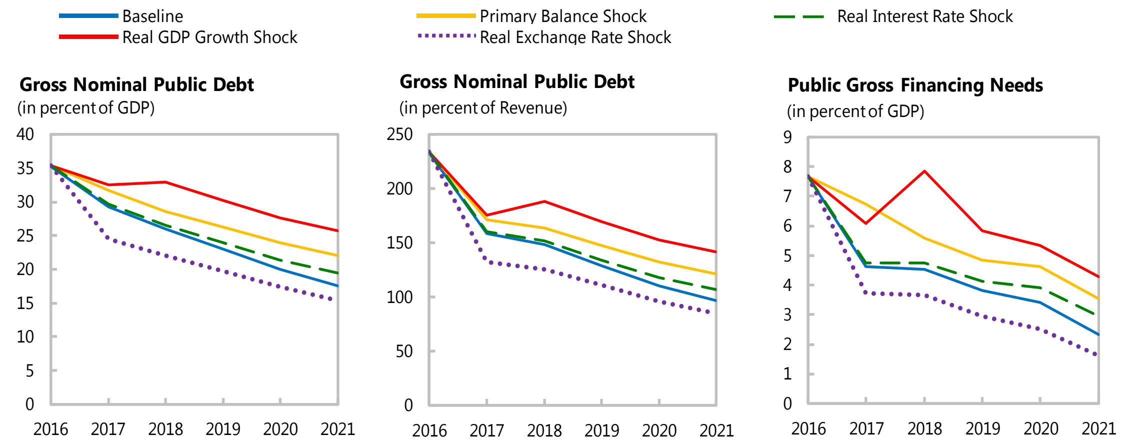
2/ Projections made in the spring WEO vintage of the preceding year.

3/ Not applicable for Iran, Islamic Republic of, as it meets neither the positive output gap criterion nor the private credit growth criterion.

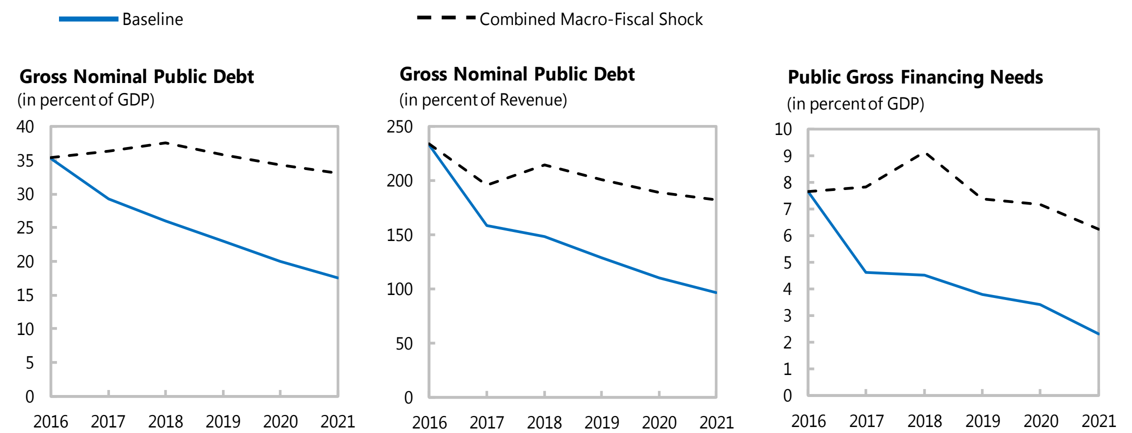
4/ Data cover annual obervations from 1990 to 2011 for advanced and emerging economies with debt greater than 60 percent of GDP. Percent of sample on vertical axis. Iran CAPB is structurally low as it includes its substantial oil revenue.

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

Macro-Fiscal Stress Tests



Additional Stress Tests



Underlying Assumptions

(in percent)

Primary Balance Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	6.5	3.3	4.3	4.5	4.5	4.4
Inflation	10.3	12.4	10.1	9.5	8.9	8.5
Primary balance	-2.1	-0.1	0.9	1.2	1.8	2.1
Effective interest rate	2.0	4.2	6.3	8.7	10.9	12.8
Real Interest Rate Shock						
Real GDP growth	6.5	3.3	4.3	4.5	4.5	4.4
Inflation	10.3	12.4	10.1	9.5	8.9	8.5
Primary balance	-2.1	1.9	0.9	1.5	2.1	2.1
Effective interest rate	2.0	4.2	5.6	8.3	10.8	13.0
Combined Shock						
Real GDP growth	6.5	-1.4	-0.4	4.5	4.5	4.4
Inflation	10.3	11.3	8.9	9.5	8.9	8.5
Primary balance	-2.1	-0.1	-1.1	1.2	1.8	2.1
Effective interest rate	2.0	6.4	7.6	10.9	13.1	15.0

Real GDP Growth Shock	2016	2017	2018	2019	2020	2021
Real GDP growth	6.5	-1.4	-0.4	4.5	4.5	4.4
Inflation	10.3	11.3	8.9	9.5	8.9	8.5
Primary balance	-2.1	0.9	-1.1	1.5	2.1	2.1
Effective interest rate	2.0	4.2	5.8	9.1	11.1	13.0
Real Exchange Rate Shock						
Real GDP growth	6.5	3.3	4.3	4.5	4.5	4.4
Inflation	10.3	45.9	10.1	9.5	8.9	8.5
Primary balance	-2.1	1.9	0.9	1.5	2.1	2.1
Effective interest rate	2.0	6.4	6.1	8.4	10.3	12.0

Source: IMF staff.

The primary balance shock assumes a total primary balance lowered by 2.5 percent over the projection period, with interest rate increased by 0.25 percent. The real GDP growth shock assumes growth lower by 1 percentage point in 2017 and 2018, while inflation and interest rates increase by 0.25 percent. The real effective exchange rate assumes a real depreciation of 100 percent, with a passthrough of 25 percent. The interest rate shock assumes a real interest higher by 2 percent. The combined shock takes the worse impact on each variables of the shocks mentioned above.

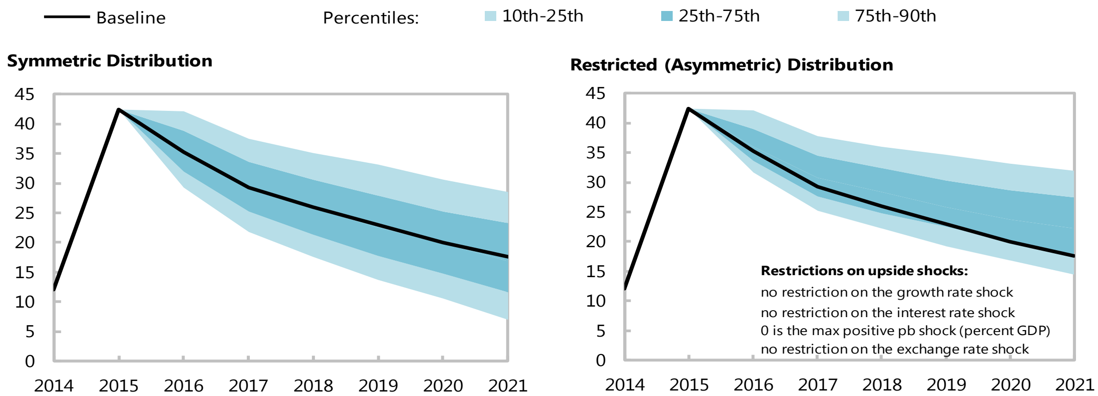
Figure 4. Islamic Republic of Iran: Public DSA—Risk Assessment

Heat Map

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

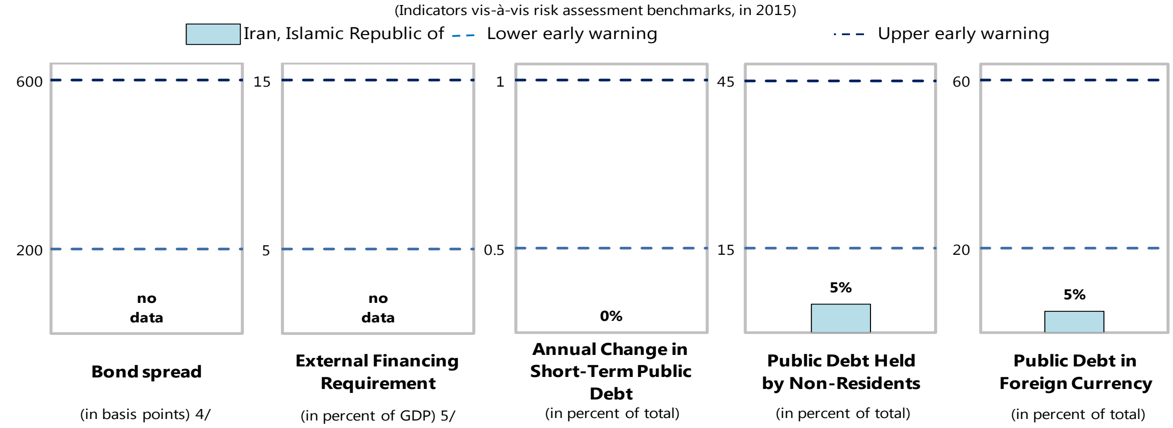
Evolution of Predictive Densities of Gross Nominal Public Debt

(in percent of GDP)



Debt Profile Vulnerabilities

(Indicators vis-à-vis risk assessment benchmarks, in 2015)



Source: IMF staff.

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

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

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

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

4/ Long-term bond spread over German bonds, an average over the last 3 months, 22-Dec-15 through 21-Mar-16.

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

INTERNATIONAL MONETARY FUND

ISLAMIC REPUBLIC OF IRAN

STAFF REPORT FOR THE 2016 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 9, 2017

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

CONTENTS

FUND RELATIONS

A. Financial Position in the Fund as of December 31, 2016

Membership Status:

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

General Resources Account

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

SDR Department

	SDR Million	Percent Allocation
Net cumulative allocation	1,426.06	100.00
Holdings	1,536.82	107.77

Outstanding Purchases and Loans: None

Latest Financial Arrangements

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

Projected Payments to the Fund[1]

(SDR million; based on existing use of resources and present holdings of SDRs)

	Forthcoming				
	2017	2018	2019	2020	2021
Principal					
Charges/Interest	0.05	0.05	0.05	0.05	0.05
Total	**0.05**	**0.05**	**0.05**	**0.05**	**0.05**

[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.

B. Exchange System

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

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

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

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

C. Last Article IV Consultation

Iran is on the standard 12-month consultation cycle. The last Article IV consultation was concluded by the Executive Board on December 7, 2015, and was published on December 21, 2015: (http://www.imf.org/external/pubs/ft/scr/2015/cr15349.pdf).

D. Technical Assistance

Since FY 2009, Iran received the following technical assistance:

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

RELATIONS WITH THE WORLD BANK GROUP

The World Bank Group does not have a country program strategy in the Islamic Republic of Iran. The last Interim Assistance Strategy covered FY2002-2005, and the last IBRD project closed in 2012. The IFC has no exposure to the Islamic Republic of Iran. MIGA issued two guarantees in 2005, and no guarantees have been provided since then. Iran is currently a member of the Bank in good standing and is a donor to IDA16.

The Bank prepares a bi-annual economic monitoring note (Iran Economic Review) that analyzes recent economic developments in Iran and provides a medium-term economic outlook as well as special focus sections on two selected issues. The Bank has also recently initiated an analytical work program on Iran that comprises several topics ranging from productivity to air pollution.

STATISTICAL ISSUES

Assessment of Data Adequacy for Surveillance
General Data provision is broadly adequate for surveillance with some data shortcomings noted below. Data are reported with delays and also provided infrequently. 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 GDP data are broadly sound. Accessibility of the quarterly estimates could be improved and made available with a consistent time lag. There is also scope for the Central Bank of Iran (CBI) and the Statistical Center of Iran (SCI) to advance their cooperation with a view to harmonizing their respective national accounts compilation programs. The CBI's GDP rebasing exercise is on track, with the results expected to be available by the end of 2016/17 Iranian year. Communicating the rebasing plans ahead to users is international best practice and would enhance the credibility of the exercise. Data on labor force and unemployment are published on the SCI website.
Price Statistics A monthly consumer price index (CPI) and producer price index (PTI) are produced and disseminated by the CBI. The indices used 2011 as the base year, are of good quality, and are released in a timely manner.
Government Finance Statistics (GFS) GFS cover only the central government; and are released without details on all the components of expenditure, and on an irregular basis. The authorities do not have the capacity to compile general government fiscal data due to shortcomings in the chart of accounts, inability to track and record general government transactions. Efforts are being made to strengthen the Treasury functions—a new debt management office was created and the authorities are transitioning over the coming years to a treasury single account and planning a gradual move to accrual based accounting—are ongoing, and are expected to enhance data quality and availability. The reporting of GFS data for publication in the Fund's *International Financial Statistics (IFS)* was discontinued in 2010. The resumption of GFS data reporting for *IFS* publication is encouraged. While central government data are compiled in accordance with the *Government Finance Statistics Manual 2001 (GFSM),* there is scope for improving the coverage of fiscal reporting on general government by including the nonfinancial public corporations sector, as well as other public agencies such as the National Development Fund of Iran, the Oil Stabilization Fund, and Targeted

Subsidy Organization. Improving the scope and coverage of GFS would safeguard against arrears and allow better monitoring of liabilities, guarantees and fiscal risks.

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

Monetary and Financial Statistics

Monthly monetary data on central bank and deposit money banks are reported to STA for publication in the *IFS*, but not using the standardized report forms (SRFs). Reporting timeliness needs to be improved. Compilation of monetary statistics for central bank and deposit money banks 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 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. The authorities do not compile and report monetary data for other financial corporations.

Financial Sector

The CBI publishes quarterly information on the ratio of nonperforming loans (NPL) to total loans in domestic and foreign currency in its *Economic Trends*. The NPL data are sourced from banks' data reported to the CBI. The authorities also share with Fund Staff several other financial soundness indicators (FSIs). Iran does not participate in the IMF's Coordinated Portfolio Investment Survey (CPIS) which collects data on cross border exposures. The availability of SRF-based MFS would also support more robust financial sector analysis using the balance sheet approach.

External Sector Statistics

The CBI has advanced work in adapting its external sector statistics compilation program in the line with the Fund's *Balance of Payments Manual*, fifth edition (*BPM5),* but has no short-term plans for moving to the most recent methodological standard (*BPM6*) issued on 2009.

The CBI does not submit balance of payments data to the Fund for re-dissemination in the *IFS*. However, based on the data provided to Fund staff for surveillance, the large size of the errors and omissions in recent periods is an area of concern, and likely reflect gaps in the recording of financial account entries. A key issue is the coverage of financial flows associated with export proceeds of the petrochemical sector. These proceeds are likely held in deposits abroad for which no information is available; and this results in unrecorded counter entries to the exports recorded in the current account (goods). Steps should be taken to collect this information directly from the companies. Inward direct investment (DI) statistics are compiled by the Organization for Investment, Economic and Technical Assistance of Iran (OIETAI) whose work is focused on investment approvals for the nonoil sector. The recording of actual investment inflows could be improved; and the use of DI surveys should be explored to address possible gaps, including reinvested earnings.

Data on the international investment position (IIP) are compiled, but not disseminated. The authorities lack of capacity to compile complete and accurate IIP data owing to difficulties in tracking foreign assets under sanctions and the lack of information on corporate net foreign asset holdings. In recent years, the compilation of data has been very difficult under sanctions owing to difficulties in tracking foreign assets. Only data on public and publicly-guaranteed external debt are disseminated, but classifications do not fully accord with the guidelines of the *External Debt Guide*. Iran does not participate in the World Bank's Quarterly External Debt Statistics (QEDS) database. Reserve asset positions are available to Fund staff but are not publicly disseminated. 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 scope and timeliness of data dissemination to meet the Enhanced-GDDS, and is encouraged to develop and maintain a national summary data page.	No data ROSC is available.

Islamic Republic of Iran: Common Indicator Required for Surveillance

(January 2016)

	Date of latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	January, 2017	January, 2017	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	March 2016	December 2016	M	I	I
Reserve/Base Money	March 2016	December 2016	M	I	I
Broad Money	October 2016	December 2016	M	M	M
Central Bank Balance Sheet	October 2016	December 2016	M	M	M
Consolidated Balance Sheet of the Banking System	October 2016	December 2016	M	M	M
Interest Rates[2]	September 2016	September 2016	M	Q	Q
Consumer Price Index	December 2016	January 2017	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	N/A	N/A	N/A	N/A	N/A
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	November 2016	January 2016	M	I	I
Stocks of Central Government and Central Government-Guaranteed Debt[5]	June 2016	January 2017	Q	I	I
External Current Account Balance	June 2016	January 2017	Q	Q	Q
Exports and Imports of Goods and Services	October 2016	December 2016	M	M	M
GDP/GNP	September 2016	December 2016	Q	Q	Q
Gross External Debt	October 2016	December 2016	M	Q	Q
International Investment Position[7]	N/A	N/A	N/A	N/A	N/A

[1]Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[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
February 24, 2017

My Iranian authorities thank staff for the high-quality engagement and policy advice under the 2016 Article IV consultation. They are also grateful for the Fund's technical assistance that has complemented their own efforts at economic reforms. They broadly concur with staff analysis and policy recommendations, and look forward to continued close dialogue and collaboration with the Fund in the period ahead.

Overview

Building on its hallmark achievement of signing and implementing the Joint Comprehensive Plan of Action (JCPOA), which paved the way for the lifting of international nuclear sanctions on January 16, 2016, President Rouhani's administration has made significant progress in restoring macroeconomic stability, improving fiscal management, advancing growth-enhancing structural reforms, and promoting Iran's reintegration into the global economic and financial system. This has enhanced confidence, as evidenced by increased private sector activity and the re-engagement of foreign investors with their Iranian counterparts, which together with increased oil production, has helped boost growth, strengthen the external and fiscal positions, and lower inflation. Iran's return to the oil market and its participation in the recent OPEC agreement have had a stabilizing impact on the oil market.

My authorities believe that the lifting of sanctions and their ambitious reform agenda are yet to produce their full beneficial impact on the Iranian economy and positive regional and global spillover effects. Indeed, the economy is still some distance away from fully tapping its huge investment and trade potential, given its vast hydrocarbon reserves, relatively diversified non-oil sector, large domestic market, and young and well-educated labor force. Regrettably, remaining US sanctions and related uncertainty have hindered the return of global banks to the Iranian market and continue to hamper large-scale investment and trade. My authorities remain fully committed to their international obligations, including under the JCPOA and to FATF. They will persevere with their reform agenda to make the economy more resilient to external shocks, while expecting that the remaining constraints to Iran's reintegration into the global economic and financial system will be eliminated soon.

Recent Economic Developments and Outlook

The economy has staged a remarkable turnaround from last year's recession, aided by a swift recovery in oil production and exports to pre-sanctions levels, and facilitated by Iranian banks' partial reintegration into the global financial system. Growth is estimated to have rebounded to about 7 percent for the current Iranian year 2016/17 with oil production back to close to full potential and recovery in non-oil activity. Average CPI inflation dropped to single digit—the first such achievement in the past 25 years—reflecting the authorities' prudent monetary and fiscal policies. However, although 667,000 new jobs were created in 2015/16, the unemployment rate has continued to hover around 11 percent and may have inched upwards in the current fiscal year, given the large number of new entrants into the labor market due to demographic factors and increased labor force participation.

Prudent fiscal policy over the past 5 years has kept the budget deficit low in spite of challenging circumstances marked by the oil embargo and price decline. Non-oil deficit of the central government to non-oil GDP in 2016/17 is estimated to widen from 9.0 percent of GDP to 10.6 percent, as improved tax and other non-oil revenue may not fully offset higher interest payments and transfers to the Targeted Subsidy Organization (TSO), which administers revenues from domestic fuel sales to finance cash transfers. Public debt-to-GDP ratio, which increased sharply from 12 percent to 42 percent in 2015/16, mainly as a result of recognition of government arrears and their securitization, is estimated to decline to 35 percent in 2016/17 and to 29 percent next year. However, it could rise again above 40 percent of GDP after full recognition of remaining government arrears and their securitization and issuance of securities for bank capitalization, but would nonetheless remain moderate, sustainable, and robust to shocks, as indicated by staff. The current account surplus is projected to increase to over 6 percent of GDP owing to higher oil export volumes, more favorable oil prices, and continued strong growth in non-oil exports. International reserves are comfortable at the equivalent of 20 months of imports, 40 percent of broad money, and 15 times the total external debt, even though access to reserves, while improving, remains somewhat constrained. The foreign exchange market has been broadly stable and the spread between the official and the market rates stands at about 15 percent.

My authorities are cognizant of the downside risks to the near- and medium-term outlook and are determined to steadfastly pursue sound policies to preserve macroeconomic and financial stability and promote inclusive growth. They will do the utmost to garner broad public and political support for their ambitious reform agenda, which is outlined in the draft Sixth Five Year Development Plan (6FYDP: 2017/18 – 2021/22) bill currently under discussion in the parliament.

Against this background, my authorities remain committed to strengthening the underlying fiscal position by reducing the non-oil fiscal deficit, anchoring low and stable inflation, unifying the exchange rate, ensuring a solid banking sector, and advancing structural reforms to foster private sector development, job creation, and high and sustainable growth. Critical reforms in these areas will allow Iran to tap its huge potential in proven oil and gas reserves (4th and 2nd largest in the world, respectively), further develop its well-diversified manufacturing and services sectors, and attract private capital inflows in the hydrocarbon, automobile, aviation, telecom, and tourism industries, among others.

My authorities have cleared virtually all unintended arrears to export credit agencies, and are diligently working on strengthening the AML/CFT framework. However, they remain concerned that renewed uncertainty regarding US sanctions, lingering memories of large fines imposed by the US on international banks that conduct business with Iran, and continued US dollar clearing restrictions, could continue to hamper the re-establishment of corresponding banking relations (CBRs) with large global banks, and potentially deter investment and trade with Iran. Should CBRs be fully re-established, and U-Turn mechanism for US dollar clearing reinstated, the envisaged reforms foreseen in the 6FYDP could help deliver significantly higher rates of growth over the medium term than those projected by staff.

Fiscal Policy

Higher oil revenue will facilitate gradual fiscal consolidation and create space for spending pressures associated with arrears securitization, bank restructuring and recapitalization, and key infrastructure and social outlays. The 2017/18 budget submitted to the parliament targets a zero balance for both the central government and the TSO. The authorities remain focused on lowering the non-oil deficit, consistent with their ultimate goal to fully fund current spending from non-oil revenue and use the oil resources for investment or building fiscal buffers. The planned fiscal adjustment seeks to increase non-oil tax collection to 10 percent of GDP and improve the composition and efficiency of spending. On the revenue side, efforts will be directed at broadening the tax base, gradually raising VAT rates, rationalizing personal and corporate income tax rates, and strengthening tax and customs administration to bolster compliance. On the expenditure side, the authorities will continue to lower the budgetary cost of fuel subsidies by adjusting domestic fuel prices, in line with international price movements, and removing high-income households from the cash transfer beneficiary list, which would make room for raising the allocation to the poorest segments of the population and improving equity. However, progress in this area will be faster once ongoing efforts at removing administrative difficulties in identifying and means-testing these households are completed.

My authorities agree on the need to cast the government's budget in a medium-term fiscal framework, better articulate fiscal objectives in the FYDPs, make the non-oil primary balance the main fiscal anchor, strengthen the link between the FYDPs and the annual budgets, and enhance coordination between key government entities in charge of budget preparation and implementation. They are benefiting from the newly-established treasury single account and phased introduction of accrual accounting. They are aware of the potential financial sector contingencies, as highlighted in the report, and are working toward allocating more resources for the prospective restructuring and recapitalization of the banking sector. Moreover, the National Development Fund of Iran (NDFI) could be used to finance priority projects in deprived areas, for which private sector funding is usually unavailable, thereby alleviating investment spending pressures on the budget. The share of oil revenue going to the NDFI could also be revisited in case budgetary oil receipts fall short of expectations.

Monetary and Exchange Rate Policies

Monetary policy is guided by the disinflation strategy aimed at maintaining inflation at single digit levels. Inflation has been gradually reduced over the past three years as a result of sound macroeconomic policies. However, a combination of factors may work in the opposite direction, including in particular the recent pickup in monetary expansion stemming from banks' increased reliance on central bank (CBI) overdraft facility, the government drawing on its revolving facility, selective reduction in statutory reserve requirements from 13 to 10 percent, based on banks' asset quality and risk management, CBI's injection of liquidity through the interbank market to reduce high interbank rates, and the high pass-through from exchange rate depreciation to CPI inflation. While inflation might temporarily rise above 10 percent by end 2017/18, the authorities are confident that prudent policies will help contain overall liquidity growth and bring inflation back to single digits.

The overhaul of the monetary policy framework, as envisaged under the draft CBI bill, would help refocus CBI's legal mandate on low and stable inflation and entrench macroeconomic stability. The bill also strengthens governance of the CBI, and mandates full repayment of all the funds the government receives from CBI by the end of the same fiscal year. My authorities agree on the need to enhance CBI's operational autonomy, collateralize liquidity facilities, define a target inflation range, broaden market-based liquidity management tools, and develop a clear communication policy. They appreciate staff work on the reform of the monetary policy framework, and welcome their reflection on the draft CBI and banking bills to ensure compliance with international best practices.

My authorities remain committed to unifying the exchange rate and returning to a managed float regime, expected to take place by end February 2018, once relations with foreign correspondent banks are normalized and full access to reserves restored. They continue to shift priority goods imports to the bureau market rate, and to encourage foreign exchange transactions to move to banks. These efforts, however, have not been facilitated by the limited access to international reserves, which has curtailed CBI's ability to intervene in the foreign exchange market, as needed, to reduce the bureau market rate premium over the official exchange rate. Exchange rate unification, would help address the moderate overvaluation in the official exchange rate and make the unified rate broadly in line with fundamentals.

Financial Sector

The banking system continues to grapple with a legacy of government payment arrears, distortive credit policies, weak risk management, and inadequate supervision. Compounded by external shocks, reflected in reduced CBRs and less efficient financial services delivery, this has resulted in capital shortages, compressed liquidity, low profitability, and deteriorated asset quality. Realizing the important challenges ahead, the authorities are determined to safeguard financial stability by resolving NPLs, bolstering capital and provisions, enhancing supervision, and strengthening the AML/CFT framework. The audit of government arrears is underway and marketable government securities are being issued to settle payment arrears; dividend payments have been restricted to protect bank capital, and higher provisions have been mandated; unlicensed financial institutions (UFIs) are brought under CBI supervision and problem UFIs have been closed or merged with banks, and IFRS reporting standards have been implemented. Moreover, the CFT law has been adopted, dedicated AML/CFT units have been created in all banks, and the ongoing implementation of an action plan agreed with FATF has led to the suspension of countermeasures for a period of twelve months.

The draft banking and resolution bills, which are being merged, aim at restructuring and recapitalizing banks, enhancing the CBI's supervisory powers, and enabling the resolution of nonviable banks. While the bills to overhaul the banking system are being finalized, the ongoing aggressive competition among banks for deposits has resulted in sustained elevated real interest rates and has prompted CBI to formulate and announce, under its existing legal mandate, a 10-point action plan to address the issue. The plan includes active management of the interbank market, increased use of open market operations for liquidity provision, classifying banks based on their supervisory data, adjusting the statutory reserve requirements, improving risk management practices in banks, regulating the UFIs, increasing banks' capital, reducing NPLs, merging or resolving insolvent banks and credit institutions, and improving bank oversight.

My authorities agree on the need to act decisively and expeditiously to strengthen regulation and supervision within the existing powers. Accordingly, and in line with staff recommendation, they intend to launch an asset quality review; revise regulations on asset classification and provisioning, liquidity provision, reporting, and monitoring; and enforce compliance with prudential regulations, while ensuring that CBI's overdraft facility is only used to build up banks' liquidity buffers. In the same vein, the authorities would initiate implementation of the roadmap to Basel II/III.

Structural Reforms

The structural reforms agenda—envisioned under the 6FYDP—targets higher sustainable growth and stronger pace of job creation. This hinges upon greater economic diversification and private sector development by boosting infrastructure investment, increasing commercial orientation of state-owned firms, streamlining regulations to improve the business climate, and enhancing the functioning of the labor market. The 6FYDP, consistent with the 20-year Vision Document, also highlights the need to address challenges ahead in water resource management, environment protection, and pension reform. Gradual reconnection to the global economic and financial system should facilitate FDI inflows to high-productivity sectors and companies and ease domestic financing constraints. The authorities attach high priority to creating employment opportunities for a growing number of university graduates who enter the job market over the next five years, and have taken steps to better align the education and training system with skill needs of employers, including introduction of entrepreneurship courses in the education curriculum. They have also taken note of staff estimation of much higher growth dividend of greater female labor force participation in Iran, which could be facilitated by targeted active labor market policies and expanded affordable in-work childcare.

Conclusion

The performance of the Iranian economy has strengthened, underpinned by sound economic policies and reforms, and supported by successful implementation of the JCPOA and improved terms of trade. My Iranian authorities are determined to pursue their reform strategy under the 6FYDP and create a more resilient economy in a more open environment of increased trade and investment relationship with their partners, which will be beneficial for all. They highly value the Fund’s contribution to their efforts through policy advice and technical assistance and are grateful to management and the Executive Directors for their support.