CHAPTER 13

# MONETARY AND BANKING POLICY AND PERFORMANCE

## Key Aspects of Monetary Policy in 1395

Inflation deceleration to 11.9 percent in 1394 and the continuation of this trend into 1395 required a revision in the monetary and credit policies, commensurate with the new macroeconomic priorities and fundamentals of the economy. Therefore, with a view to money market conditions and banks' credit and resource constraints, the CBI continued and expedited the non-administrative and gradual approach in revising banks' deposit rates in 1395, which had already been put in place in the years before. The CBI recommendation on lowering banks' deposit rates was submitted to the MCC in Tir 1395. The MCC, upon welcoming the CBI proposed policies on better management of money market and banks' deposit rates by using interbank money market as an indirect instrument as well as those by banks and credit institutions concerning the adjustment of deposit rates, approved the CBI recommended rates accordingly in its 1220th Meeting on Tir 8, 1395. On this basis, the ceiling on one-year deposit rates decreased from 18 percent in 1394 to 15 percent in 1395. Moreover, with the aim of reducing violation opportunities, the ceiling on bank' lending rates for both PLS and non-PLS contracts, while lowered from respectively 22 and 20 percent, on average, in 1394, was unified for the first time at a maximum rate of 18 percent in 1395.

Other CBI measures regarding the adjustment and harmonization of banks' deposit rates with the macroeconomic fundamentals and further deepening of the interbank money market through CBI active intervention merited special attention. This policy led to more intensive use of the interbank money market capacity for short-term funding of banks and better management of banks' liquidity position with the ultimate result of lowered average profit rate on interbank market transactions from about 29 percent in early-1394 to an average rate of 18.6 percent in 1395.

The CBI persistent measures aiming at terminating the activities of unlicensed financial institutions were among other initiatives by the CBI for 1395, that positively affected the organization process of the money market. This issue deserves special attention as the unregulated nature of unlicensed financial institutions and their clumsy expansion over the past decade had severely damaged the money market structure especially with regard to banks' deposit rate settings and arrangements as well as the economic sector stability. The expansion of unlicensed financial institutions in Iran over the past decades had immense negative impacts on the stability of banking and financial systems and had set the ground for banks' extensive risk-taking operations, negative competition, costly financial distress, and speculative activities in asset markets like gold and foreign exchange markets. Given the severity of this situation and the need for a stricter market regulation and supervision, the CBI adopted measures in line with the four-step initiative approved by the National Security High Council, starting with the liquidation of some troubled credit institutions and the merging of some unlicensed institutions in 1395. In this respect, the CBI was mainly aiming at protecting the rights and profits of retail depositors in these institutions. As a result of the adoption of these measures, the share of unlicensed institutions in money market experienced a sharp decline.

In addition, the CBI designed the banking system reform program and drafted 10 action plans, aimed at reducing banks' credit constraints. Some of those plans are as follows:

- Effective management of interbank money market;

- Mobilization of banking resources;

- Lowering of the reserve requirement ratio;

- Classification of banks based on their ratings;

- Rationalization of money market through resolution and liquidation of unlicensed non-bank credit institutions;

- Recapitalization of banks;

- Addressing banks' non-performing loans (NPLs);

- Enhancement of effective supervision on banks' activities.

In implementation of the mentioned action plans, the CBI was particularly aiming at a non-administrative approach to reducing banks' deposit rates using some indirect and market-based monetary instruments including the open market operations as against direct instruments.

## Banking System[1] Performance

Banking system assets and liabilities grew by 12.9 percent to Rls. 25,496.6 trillion in 1395. On the assets side, 24.7 percent growth (Rls. 1,815.0 trillion increase) in claims on non-public sector (including profit and revenue receivables) was the main contributing factor. Other factors affecting the increase in banking system assets included "other assets" and claims on public sector, which experienced respectively 8.2 and 26.4 percent growth (Rls. 630.5 trillion and Rls. 458.9 trillion increase). On the liabilities side, 23.2 percent rise (Rls. 2,361.1 trillion increase) in liquidity and 7.3 percent growth (Rls. 612.7 trillion increase) in other liabilities (including other liabilities, capital account of the banking system, advance payments on public sector's L/Cs, and order registration deposit of non-public sector) were the major factors contributing to the rise of banks' liabilities.

### *Banking System and External Sector*

In 1395, net foreign assets of the banking system increased by about 2.0 percent (Rls. 48.3 trillion) to Rls. 2,512.6 trillion. This was attributable to the increase in net foreign assets of the public and private banks as well as non-bank credit institutions by about Rls. 60.1 trillion, along with a fall in net foreign assets of the Central Bank by Rls. 11.8 trillion. Decrease in net foreign assets of the Central Bank was due to Rls. 123.4 trillion decline in CBI foreign assets as against Rls. 111.6 trillion fall in CBI foreign liabilities. Increase in net foreign assets of banks and non-bank credit institutions was

[1] Includes Central Bank, public commercial and specialized banks, private banks, and non-bank credit institutions.

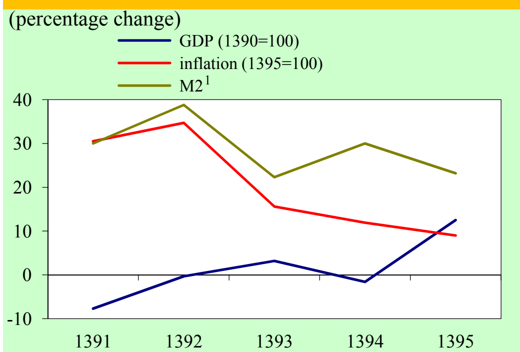
attributable to the rise in their foreign assets by Rls. 123.9 trillion and increase in their foreign liabilities by Rls. 63.8 trillion.

### Banking System and Public Sector

Banking system net claims on the public sector experienced an increase of Rls. 480.0 trillion compared with 1394 and reached Rls. 1,583.1 trillion. In 1395, the Central Bank claims on public sector increased by 10.7 percent (Rls. 55.8 trillion), which was due to 12.2 percent growth in CBI claims on the government and 9.4 percent rise in public corporations' and institutions' indebtedness to CBI. Of total Central Bank's claims on the government, Rls. 39.2 trillion (14.3 percent) was due to the deficit in foreign exchange obligations account[1]. Meanwhile, Rls. 8.9 trillion of total government debt to the CBI at end-1395 was related to the unification of the exchange rate in 1381. In 1395, public sector deposits with the Central Bank increased by 10.5 percent (Rls. 35.4 trillion), mainly attributable to the increase in government's deposits with the Central Bank by Rls. 29.8 trillion and increase in public corporations' and institutions' deposits with the Central Bank by Rls. 5.6 trillion.

Public sector indebtedness to banks and non-bank credit institutions surged by 33.1 percent (Rls. 403.1 trillion), mainly due to 33.0 percent rise (Rls. 392.8 trillion growth) of banks' and non-bank credit institutions' claims on the government. Government indebtedness to banks and non-bank credit institutions reached Rls. 1,584.1 trillion at end-1395.

**Figure 13.1. Major economic variables**




[1] In 1392, the homogenous growth figure for M2, comparable with corresponding figures of previous years, was 25.9 percent.

**Table 13.1. Assets and Liabilities of the Banking System[1]** (trillion rials)

| | Year-end balance | | | Percentage change | |
|---|---|---|---|---|---|
| | 1393 | 1394 | 1395 | 1394 | 1395 |
| **Assets** | **18,518.4** | **22,591.7** | **25,496.6** | **22.0** | **12.9** |
| Foreign assets | 5,035.3 | 5,823.0 | 5,823.5 | 15.6 | 0.0 |
| Central Bank | 3,126.2 | 3,517.5 | 3,394.1 | 12.5 | -3.5 |
| Public banks | 665.9 | 854.7 | 982.7 | 28.4 | 15.0 |
| Private banks and non-bank credit institutions | 1,243.2 | 1,450.8 | 1,446.7 | 16.7 | -0.3 |
| Claims on public sector | 1,466.0 | 1,738.6 | 2,197.5 | 18.6 | 26.4 |
| Claims on non-public sector | 6,309.0 | 7,362.2 | 9,177.2 | 16.7 | 24.7 |
| Others | 5,708.1 | 7,667.9 | 8,298.4 | 34.3 | 8.2 |
| **Liabilities** | **18,518.4** | **22,591.7** | **25,496.6** | **22.0** | **12.9** |
| M2 | 7,823.8 | 10,172.8 | 12,533.9 | 30.0 | 23.2 |
| Loans and deposits of public sector | 770.2 | 635.5 | 614.4 | -17.5 | -3.3 |
| Foreign liabilities | 3,008.6 | 3,358.7 | 3,310.9 | 11.6 | -1.4 |
| Central Bank | 1,541.5 | 1,581.1 | 1,469.5 | 2.6 | -7.1 |
| Public banks | 439.9 | 574.7 | 696.5 | 30.6 | 21.2 |
| Private banks and non-bank credit institutions | 1,027.2 | 1,202.9 | 1,144.9 | 17.1 | -4.8 |
| Others[2] | 6,915.8 | 8,424.7 | 9,037.4 | 21.8 | 7.3 |

[1] Excludes below the line items. [2] Includes other liabilities, capital account of the banking system, advance payments on public sector's L/Cs, and order registration deposit of non-public sector.

[1] The foreign exchange obligations account was opened in 1372, upon the unification of the exchange rate.

## Banking System[1] and Non-public Sector[2]

In 1395, the outstanding facilities[3] extended by the banking system to the non-public sector grew by 23.8 percent (1,585.4 trillion) to Rls. 8,240.7 trillion. This shows 6.8 percentage points increase as compared with 17.0 percent growth in 1394. The share of the outstanding facilities extended by the banking system to the non-public sector equaled 83.6 percent of total extended facilities, indicating one percentage point decrease compared with the respective figure of 1394 (84.6 percent).

The outstanding facilities extended by public commercial banks to non-public sector (excluding profit and revenue receivables) rose 23.7 percent (Rls. 243.7 trillion) to reach Rls. 1,270.3 trillion at end-1395. Moreover, the outstanding facilities extended by specialized banks to the non-public sector grew by 12.6 percent (Rls. 184.0 trillion) to Rls. 1,644.3 trillion. For private banks and non-bank credit institutions, this variable grew by 27.8 percent (Rls. 1,157.7 trillion) to Rls. 5,326.1 trillion.

In 1395, the highest share (72.4 percent) of the increase in net outstanding facilities extended by the banking system to the non-public sector belonged to "domestic trade, services, and miscellaneous" sector, followed by "manufacturing and mining" by 13.2 percent, "construction and housing" by 9.1 percent, and "agriculture" by 5.5 percent.

**Figure 13.2. Public & non-public sectors' debt to banks and non-bank credit institutions (excluding profit and revenue receivables)**

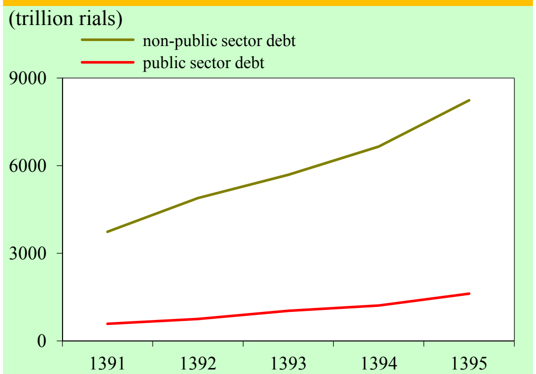



**Table 13.2. Change in Net Claims of Banking System on Public Sector** (trillion rials)

| | 1394 | 1395 |
|---|---|---|
| **Public sector** | **407.2** | **480.0** |
| Central Bank | 148.9 | 20.4 |
| Commercial and specialized banks (public) | 109.6 | 228.3 |
| Private banks and non-bank credit institutions | 148.7 | 231.3 |
| **Government** | **382.1** | **449.2** |
| Central Bank [1] | 115.3 | -0.1 |
| Commercial and specialized banks (public) | 119.7 | 229.7 |
| Private banks and non-bank credit institutions | 147.1 | 219.6 |
| **Public corporations and institutions** | **25.1** | **30.8** |
| Central Bank | 33.6 | 20.5 |
| Commercial and specialized banks (public) [2] | -10.1 | -1.4 |
| Private banks and non-bank credit institutions | 1.6 | 11.7 |

[1] Includes the deficit in foreign exchange obligations account, resulted from the unification of the exchange rate in 1372, as well as government debt to CBI due to the unification of the exchange rate in 1381.

[2] Includes indebtedness for the exchange rate differential, resulted from the unification of the exchange rate in 1372.

[1] Includes state-owned and private banks as well as non-bank credit institutions.

[2] Figures in this section exclude profit and revenue receivables and are therefore different from the figures in Appendix.

[3] Includes overdue and non-performing loans.

The composition of the outstanding facilities extended by the banking system to the non-public sector according to Islamic contracts indicates that civil partnership and installment sale contracts held the highest shares by respectively 42.3 and 25.6 percent in 1395.

The shares of facilities extended in the form of Murabaha, installment sale, legal partnership, hire purchase, and Gharz-al-hasaneh were higher while the shares of civil partnership, Ju'alah, Mudarabah, direct investment, and forward transactions were lower than 1394.

**Table 13.3. Facilities Extended by Banking System to Non-public Sector [1]** (trillion rials)

| | Year-end balance | | | Percentage change | | Share (percent) | |
|---|---|---|---|---|---|---|---|
| | 1393 | 1394 | 1395 | 1394 | 1395 | 1394 | 1395 |
| Public commercial banks | 853.6 | 1,026.6 | 1,270.3 | 20.3 | 23.7 | 15.4 | 15.4 |
| Specialized banks | 1,295.6 | 1,460.3 | 1,644.3 | 12.7 | 12.6 | 22.0 | 20.0 |
| Private banks and non-bank credit institutions | 3,538.0 | 4,168.4 | 5,326.1 | 17.8 | 27.8 | 62.6 | 64.6 |
| **Total** | **5,687.2** | **6,655.3** | **8,240.7** | **17.0** | **23.8** | **100.0** | **100.0** |

[1] Excludes profit and revenue receivables.

**Table 13.4. Share of Economic Sectors in Increase in Net Outstanding[1] Facilities Extended by Banking System to Non-public Sector** (percent)

| | 1394 | | | 1395 | | |
|---|---|---|---|---|---|---|
| | Public banks | Private banks & non-bank credit institutions | Banking system | Public banks | Private banks & non-bank credit institutions | Banking system |
| Agriculture | 16.9 | 1.3 | 6.2 | 14.4 | 1.8 | 5.5 |
| Manufacturing and mining | 13.9 | 18.6 | 17.1 | 14.5 | 12.7 | 13.2 |
| Construction and housing | 24.4 | 7.1 | 12.5 | 20.2 | 4.6 | 9.1 |
| Exports | -0.5 | -1.3 | -1.1 | -0.7 | 0.0 | -0.2 |
| Domestic trade, services, and miscellaneous | 45.3 | 74.3 | 65.3 | 51.6 | 80.9 | 72.4 |
| **Total** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** | **100.0** |

[1] Net outstanding facilities are calculated after deduction of outstanding debts of customers and extended facilities related to the exchange rate differential, profit receivables, profit and commission receivables, receipts from Mudarabah, civil partnership (bank's share), outstanding profit, and outstanding commission. Moreover, net outstanding facilities include legal partnership and direct investment contracts.

**Table 13.5. Composition of Outstanding Facilities Extended by Banking System to Non-public Sector by Contracts** (percent)

| | Banking system | |
|---|---|---|
| | 1394 | 1395 |
| Installment sale | 24.7 | 25.6 |
| Mudarabah | 2.3 | 1.8 |
| Civil partnership | 44.0 | 42.3 |
| Gharz-al-hasaneh | 5.0 | 5.1 |
| Hire purchase | 0.2 | 0.3 |
| Forward transactions | 0.4 | 0.3 |
| Legal partnership | 3.4 | 3.6 |
| Direct investment | 1.1 | 0.9 |
| Ju'alah | 4.2 | 3.6 |
| Murabaha [1] | 3.7 | 5.3 |
| Others [2] | 11.0 | 11.2 |
| **Total** | **100.0** | **100.0** |

[1] Executive Guideline on Murabaha contracts was declared to the banking system in 1390 (Circular No. 90/141696 on Shahrivar 20, 1390) while the data on this type of contract were added to the banking system data as of Tir 1394. Due to the significance of this contract for the Iranian banking system, the Guideline declared in 1390 was revised in 1394 to eliminate ambiguities, and was later approved by the MCC in 1213th Meeting on Dey 29. Banking Studies and Regulations Department of CBI declared the mentioned Approval to the banking system through Circular No. 94/347278 on Bahman 27, 1394.

[2] Includes debt purchase, machinery and housing units transacted under Islamic contracts, Istisna, and overdue and non-performing loans.

The ratio of overdue and non-performing loans to total rial facilities extended by banks and non-bank credit institutions to public and non-public sectors decreased by 0.2 percentage point from 9.7 percent at end-1394 to 9.5 percent in 1395. This variable declined by 1.2 and 0.3 percentage points for public commercial banks and private banks and non-bank credit institutions and rose by 0.6 percentage point for specialized banks.

Given the important role of the Small and Medium-sized Enterprises (SMEs) in job creation and realization of the objectives of resilient economy, "Guideline on Financing the SMEs" was drafted by the CBI in Ordibehesht 1395 and announced for complementation to the banking system[1]. Accordingly, the facilities under this guideline were specifically targeted to those SMEs that previously had a reasonable market but ceased production due to problems like credit crunch and lack of working capital. Meanwhile, those projects whose physical progress index was above 60 percent were subject to the extension of required facilities. On this basis and with the coordination of the Ministry of Industry, Mine, and Trade, a registration platform was designed for the identification and selection of qualified applicants. Therefore, Rls. 168.1 trillion worth of facilities were allocated to a total of 24.2 thousand eligible manufacturing establishments by year-end, within the framework of the approvals of a provincial working group and banks' scheduled facilities.

In 1395, total banks' and credit institutions' scheduled facilities amounted to Rls. 183.1 trillion, of which a sum of Rls. 112.0 trillion (61.2 percent) was related to Gharz-al-hasaneh facilities and the remaining Rls. 71.1 trillion was related to other uses. Of total Rls. 112.0 trillion facilities extended in the form of Gharz-al-hasaneh facilities, Rls. 98.7 trillion (88.1 percent) was exclusively allocated as marriage facility and the remaining Rls. 13.3 trillion was extended for employment of help-seekers of welfare organizations, home-based businesses, and the release of needy prisoners. Other scheduled facilities equaled Rls. 71.1 trillion, of which Rls. 45.7 trillion was related to the purchase of domestic wheat and other agricultural products and Rls. 12.0 trillion was related to Mehr Housing Program[2].

**Table 13.7. Banks' Performance on Scheduled Facilities in 1395** (trillion rials)

| Purposes | Paid facilities in 1395 |
|---|---|
| **Gharz-al-hasaneh facilities** | **112.0** |
| Marriage | 98.7 |
| Other | 13.3 |
| **Other scheduled facilities** | **71.1** |
| Purchase of domestic wheat and other agricultural products | 45.7 |
| Rural housing | 1.8 |
| Mehr Housing Program | 12.0 |
| Old buildings | 7.8 |
| Veterans' Home Facility | 3.8 |
| **Total** | **183.1** |

**Table 13.6. Ratio of Overdue and Non-performing Loans to Total Facilities Extended by Banking System (in rials)[1]** (percent)

| | 1394 | 1395 | Change (percentage points) |
|---|---|---|---|
| Public commercial banks | 8.8 | 7.6 | -1.2 |
| Specialized banks | 7.2 | 7.8 | 0.6 |
| Private banks and non-bank credit institutions | 11.0 | 10.7 | -0.3 |
| **Banking system** | **9.7** | **9.5** | **-0.2** |

[1] Includes overdue, non-performing, and doubtful claims of public and non-public sectors.

[1] Circular No. 95/27577 dated Ordibehesht 1, 1395.

[2] Includes only the performance of the year 1395.

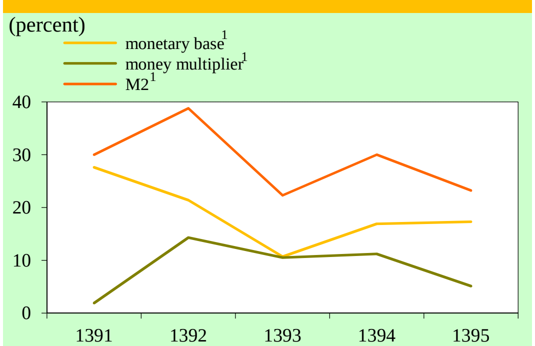
## Broad Money (M2)

In 1395, broad money, M2, grew by 23.2 percent to Rls. 12,533.9 trillion, down by 6.8 percentage points compared with the M2 growth of the previous year (30.0 percent). This was mainly due to the 17.3 percent growth in monetary base, which was in turn attributable to the rise in CBI claims on banks. Money multiplier increased by 5.1 percent compared with the year before and reached 6.970 in 1395.

**Table 13.8. M2 and its Determinants**

| | Year-end balance | | Percentage change | |
|---|---|---|---|---|
| | 1394 | 1395 | 1394 | 1395 |
| Monetary base (trillion rials) | 1,533.6 | 1,798.3 | 16.9 | 17.3 |
| Money multiplier | 6.633 | 6.970 | 11.2 | 5.1 |
| M2 (trillion rials) | 10,172.8 | 12,533.9 | 30.0 | 23.2 |

**Figure 13.3. M2 growth and its determinants**




[1] In 1392, the homogenous growth figures for M2, money multiplier, and monetary base, comparable with corresponding figures of previous years, were 25.9, 7.7, and 16.9 percent.

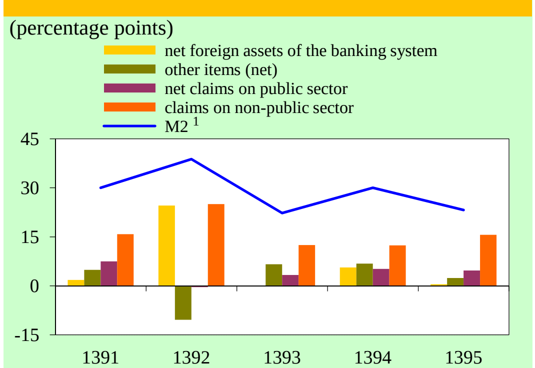
Among factors affecting M2 growth in 1395, net domestic assets of the banking system, with 30.0 percent growth compared with 1394, had an increasing share of 22.7 percentage points in raising M2. Among the items of net domestic assets, non-public sector indebtedness to banks and non-bank credit institutions (excluding profit and revenue receivables), with 23.8 percent growth and an increasing share of 15.6 percentage points, and banks' net claims on public sector, with 43.7 percent growth and a positive contribution of 4.7 percentage points, were the main factors contributing to M2 growth. Other items (net) had an increasing share of 2.4 percentage points in raising M2. Moreover, net foreign assets of the banking system, with 2.0 percent rise compared with 1394, had a positive share of 0.5 percentage point in M2 growth.

**Table 13.9. Contribution of Factors Affecting M2 Growth** (percentage points)

| | 1394 | 1395 |
|---|---|---|
| **Net foreign assets of the banking system** | **5.6** | **0.5** |
| **Net domestic assets of the banking system** | **24.4** | **22.7** |
| Banks' claims on public sector (net) | 5.2 | 4.7 |
| Government | 4.9 | 4.4 |
| Public corporations | 0.3 | 0.3 |
| Banks' and non-bank credit institutions' claims on non-public sector[1] | 12.4 | 15.6 |
| Other items (net) | 6.8 | 2.4 |
| **M2 (percent)** | **30.0** | **23.2** |

[1] Excludes profit and revenue receivables.

**Figure 13.4. Factors affecting M2 growth**




[1] In 1392, the homogenous growth figure for M2, comparable with corresponding figures of previous years, was 25.9 percent.

### *Monetary Base*

Monetary base grew by 17.3 percent in 1395, showing 0.4 percentage point increase compared with 16.9 percent growth of the previous year. CBI claims on banks, with 19.2 percent growth and an increasing share of 10.5 percentage points, was the most important factor behind the rise in monetary base which, compared with the previous year (a decreasing share of 1.7 percentage points in 16.9 percent growth of monetary base), indicates 12.2 percentage points increase. In spite of CBI efforts in restricting banks' access to CBI overdraft facilities and lowering CBI claims on banks in 1394, including through launching and activation of CHAKAVAK (Electronic System for Checks Image Transfer and Clearance), conversion of banks' overdrafts for scheduled facility purposes to lines of credit, and initiation and enhancement of interbank money market, banks' debt to the CBI surged in 1395. The sharp growth of banks' indebtedness to the CBI in 1395 was mostly due to rise in banks' scheduled facilities and banks' balance sheet difficulties and poor management.

CBI other items (net), with 6.7 percent increase and an increasing share of 6.3 percentage points, was the second contributing factor in the growth of monetary base at end-1395. Rise in the share of other items (net) in monetary base growth in 1395 was due to the implementation of Note 35 of the 1395 Budget Amendment approved in Shahrivar. The contribution of CBI other items (net) to monetary base growth is greatly reduced from 6.3 percentage points to -1.2 percentage points if the effect of exchange rate revaluation account is eliminated from CBI balance sheet (subject of Note 35 of the 1395 Budget Amendment).

CBI net claims on public sector, with 11.2 percent increase compared with the previous year-end and a positive contribution of 1.3 percentage points, was another factor responsible for the growth of monetary base. CBI net foreign assets, with 0.6 percent decrease compared with end-1394 and a decreasing share of 0.8 percentage points, was the only factor negatively affecting the monetary base.

**Table 13.10. Breakdown of Factors Affecting Monetary Base Growth** (percentage points)

| | 1394 | 1395 |
|---|---|---|
| CBI net foreign assets | 26.8 | -0.8 |
| CBI net claims on public sector | 11.4 | 1.3 |
| CBI claims on banks | -1.7 | 10.5 |
| CBI other items (net) | -19.6 | 6.3 |
| **Monetary base (percent)** | **16.9** | **17.3** |

### Composition of M2

The share of narrow money, M1, in M2 declined from 13.4 percent at end-1394 to 13.0 percent in 1395 year-end. The share of quasi-money, however, increased by 0.4 percentage point to 87.0 percent. This was attributable not only to the customers' interest in non-sight deposits' profit rates as compared to cash, but also to the growth in the use of electronic banking and payment cards connected to short-term deposits.

The share of one-year deposits in total long-term deposits increased by 8.5 percentage points from 77.1 percent in 1394 to 85.6 percent in 1395. On the other hand, the share of five-year deposits in total long-term deposits decreased by 5.1 percentage points from 18.2 percent in 1394 to 13.1 percent in 1395 and shares of two-, three-, and four-year deposits decreased from respectively 4.0, 0.4, and 0.3 percent in 1394 to 0.9, 0.2, and 0.2 percent in 1395. The setting of a ban on the opening of deposits with maturities of more than a year in Ordibehesht 1393 which was also in effect in 1394 and 1395, was the most important reason behind the fall in the share of long-term deposits of more than one year in 1395.

**Table 13.11. Composition of Long-term Deposits** (percent)

| Deposits | Year-end 1393 | 1394 | 1395 |
|---|---|---|---|
| One-year | 57.4 | 77.1 | 85.6 |
| Two-year | 11.9 | 4.0 | 0.9 |
| Three-year | 0.9 | 0.4 | 0.2 |
| Four-year | 0.6 | 0.3 | 0.2 |
| Five-year | 29.2 | 18.2 | 13.1 |

## Sources and Uses of Funds of Public Commercial Banks

The value of non-public sector's deposits with public commercial banks grew by 31.6 percent (Rls. 545.9 trillion) in 1395. Deposits of non-public sector held with these banks included sight deposits, the value of which rose Rls. 33.7 trillion and non-sight deposits whose value increased by Rls. 512.2 trillion. The non-usable resources of public commercial banks increased by Rls. 54.3 trillion, mainly owing to Rls. 54.9 trillion increase of reserve requirement and Rls. 0.6 trillion decrease in notes and coins kept with commercial banks. Moreover, the balance of the capital account of public commercial banks went up by Rls. 39.8 trillion while public sector's deposits and funds decreased by Rls. 50.4 trillion. Accordingly, non-public sector indebtedness[1] and public sector indebtedness[2] rose by Rls. 243.7 trillion and Rls. 103.0 trillion, respectively.

## Sources and Uses of Funds of Specialized Banks

In 1395, non-public sector's deposits held with specialized banks grew by Rls. 189.9 trillion. The value of sight deposits increased by Rls. 30.3 trillion and that of non-sight deposits increased by Rls. 159.6 trillion. In this year, the non-usable resources of specialized banks rose by Rls. 7.4 trillion, resulting from Rls. 6.3 trillion increase in reserve requirement and Rls. 1.1 trillion rise in the value of notes and coins kept with specialized banks. Free resources out of non-public sector's deposits held with specialized banks increased by Rls. 182.5 trillion. Total free resources of specialized banks, including other sources (debt to the Central Bank, external debt, debt to other banks, and other funds), rose by Rls. 248.9 trillion. This included rise in non-public sector's debt to specialized banks by Rls. 186.4 trillion and

**Table 13.12. Composition of Broad Money** (trillion rials)

| | Year-end balance 1393 | Year-end balance 1394 | Year-end balance 1395 | Percentage change 1394 | Percentage change 1395 | Share (percent) 1394 | Share (percent) 1395 |
|---|---|---|---|---|---|---|---|
| **M1** | **1,207.5** | **1,367.0** | **1,630.3** | **13.2** | **19.3** | **13.4** | **13.0** |
| Notes and coins with the public | 351.7 | 371.9 | 393.3 | 5.7 | 5.8 | 3.7 | 3.1 |
| Sight deposits of non-public sector | 855.9 | 995.1 | 1,237.0 | 16.3 | 24.3 | 9.7 | 9.9 |
| **Quasi-money** | **6,616.3** | **8,805.8** | **10,903.6** | **33.1** | **23.8** | **86.6** | **87.0** |
| Gharz-al-hasaneh savings deposits | 390.9 | 469.8 | 602.9 | 20.2 | 28.3 | 4.6 | 4.8 |
| Term investment deposits | 6,100.9 | 8,187.4 | 10,123.1 | 34.2 | 23.6 | 80.5 | 80.8 |
| Miscellaneous deposits | 124.5 | 148.6 | 177.6 | 19.4 | 19.5 | 1.5 | 1.4 |
| **M2** | **7,823.8** | **10,172.8** | **12,533.9** | **30.0** | **23.2** | **100.0** | **100.0** |

[1] Excludes profit and revenue receivables.

[2] The sources and uses of funds' data in the text and tables exclude participation papers issued by the government. Hence, the figure for public sector indebtedness is different from the figure in the table on summary of assets and liabilities of banks.

increase in public sector's debt by Rls. 62.5 trillion. CBI claims on specialized banks declined by 13.7 percent (Rls. 78.4 trillion) to Rls. 494.4 trillion at end-1395.

## Sources and Uses of Funds of Private Banks and Non-bank Credit Institutions[1]

Non-public sector's deposits with private banks and non-bank credit institutions went up by 22.7 percent (Rls. 1,603.9 trillion) in 1395. In this regard, the value of sight deposits increased by Rls. 177.9 trillion and that of non-sight deposits, by Rls. 1,426.0 trillion. Non-usable resources of private banks and non-bank credit institutions rose by Rls. 179.2 trillion in this year, due to Rls. 173.1 trillion growth in reserve requirement and Rls. 6.1 trillion increase in notes and coins held with private banks and non-bank credit institutions. Furthermore, the balance of the capital account of private banks and non-bank credit institutions decreased by Rls. 243.9 trillion and public sector's deposits and funds kept with private banks and non-bank credit institutions fell Rls. 0.3 trillion. Consequently, private banks' and non-bank credit institutions' claims on non-public sector increased by Rls. 1,164.2 trillion and public sector's debt rose by Rls. 188.6 trillion.

## Banking Units and Personnel

The number of banking units, including branches and counters in both domestic offices and representative offices abroad, rose 1.8 percent to 23,415 in 1395. A total of 23,370 units were located in Iran and the remaining units were on foreign lands. Bank Melli Iran and Bank Saderat Iran held the highest shares in the number of domestic units by 14.2 and 12.5 percent, respectively.

In 1395, the number of banking system employees decreased by 1.0 percent to 222,606 persons, with the number of employees in public commercial banks, public specialized banks, and private banks and non-bank credit institutions falling by 2.3, 0.5, and 0.5 percent, respectively. The number of banking sector employees was 9.5 persons in each banking unit on average, down by almost 3.1 percent compared with 1394. Furthermore, the ratio of total population to each domestic banking unit decreased by about 20 persons to reach 3,420 persons in 1395.

## Banking Sector Developments

The major measures adopted by the CBI in 1395 were as follows:

## Section One- Major Regulations, Bylaws, Guidelines, Circulars, and Amendments

- Proposed bylaw revision of terms and conditions on safekeeping and security of commercial papers, documents, and financial reports of credit institutions with the aim of document scanning and digital imaging of bulk papers and hard copy archives and the likely safeguarding cost reductions thereof;

**Table 13.13. Number of Banking Units[1]**

| | 1394 | 1395 |
|---|---|---|
| **Domestic branches** | **22,950** | **23,370** |
| Public commercial banks | 5,515 | 5,488 |
| Specialized banks | 3,847 | 3,838 |
| Private banks and non-bank credit institutions | 13,588 | 14,044 |
| **Foreign branches** | **45** | **45** |
| **Total** | **22,995** | **23,415** |

[1] Excludes representative offices.

[1] Includes banks, subject of Article 44 of the Constitution.

- Proposed bylaw revision and announcement on Murabaha Credit Card (KAM), aimed at facilitating the use of credit cards at a country-wide level, eliminating ambiguities, and making the related rules compatible with the most urgent needs of the public at large and implementation of government plans for credit card promotions, offers, deals, and bonuses for customers and the business sector;

- Proposed bylaw revision and announcement on investment in securities, aimed at discouraging banks and credit institutions from engaging in firm-related non-financial activities and further regulation of investment in securities;

- Proposed bylaw revision and announcement on rules governing corporate governance in non-public credit institutions, with the aim of raising stability and soundness of credit institutions through proper management;

- Proposed bylaw revision and announcement on establishment, operation, and supervision of savings and housing facilities institutions to the banking system, in implementation of Article 2, Executive Bylaw of Note 2, Article 7 of the Law on Support of Renovation and Reinforcement of Old Urban Textures;

- Proposed bylaw revision and announcement on establishment, operation, and supervision of leasing companies to the banking system, with the aim of improving the business environment and facilitating the activities of such companies using the potential financing capacities of such firms for optimum financing of different economic sectors;

- Proposed bylaw revision and announcement on issuance of license for foreign exchange operations by credit institutions to the banking system for upgrading and harmonizing the rules governing issuance of license for credit institutions to perform foreign exchange operations based on new standards;

- Proposed bylaw revision and announcement on opening rial deposit accounts by foreign entities, aimed at further facilitation of conditions for rendering monetary and banking services to investors and foreign tourists and lowering restrictions on opening rial deposit accounts for the maximum utilization of potential opportunities in the post-JCPOA era within the framework of national interests and realization of economic targets;

- Proposed bylaw revision and announcement regarding confirmation process of qualified or disqualified candidates for Managing Director or Board Member positions in credit institutions;

- Translation and declaration of Basel II Accord for the better communication of the concepts of this document within the banking system and facilitation of the operation and implementation of its standards in credit institutions;

- Translation and declaration of the 23-principle document submitted through "liquidity risk management guideline for institutions rendering Islamic financial services, published by Islamic Financial Services Board (IFSB)", with the aim of raising awareness on liquidity risk management in the banking system and with a view to the importance of liquidity risk management in credit institutions;

- Translation and declaration of "Corporate Governance Principles Document for Banks Published by the Basel Committee in 2015", with the aim of establishing optimal corporate governance in the banking system.

## Section Two- Major Anti-Money Laundering (AML) Measures

- Coordination in preparation and pursuance of the approval process of the "Law on Combating the Financing of Terrorism", given its importance regarding the removal of Iran as a "high-risk and non-cooperative country" from the FATF[1] blacklist;

- Holding of a pre-assessment course by the IMF in CBI for the members subject to the Law on Anti-Money Laundering and Combating the Financing of Terrorism in 2018;

- Updating circulars related to the United Nations Security Council Resolution 1267;

- Identification of regulatory and executive loopholes of anti-money laundering and combating the financing of terrorism measures and reporting thereof to the President;

- Active participation in answering sessions to the IMF questionnaire regarding Resolution 1373;

- Tracking the sources of initial capital for the establishment or capital increase of banks and credit institutions, as per the Approval of the National Security High Council;

- Tracking the sources of initial capital for the establishment or capital increase of insurance companies, as per the Approval of the High Council of Anti-Money Laundering;

- Conduct of comprehensive oversight on banks' regular practices regarding the implementation of anti-money laundering regulations;

[1] Financial Action Task Force.

- Proposed circular revision and announcement to the banking system, in line with the implementation of the Approvals of the High Council of Anti-Money Laundering;

- Active participation in the specialized committee of Anti-Money Laundering with the aim of revising the Law on Anti-Money Laundering and Combating the Financing of Terrorism;

- Active participation in the Revision Working Group of the Ministry of Economic Affairs and Finance, for the reform of Anti-Money Laundering Law.

## Section Three- Bank Licensing[2]

In implementation of the Monetary and Banking Law of Iran, the CBI adopted appropriate measures to fulfill its supervisory role in terms of reviewing new establishment license applications as well as operation and registration developments of monetary foundations in 1395. This was in line with the Law on Rationalization of the Unorganized Money Market and the regulations concerned with the development of the country.

Accordingly, the CBI issued operation licenses for 18 credit cooperatives, 64 Gharz-al-hasaneh Funds, 337 exchange bureaus, and 8 leasing companies. Meanwhile, the CBI renewed work permits for 216 institutions, which used to have a temporary work permit, and licenses of 160 exchange bureaus and one Gharz-al-hasaneh Fund were revoked.

[2] There is a time gap between CBI granting of a license to banks and credit institutions and the forwarding of the standard general ledger by these institutions to the CBI for inclusion in the monetary and banking data.

**Table 13.14. Number of Licenses Issued, Renewed, and Cancelled for Institutions Active in Unorganized Money Market in 1395**[1]

| | Initial licenses | | Renewed licenses | Total | Cancelled/Suspended licenses |
|---|---|---|---|---|---|
| | Established | Reorganized | | | |
| Credit cooperatives | 5 | 13 | 53 | **71** | 0 |
| Gharz-al-hasaneh Funds | 30 | 34 | 0 | **64** | 1 |
| Leasing companies | 2 | 6 | 4 | **12** | 0 |
| Exchange bureaus | 150 | 187 | 159 | **496** | 160 |
| **Total** | **187** | **240** | **216** | **643** | **161** |

[1] Establishment licenses are issued for the purpose of registering and establishing the mentioned entities. Operation licenses facilitate the operation of these units.

## 5th Five-Year Development Plan (1390-1395)

The 5th FYDP includes 3 Sections, 9 Chapters, and 235 Articles. Articles 86-98 in Section 2 of Chapter 5 are related to the money and banking issues. Contrary to the two previous development plans, the 5th FYDP does not stipulate quantitative targets for monetary aggregates. Therefore, the performance figures of this sector cannot be compared with any Plan targets. However, a general qualitative review of the monetary and credit policies over the mentioned years could provide a rather clear picture of the performance of the monetary and credit system in those years.

Over the 5th Plan period, the monetary policy framework experienced a tumultuous course. First and foremost, despite the emphasis of the 5th Plan on a market-based approach to the determination of banks' deposit rates (to be in tandem with inflation), the policymakers followed an administrative and directive approach in lowering deposit rates from the very first year of the Plan. In the aftermath of the fluctuations in the foreign exchange market and the turbulence in the money market in 1391 and 1392, policies regarding banks' deposit rates had to be revised. As a result, a gradual and non-administrative approach was taken and banks' deposit rates, bolstered by the capacities of the interbank market, were lowered.

Furthermore, as of the second half of 1387 until late-1392, the implementation of Mehr Housing Program and the financing of this Program out of the CBI resources had a major impact on monetary aggregates. These policies had significant effects on money and credit variables, prudential ratios, and money market developments. Simultaneous with the change in monetary policies in 1392 and the surfacing of the unfavorable ramifications of financing Mehr Housing Program out of CBI resources for the banking system of the country, the financing method of the mentioned program was revised. Moreover, the Central Bank adopted appropriate measures in terms of financing the working capital of manufacturing establishments and supporting the SMEs, deepening the local currency interbank market, reorganizing the unlicensed financial institutions, increasing statistical coverage, raising the number of Islamic contracts used in Iran's banking sector, developing new financial instruments, using microfinance to support households, and implementing credit facilitation policies in the housing sector, all with the aim of bringing discipline back to the money market.

Over the course of the 5th FYDP, poor management of banks' balance sheets, along with the facilities scheduled by government and large volumes of banks' claims on public sector and non-performing loans as well as aggregation of non-financial residual assets on banks' balance sheets, led to credit constraints and the freezing of a remarkable part of banks' assets. This led to huge banks' indebtedness to the Central Bank which in turn created colossal increase in monetary base and liquidity.

### *Monetary and Credit Policies*

General monetary and credit policy rules and directions of the 5th FYDP were as follows:

- Inhibiting financial repression in money market through introducing rules on market-based banks' deposit rates (in tandem with inflation);

- Allocation of interest subsidy from government administered funds for scheduled lending facilities assigned to banks at below market rates;

- Lowering fiscal dominance and restraining from the financing of budget deficit out of banks' resources;

- Decoupling banks' accounts and introducing necessary mechanisms to ensure that Gharz-al-hasaneh savings deposits are only used for Gharz-al-hasaneh facilities;

- Introducing new Islamic instruments and contracts including Istisna, Murabaha, Debt Purchase, and Sukuk (in rials and foreign exchange);

- Capital increase for public banks;

- Designating agent banks for publicly-owned economic firms, institutions, companies, and non-public enterprises;

- Creation of a Deposit Insurance Fund to protect depositors against banks' and credit institutions' bankruptcy;

- Revising executive, accounting, and appropriate financial rules in the banking system, in congruence with the targets and specifications of Usury Free Banking Law;

- Revising the CBI organization to strengthen supervision on monetary and financial institutions for better realization of macroeconomic targets;

- Enhancement of transparency and enforcing sound competition measures in rendering banking sector services, aimed at higher efficiency and lower costs.

A review of the money and banking developments of the country over the years of the 5th FYDP indicates that the introduction of these measures was at some instances weaker than expected. Strict adherence to inflation as a rule in setting banks' deposit rates and other weaknesses in the law thereof including the rigidity in setting administrative rates for banks, negligence of other macroeconomic fundamentals like GDP growth, unemployment rate, and asset market developments in the absence of some degree of discretion for proper application of Article 92 through the course of the Plan, led to distortions in monetary policy implementation[1]. The initial years of the 5th FYDP were marked by sharp increase of inflation and the final years, with banks' balance sheet impairment.

Moreover, despite the ban on direct government borrowing from the Central Bank over the course of the 5th FYDP, the government was still dominant on the monetary policymaking area. Rise in public companies' debt to the banking system, obligation on banks to extend budgetary and quasi-budgetary facilities including Mehr

[1] Article 92 of the 5th FYDP Law was devised in view of low inflation of the period and for the prevention of the financial repression intensified during the 4th FYDP.

Housing Program, the guaranteed purchase of agricultural products, and the accumulation of residual assets in the form of participation papers issued by public companies on banks' balance sheets are among items that point well to the mentioned dominance.

### *Banks' Deposit Rates*

Banks' deposit rates were lowered under the monetary, credit, and supervisory policy package for the year 1390 (the first year of the Plan). This was contrary to the backdrop of a prior reduction in real deposit rates in the aftermath of the implementation of Targeted Subsidy Law as of Azar 1389, which led to inflationary pressures and intensified financial repression. The following developments led to instability in the foreign exchange market as of mid-1390. Hence the CBI revised the initial monetary policy package in Dey 1390 which, contrary to previous policy packages, did not restrict the implementation period until the end of the mentioned year. The CBI's newly revised package focused on authorizing banks to determine the deposit and lending rates based on their own discretion. Meanwhile, for the sake of preventing any negative competition in liberalization of rates, the Coordination Council of State-owned Banks and the Association of Private Banks and Non-bank Credit Institutions were encouraged to coordinate comparable rates by banks and credit institutions for term deposits.

Due to major economic developments in 1391 and 1392 including volatility in asset markets, operation of unlicensed financial institutions, and weaknesses in the money market, structural problems were intensified, the volume of NPLs in banks' balance sheets increased, and the credit constraint issue manifested itself in the form of unsound competition in terms of resource mobilization and rise in deposit rates. Therefore, the CBI took the initiative in revising the monetary frameworks. With positive improvements in inflation expectations and in line with efforts to contain inflation, CBI's overall approach was directed towards harmonizing monetary, fiscal, and foreign exchange policies, raising monetary discipline as well as the share of endogenous money in M2 growth, and sound financing of the economy. Thus, in line with the approvals of the MCC, nominal deposit rates were lowered gradually and in stages, congruent with the continued fall in inflation and in accordance with the macroeconomic requirements of the economy. As a result, the profit rate for one-year deposits declined from a maximum of 22 percent in 1393 to 15 percent in the last year of the 5$^{th}$ FYDP.

**Table 13.15. Provisional Profit Rate of Term Deposits during the 5$^{th}$ FYDP** (percent)

| | Short-term | Special short-term (6 months) | One-year | Two-year | Three-year | Four-year | Five-year |
|---|---|---|---|---|---|---|---|
| 1390 | at banks' and credit institutions' discretion within a range of 6-20 percent | | | | | | |
| 1391 | at banks' and credit institutions' discretion within a range of 7-20 percent | | | | | | |
| 1392 | at banks' and credit institutions' discretion within a range of 7-20 percent | | | | | | |
| 1393 | 10 | 14-18 | 22 | – | | | |
| 1394 | at banks' and credit institutions' discretion | | 20 | – | | | |
| | 10 (maximum) | at banks' and credit institutions' discretion | 18 | – | | | |
| 1395 | at banks' and credit institutions' discretion | | 15 | – | | | |

Moreover, the maximum lending rates on non-PLS and PLS contracts concluded between banks and credit institutions and their clients were lowered from respectively 22 and 21 percent in 1393 to a maximum of 18 percent in Tir 1395 (the last year of the 5th FYDP).

### *Mehr Housing Program*

Mehr Housing Program was approved and implemented from the year 1386 within the framework of Note 6 to the Budget Law and with the aim of provision of housing to low-income households. This program was gradually expanded to cover other beneficiary social and economic groups like the employees of government and public organizations and the army. The program was also expanded on the supply side to include different types of construction activities such as reinforcement of old buildings and rural houses. Since Mehr Housing Program was a large-scale project for which a comprehensive financing package was not designed in advance, it created severe funding difficulties for Bank Maskan (the agent bank), forcing it to rely on CBI resources and use CBI overdraft facilities for the funding of this project. This unhealthy arrangement in financing Mehr Housing Program became one of the major factors behind the rise in monetary base and M2 as well as the emergence of inflationary pressures in mid-1387; a trend that continued up until late-1392.

Given the constant pressure of Mehr Housing Program on CBI resources, revision of the financing arrangement of the said program was put on government agenda in 1392. On this basis, MCC approvals from 1392 through 1395 contained the following decisions regarding the revision of the financing arrangement and the completion of semi-finished projects under the Mehr Housing Program[1]:

- Raising the ceiling on CBI commitments for Mehr Housing Program from Rls. 480 trillion to Rls. 555.4 trillion;

- Increasing the ceiling on individual facilities extended in urban areas from Rls. 250 million to Rls. 400 million, with the aim of expediting the completion of semi-finished projects (while observing the commitment ceiling of Rls. 555.4 trillion);

- Extending the installment repayment period (civil partnership and installment sale in total) from 15 to 20 years;

**Table 13.16. Lending Rate on Transaction Contracts during the 5th FYDP**
**(minimum lending rate on PLS contracts)** (percent)

| | Manufacturing and mining | Construction and housing | Agriculture | Trade and services | Exports |
|---|---|---|---|---|---|
| 1390 | 11-15 | 11-15 | 11-15 | 11-15 | 11-15 |
| 1391 | 14-15 | 14-15 | 14-15 | 14-15 | 14-15 |
| 1392 | 14-15 | 14-15 | 14-15 | 14-15 | 14-15 |
| 1393 | 21-22 | 21-22 | 21-22 | 21-22 | 21-22 |
| 1394 | 20-21 | 20-21 | 20-21 | 20-21 | 20-21 |
| 1395 | 18 | 18 | 15 | 18 | 18 |

[1] The 1172nd, 1990th, 1207th, and 1227th MCC Meetings dated respectively Bahman 8, 1392, Dey 15, 1393, Shahrivar 31, 1394, and Dey 14, 1395.

- Granting a three-year grace period for the current contracts of Bank Maskan (it was decided that the funds received from the repayment of facilities in the course of 3 years be used for the completion of semi-finished projects);

- Granting a further grace period for 7 years (10 years in total) for CBI lines of credit to Mehr Housing Program, with priority for completion of semi-finished projects;

With these measures in place, continuation of financing the Mehr Housing Program and completion of the unfinished part of housing projects became possible without reliance on CBI funds and the high-powered money.

### *Production and Employment Support*

One of the most important approaches of CBI, along with the revision of monetary policy approaches in 1392, was to prioritize the financing of the working capital of manufacturing units, aimed at putting the unused capacities of the economy into operation and supporting the SMEs. Therefore, the CBI obligated banks and credit institutions to allocate a minimum of 60 percent of their new facilities to the financing of the working capital for manufacturing units[1].

In the aftermath of the fall in crude oil prices in the middle years of the 5th FYDP and its negative impact on government budget and economic activities, the CBI increased its support for the production sector, emphasizing the financing of the SMEs. Among CBI's most important measures in this regard were its active cooperation in formulation of economic stimulus package in 1394, declaration and communication of circulars and guidelines on supportive policies for the strengthening of production, requiring banks and credit institutions to prioritize the SMEs in extending facilities and provisionally exempting them from the "no bounced checks", return on equity, and no NPL requirements, as well as measures to spur the housing sector. CBI continued its support policies for higher growth and employment with an emphasis on SMEs, allocating Rls. 168.1 trillion facilities to 24.2 thousand SMEs by end-1395.

### *Reserve Requirement Ratio*

The reserve requirement ratio for banks and non-bank credit institutions (except for specialized banks[2]) was determined within the framework of the monetary, credit, and supervisory policy packages in the years 1390 through 1392. In 1393, developments of banking resource allocations majorly affected the reserve requirement of banks with the CBI in a way that the share of this variable in non-public sector deposits underwent remarkable fluctuations, which in turn affected money multiplier. Hence, in Ordibehesht 1393, CBI banned all banks and credit institutions from opening deposit accounts with more than one year maturities

**Table 13.17. Facilities Extended by Banking System during the 5th FYDP**

| | 1391 | 1392 | 1393 | 1394 | 1395 |
|---|---|---|---|---|---|
| Extended facilities (trillion rials) | 1,955.9 | 2,362.2 | 3,414.2 | 4,173.2 | 5,483.7 |
| Share of working capital in total facilities (percent) | 46.0 | 53.9 | 60.7 | 63.1 | 64.0 |

[1] Cabinet Approval No. 50582/84570 dated Mehr 26, 1393.

[2] Reserve requirement ratio for deposits held with specialized banks was 10 percent on average over the course of the Plan.

and made attempts at unifying banks' legal reserve requirements, aimed at lowering banks' reserve volatilities and the likely violations of these institutions in changing the classification of deposits. Based on Article 3 of the Monetary and Credit Policy Package, approved in 1179th MCC Meeting on Tir 3, 1393, the reserve requirement ratio of commercial banks and public and private credit institutions was fixed at a unified rate of 13.5 percent. Accordingly, it was decided that the resources thereby released be earmarked for the settlement of banks' debt to the CBI. Based on Note 1 to this Article, the reserve requirement ratio of Gharz-al-hasaneh deposits with banks and credit institutions was set at 10.0 percent. Furthermore, based on Note 2 of the mentioned policy package, the previously approved measure giving a permission to banks for holding up to 2 percentage points of reserve requirements as cash in vault (for liquidity purposes) remained in force[1]. According to the Guideline on Monetary and Credit Policies in 1394[2], the reserve requirement ratio for all types of deposits in commercial banks and public and private credit institutions decreased again to 13 percent. The reserve requirement ratio for Gharz-al-hasaneh savings deposits of banks and credit institutions was set at 10 percent and the one for the Housing Savings Fund of Bank Maskan remained unchanged at 2 percent. The Monetary and Credit Policy Package of 1394 was revised through the 1208th MCC Meeting dated Mehr 28, 1394, in order to spur growth. Based on Paragraph (3) to the mentioned Approval, the reserve requirement ratio for the deposits in commercial banks and non-bank credit institutions was set within a range of 10 to 13 percent. It was also decided that the ratios set by the CBI should be revised every three months, based on banks' and credit institutions' performance in this regard. These measures on legal reserve requirements were approved and implemented in 1395 as well.

### *Participation Papers Issued by CBI*

According to the Monetary, Credit, and Supervisory Policy Package for 1390 (which was approved in Esfand 1389) and the package revised in Dey 1390, the general conditions for the issuance, maturity, and provisional profit rate of CBI participation papers were left at the discretion of the CBI Governor. Nevertheless, due to the proportionate growth of liquidity, the CBI authorities opted not to issue participation papers in 1390.

**Table 13.18. Reserve Requirement Ratio for Banks and Non-bank Credit Institutions (public and private) during the 5th FYDP** (percent)

| Deposits | 1390 | 1391 | 1392 | 1393 | 1394 | 1395 |
|---|---|---|---|---|---|---|
| Gharz-al-hasaneh savings | 10 | 10 | 10 | 10 | 10 | 10 |
| Sight, cash, L/Cs, L/Gs, and other | 17 | 17 | 17 | 13.5 | 10-13 | 10-13 |
| Short-term | 15.5 | 15.5 | 15.5 | 13.5 | 10-13 | 10-13 |
| One-year | 15 | 15 | 15 | 13.5 | 10-13 | 10-13 |
| Two- and three-year | 11 | 11 | 11 | – | – | – |
| Four-year | 10 | 10 | 10 | – | – | – |
| Five-year | 10 | 10 | 10 | – | – | – |

[1] Subject of CBI Circular No. MB/2412 dated Shahrivar 28, 1387.
[2] Based on 1198th MCC Meeting Approval dated Ordibehesht 8, 1394, effective Ordibehesht 16, 1394.

In 1391 and 1392, with the tightening of economic conditions and the emergence of inflationary pressures of the monetary base, due to implementation of budgetary and quasi-budgetary bank financing operations (such as Mehr Housing Program) and the volatile foreign exchange and gold markets, CBI sold Rls. 46.9 trillion of participation papers in 1391 and Rls. 21.9 trillion in 1392, in line with MCC approvals[1].

### *Banks' Capital Increase*

According to Article 93 of the 5th FYDP Law and based on the joint recommendation of the Deputy of the Ministry of Economic Affairs and Finance and the Central Bank, the government has been made authorized to allocate part of the after-tax profit of Iran Insurance Company and the banks 100 percent owned by government under the General Policies of Article 44 of the Constitution, as government capital increase in the mentioned company and banks in the framework of annual budget laws.

Moreover, based on Note 35 of the Amendment to the Budget Law for 1395 (approved in Shahrivar 1395), the government was authorized to use the surplus of CBI net foreign assets revaluation account (up to the ceiling of Rls. 450 trillion) for clearance and settlement of CBI claims on banks and raising government capital in public banks as well as interest payment reduction of banks' loan (asset) values lower than one billion rials. The mentioned allocations were to be made after deduction of the required funds from the revaluation account for implementation of Article 46 of the Law for Elimination of Bottlenecks to Competitive Production and Improvement of Financial System (approved in 1394) and the required funds estimated for foreign exchange debt repayment commitments, and required resources for financing the unification of the exchange rate (in case it is implemented). Based on Article 3 of the Executive Bylaw of the mentioned Note[2], the Ministry of Economic Affairs and Finance was authorized to raise government capital in public banks up to Rls. 292.5 trillion out of the CBI foreign assets revaluation account, in coordination with the Plan and Budget Organization and the Central Bank.

### *Monetary and Credit Aggregates*

Given the money and credit policy changes, M2 growth followed a tumultuous trend over the course of the 5th Plan, rising from 20.1 percent in 1390 to 30.0 percent in 1391 and 38.8 percent in 1392[3] and decreasing later to 22.3 percent in 1393. Due to the obligation of the banking system for the implementation of economic stimulus package and the incentive for growth in the production sector, M2 growth rose to 30.0 percent in 1394. With the adoption of monetary disciplinary policies, the growth trend of M2 reversed in 1395 to 23.2 percent, despite continuation of supportive measures including the guaranteed purchase of agricultural products and support for production.

The stabilization of the economy and foreign exchange market in 1393 contained inflation expectations and lowered inflation to 9.0 percent in Esfand 1395. The attainment of a 9.0 percent inflation rate, which was achieved for the second time after the single-digit rate of the year 1369, was a great achievement for the Iranian economy after 26 years.

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[1] MCC authorized the CBI to issue Rls. 100 trillion participation papers in 1391 and Rls. 30 trillion in 1392.

[2] Subject of Cabinet Approval No. E53488I/135579 dated Bahman 13, 1395.

[3] In an effort to enhance the transparency of money and banking data, the CBI raised data coverage by adding the money and banking data of new institutions to the banking system. Therefore, 12.9 percentage points of the total 38.8 percent M2 growth of 1392 is attributed to the mentioned increase. Excluding the 12.9 percentage points growth mentioned herein, the homogenous figure for M2 growth would be 25.9 percent.

### *Factors Affecting Monetary Base Growth*

Over the course of the 5th FYDP, rise in banks' debt to the CBI was the most important factor behind the rise in monetary base. High growth of monetary base due to the large and increasing amount of CBI claims on banks became a daunting problem and a structural issue in banks' management of balance sheet flow of resources. A review of the components of monetary base over the recent years shows that banks' debt to the CBI had contributions of 12.9, 9.2, 11.7, and 21.6 percentage points to the monetary base growth in 1390, 1391, 1392, and 1393, respectively. Meanwhile, the share of growth of the mentioned variable was higher than the total monetary base growth in some years. CBI adopted certain policy measures aimed at organizing banks' debt to the CBI in 1394, among which the development of CHAKAVAK and the change of banks' overdraft facility to lines of credit as well as the deposits in the interbank market are to mention but a few.

**Table 13.19. M2 Growth and Inflation Rate during the 5th FYDP** (percent)

| | 1390 | 1391 | 1392 | 1393 | 1394 | 1395 | Annual average growth[1] |
|---|---|---|---|---|---|---|---|
| M2 | 20.1 | 30.0 | 38.8[2] | 22.3 | 30.0 | 23.2 | 24.6[3] |
| Inflation[4] | 21.5 | 30.5 | 34.7 | 15.6 | 11.9 | 9.0 | 20.2 |

[1] Calculated based on continuous-growth formula.
[2] The homogenous growth figure for M2 (excluding new statistical coverage) would be 25.9 percent for 1392.
[3] M2 figure for 1395 excludes increase in statistical coverage.
[4] CPI for 1395 equals 100.

**Table 13.20. Performance of Monetary and Credit Aggregates during the 5th FYDP** (trillion rials-percent)

| | 1390 | | 1391 | | 1392 | | 1393 | | 1394 | | 1395 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Balance | Growth | Balance | Growth | Balance | Growth | Balance | Growth | Balance | Growth | Balance | Growth |
| **Banks' claims on government** | **488.5** | **4.2** | **699.0** | **43.1** | **886.5** | **26.8** | **1,188.4** | **34.0** | **1,435.4** | **20.8** | **1,857.9** | **29.4** |
| Debt to Central Bank | 93.9 | -45.8 | 131.6 | 40.2 | 158.3 | 20.3 | 183.6 | 16.0 | 244.1 | 33.0 | 273.8 | 12.2 |
| Debt to banks and non-bank credit institutions | 394.6 | 33.4 | 567.4 | 43.8 | 728.3 | 28.4 | 1,004.8 | 38.0 | 1,191.3 | 18.6 | 1,584.1 | 33.0 |
| **Banks' claims on public corporations and institutions** | **150.0** | **77.6** | **211.4** | **40.9** | **223.0** | **5.5** | **277.6** | **24.5** | **303.2** | **9.2** | **339.6** | **12.0** |
| Debt to Central Bank | 125.0 | 152.0 | 182.7 | 46.1 | 191.7 | 4.9 | 242.1 | 26.3 | 276.2 | 14.1 | 302.3 | 9.4 |
| Debt to banks and non-bank credit institutions | 25.0 | -28.4 | 28.7 | 15.0 | 31.3 | 9.1 | 35.5 | 13.4 | 27.0 | -23.9 | 37.3 | 38.1 |
| **Banks' claims on public sector** | **638.5** | **15.4** | **910.4** | **42.6** | **1,109.5** | **21.9** | **1,466.0** | **32.1** | **1,738.6** | **18.6** | **2,197.5** | **26.4** |
| **Banks' claim on non-public sector** [1] | **3,178.6** | **19.5** | **3,738.1** | **17.6** | **4,888.0** | **30.8** | **5,687.2** | **16.4** | **6,655.3** | **17.0** | **8,240.7** | **23.8** |
| **Monetary base** | **764.6** | **11.4** | **975.8** | **27.6** | **1,184.9** | **21.4** | **1,311.5** | **10.7** | **1,533.6** | **16.9** | **1,798.3** | **17.3** |
| **M2** | **3,542.6** | **20.1** | **4,606.9** | **30.0** | **6,395.5** | **38.8** | **7,823.8** | **22.3** | **10,172.8** | **30.0** | **12,533.9** | **23.2** |
| **CPI of goods and services (1395=100)** | **40.3** | **21.5** | **52.6** | **30.5** | **70.9** | **34.7** | **81.9** | **15.6** | **91.7** | **11.9** | **100.0** | **9.0** |

[1] Excludes profit and revenue receivables.

As a result of the mentioned measures, banks' debt to the CBI was lowered and its share in monetary base reached -1.7 percentage points in 1394. Due to the increase in obligations for banks and the deepening of balance sheet difficulties, banks' debt to the CBI again turned to be the most important factor behind the rise in the monetary base in the last year of the Plan, constituting 10.5 percentage points share in the 17.3 percent growth of monetary base.

**Table 13.21. Contribution to Monetary Base Growth during the 5th FYDP**

(percent-percentage points)

| | 1390 | 1391 | 1392 | 1393 | 1394 | 1395 |
|---|---|---|---|---|---|---|
| **Sources** | **11.4** | **27.6** | **21.4** | **10.7** | **16.9** | **17.3** |
| CBI net foreign assets | 19.4 | 2.7 | 93.2 | -7.9 | 26.8 | -0.8 |
| CBI net claims on public sector | -8.6 | 15.6 | -0.7 | -0.5 | 11.4 | 1.3 |
| CBI claims on banks | 12.9 | 9.2 | 11.7 | 21.6 | -1.7 | 10.5 |
| CBI other items (net) | -12.3 | 0.1 | -82.8 | -2.5 | -19.6 | 6.3 |
| **Uses** | **11.4** | **27.6** | **21.4** | **10.7** | **16.9** | **17.3** |
| Notes and coins in circulation | 3.5 | 7.9 | 2.1 | 2.5 | 2.7 | 1.8 |
| Banks' and non-bank credit institutions' deposits with CBI | 7.9 | 19.7 | 19.3 | 8.2 | 14.2 | 15.5 |