CHAPTER ONE

OVERVIEW

Favorable developments in oil market in 1379 created a positive and a relatively balanced condition for Iranian economy in 1380. Considerable surplus of the OSF account despite fluctuations of crude oil prices in international markets, especially in the aftermath of September 11 events, and adoption of non-expansionary fiscal policy by the government strengthened public confidence in economic policies.

GDP growth was reduced to 4.7 percent, mostly affected by crude oil production cut, which in turn was due to reduction in Iran's quota according to OPEC approvals. However, increase in domestic demand resulting from public confidence led the non-oil GDP growth to rise by one percentage point as compared with 1379 to 5.8 percent in 1380.

Gross fixed capital formation kept its increasing trend as the previous year to reach 9.9 percent. This was mostly due to the remarkable growth of 20.8 percent in private sector gross fixed capital formation in construction.

The per capita income reached Rls. 8,526.4 thousand in 1380, up by 26.8 percent, as compared with the previous year. Moreover, the per capita income at constant 1369 prices enjoyed a rise of 2.7 percent, when compared with 1379.

In the review year, government support policies in agriculture sector were still adopted. With increase in rainfall, the area under cultivation of agricultural crops grew markedly. Production of cereals rose by 18.1 percent as compared with the previous year to reach 13,872 thousand tons, 29.1 percent less than the amount projected in the 3rd Plan. Therefore, government imported foodstuffs, which was reflected in increase in the weight of imported wheat by 22.6 percent. This was due to measures taken in the wake of September 11 events and its ensuing effects in the region. In 1380, the agriculture sector still was paid the highest amount of subsidy. This amount, with 22.5 percent rise compared with the previous year, reached Rls. 9,328.8 billion.

The average crude oil production, in the framework of Iran's production quota determined by OPEC, reached 3.6 mb/d, showing 2.4 percent fall compared with the previous year. Crude oil exports fell by 4.0 percent to reach 2.4 mb/d. Of this amount, 91 percent was related to crude oil export and 9.0 percent to oil products export. The average annual consumption of oil products reached 1,330 thousand b/d, showing 3.1 percent rise compared with the previous year. Moreover, according to the Budget Law for 1380, the average price of oil products went up by 10 percent.

Manufacturing and mining activities enjoyed an upturn in 1380. The value-added of manufacturing and mining sectors at constant 1369 prices grew by 10 and 9.6 percent, respectively. The performance figures of these sectors in comparison with the projected target figures for manufacturing (7.7 percent) and mining (5.1 percent) in the 3rd FYDP indicate the growing trend of production and private sector investment. In 1380, banks played an active role in financing manufacturing and mining sectors. Thus, the outstanding facilities extended by banks and credit institutions to non-public manufacturing and mining sectors, with 45.8 percent rise compared with the previous year, amounted to Rls. 58.2 trillion. Production growth and investment resulted in a remarkable growth (11 million tons) in export of industrial products at $ 2,282.6 million, showing 17.3 and 22.9 percent rise in terms of amount and value of export, respectively.

The trend of economic indicators in construction and housing sector indicates a boom in this market and a relative success in achieving the targets set in the 3rd Plan. The value-added of construction sector at constant 1369 prices grew markedly by 12.3 percent in 1380, as compared with 9.2 percent target set in the Plan. Due to the pivotal role of the private sector in construction and housing sector, the share of government activity declined in this year. The performance figures for government national development expenditures in construction, housing and urban development chapters fell by 7.6 percent compared with the previous year.

In order to assist low-income groups and government employees, back loaded repayment plan was approved by the Cabinet. According to the mentioned plan, the amount of installment is proportionate to the level of applicants' income and increases gradually during the period of repayment. Moreover, Rls. 228.3 billion was paid in the framework of "creditory and technical aid" to support mass construction. In the review year, the number and total floor space projected for constructions according to permits issued in Tehran grew by 22.8 and 27.6 percent respectively, as compared with the previous year.

Employment and job creation remained one of the most important priorities for economic policy makers in 1380. The total number of the employed increased from 15,581 thousand in 1379 to 15,957 thousand in 1380. This indicates creation of 376 thousand new job opportunities in this year, indicating 308 thousand job opportunities less than the target set in the Plan. Among the measures taken in the area of creating employment were extending directed facilities, allocating administered funds and extending facilities according to Article 56 of the 3rd Plan Law.

The General Budget for 1380 was designed without benefiting from banking system facilities. This was due to oil price rise in international markets and the recovery of economic indicators in 1379. Moreover, the rise in the OSF account, as before, offset the expansionary effects of oil revenues on the budget. However, despite the continued improvement in oil market in 1380, the budget law was designed conservatively. Thus, government general approved revenues and expenditures (excluding special revenues and expenditures) amounted to Rls. 134,768.9 and 141,154.9 billion, respectively. Government expenditures exceeded its revenues by Rls. 6,386 billion, and budget deficit was financed from other sources. However, Budget Law for 1380, owing to the underrealization of certain revenue items was revised in this year.

Government general revenues (excluding special revenues) amounted to Rls. 125,479.5 billion, showing 19.9 percent rise compared with the previous year, and 93.1 percent realization when compared with the approved figure. About 59.7 percent of government revenues was derived from crude oil export revenues, 30.9 percent from taxes and 9.4 percent from other revenues. In government general expenditures, 81.3 and 18.7 percent were respectively out of current and development expenditures. In 1380, government budget ran a deficit of Rls. 3,380.1 billion, which was mainly financed through the sale of participation papers. Moreover, the government repaid Rls. 1,000 billion of its indebtedness to the banking system. The government also repaid a portion of its indebtedness resulting from foreign exchange losses to the Central Bank. Thus, the outstanding balance of the OSF fell by $ 2,347.6 billion.

Reform of tax system became the main concern of policy markers in 1380. On this basis, Direct Tax Law (dated end of 1369 and its revision in Ordibehesht, 1371) was revised in Bahman, 1380 and was approved by the Parliament. "Tax Affairs Organization" as a governmental institution and under the auspices of the Ministry of Economic Affairs and Finance was established. Moreover, "Large Tax-payers Organization", with the aim of optimal allocation of resources, was established.

In the external sector, new foreign exchange and trade policies were pursued to meet the targets set in the 3rd Plan. In this year, facilitation in the repayment of external debts and improvement in the foreign reserves were the positive aspects of the balance of payments. Besides, deregulation policy was still implemented in the external sector. In this year, reduction in the price of crude oil led the export revenues to fall by 20.4 percent. However, non-oil exports, with 9.2 percent rise, reached $ 4,565 million. Thus, despite reduction in export revenues by $ 23,904 million, relaxation of trade regulation caused the imports to grow by 20.2 percent and trade surplus to reach a figure of $ 5,775 million. External debts fell by 9.3 percent to reach $ 7,215 million in 1380, against $7,953 million in 1379. The change in the composition of obligations, with the predominant share of contingent obligations, increased the flexibility in foreign debts.

In 1380, liquidity faced a less growth as compared with the previous year. Thus, at the end of 1380, liquidity with a 28.8 percent growth reached Rls. 320,957.3 billion. The major factor responsible for liquidity growth during the past two years was increase in the monetary base, resulting from rise in the other items (net) of the CBI. Monetary base grew by 15.2 percent and money multiplier, with 11.9 percent growth, reached 3.303. Quasi-money with 55.5 percent share in the composition of liquidity grew more as compared with the previous year.

In 1380, according to Article 93 of the 3rd Plan Law, the CBI issued Rls. 5,000 billion participation papers to strengthen banks' capital base and increase Iranian banks' capacity worldwide. The CBI's supervisory methods, along with the establishment of private banks, underwent drastic developments, such as preparation of contingent regulations to control foreign exchange risks in banks.

The Tehran Stock Exchange activities were limited, owing mostly to the issuance and sale of participation papers and investors' more familiarity with this new financial instrument. In 1380, the ratio of rial value of transactions to the average liquidity and GDP fell from 4.3 and 1.6 percent to 2.8 and 1.2 percent, respectively. These ratios were indicative of limited activities of TSE as compared with world capital markets.

Inflation rate was reduced to 11.4 percent in 1380. It was 20.1 and 12.6 percent in 1378 and 1379, respectively. Increase in government foreign exchange revenues, exchange rate stability, government observance of fiscal discipline, and rise in supply of consumer goods and services were among the major factors responsible for reduction of inflation rate during the past two years.