CHAPTER ONE

OVERVIEW

Iranian economy enjoyed a stable condition in 1381 (2002/03), the third year of the 3rd Plan. Measures taken by the government during the first three years of the Plan proved successful in curbing inflation, financing production and investment growth, creating job opportunities and increasing foreign exchange resources. Exchange rate unification, establishment of foreign exchange interbank market, continuation of liberalization policy aimed at convertibility of national currency in BOP current account, and further transparency of the government budget especially in the area of subsidy payments were among the salient policies adopted in 1381. In the area of employment, it was planned to provide financial resources required by investment and job creating projects through the mechanism envisaged in the 3rd Plan Law and extension of banking facilities to economically active units and to extend foreign exchange facilities to manufacturers and investors through the Oil Stabilization Fund (OSF).

Although the pace of global recovery proved weaker during this year and despite unfavorable international developments especially political tensions in the Persian Gulf and the increased expectations of war in Iraq, together with certain domestic restrictions resulting from structural impediments to productive and services sectors, Iranian economy kept its positive and long-term balanced growth in production and investment. This was due to the moderate growth in oil prices in tandem with the implementation of the aforementioned policies. Moreover, mild stability in domestic financial market and a balance in external sector, largely due to the adoption of sound economic policies and rise in international crude prices contributed greatly to creating a benign economic growth climate in Iran.

In the review year, certain strategic measures were taken to improve foreign trade. The approval of the Foreign Investment Act, elimination of surrender requirement for exports, reduction of operational expenses, and provision of export subsidies were among the mentioned measures and policies. Approval of the new Tax Law and Tax Consolidation Bill were among other bold measures taken to pave the ground and formulate legal framework to enhance transparency and support domestic manufacturing units in the area of adjusting the commercial profit rates. In this year, for the first time, Iran's Eurobonds were issued with two placements in international markets and sold out.

In 1381, in line with liberalization of financial market, permits were issued for the establishment of private insurance companies. Moreover, issuance of participation papers, to finance development projects was expanded in the review year. As a matter of fact, issuance of participation papers is a key instrument which not only finances productive and manufacturing projects, but also reduces dependence of productive units on banking sources.

Adoption of the above mentioned policies brought about positive and significant improvements in all economic sectors (services, agriculture, manufacturing and mining and oil), bringing the GDP growth to 7.5 percent in 1381, compared with the previous year. This growth is noticeable compared with the performance of the past two decades and more than the target growth set in the 3rd Plan (6 percent). Part of this production growth helped in building economic capacity in the form of gross domestic fixed capital formation including machinery and construction, which grew by 11.8 percent compared to the previous year. On the other hand, since population growth rate remained almost unchanged during the course of 1381, per capita income at current and constant 1376 prices reached Rls. 12,010 and 4,816 thousand, respectively.

In 1381, government support policies in agriculture sector in the form of supply of agricultural inputs at support prices, guaranteed purchase of basic agricultural crops and extending banking facilities at preferential rates, in tandem with increase in precipitation level raised the area under cultivation and growth in yield per hectare of agricultural crops.

Having been adhered to production quota set by the OPEC and to meet OPEC approvals, Iran reduced its crude production by 8.5 percent to 3.4 mb/d to regulate market and stabilize oil prices. In this context, crude oil export was also reduced by 8.5 percent to 2 mb/d, and export of oil products edged up by 23.4 percent to reach 269,000 b/d.

Despite certain structural impediments to manufacturing sector, the value-added of manufacturing and mining sectors at constant 1376 prices grew by 11 and 12 percent respectively compared to the previous year, more than the target figures projected for this year.

Construction activities proved stronger in 1381, in a way that the value-added of construction sector edged up by 17.4 percent, higher than the 9.6 percent target set in the 3rd Plan.

The remarkable growth of investment, especially private sector investment, and banking facilities extended out of Gharz-al-hasaneh deposits and administered funds played a significant role in reducing unemployment. Based on the data drawn by Statistical Center of Iran, unemployment rate fell by 2.5 percentage points from 14.7 percent in Bahman, 1380 to 12.2 percent in Bahman, 1381.

To enhance budget transparency, the Budget Law for 1381 was designed and prepared on the basis of GFSM 2001 methodology as the latest international standards. Inclusion of the impact of exchange rate unification in the budget was another measure taken to enhance budget transparency, especially in subsidies. Since the beginning of 1381, the new "Direct Tax Law" was put into effect and a new Tax Affairs Organization was also established. The 1381 Budget Law was formulated in the framework of the 3rd Plan, while no borrowing from the banking system was allowed.

As is shown by the 1381 Budget performance, government revenues reached Rls. 62,108.6 billion. Moreover, expenses reached Rls. 148,297.3 billion. As a result, the operating balance ran a deficit of Rls. 86,188.7 billion.

In the review year, government receipts out of disposal of non-financial assets amounted to Rls. 103,101.6 billion. Acquisition of non-financial assets (development expenditures) reached Rls. 37,212.5 billion. Thus, the net disposal of non-financial assets equaled Rls. 65,889.1 billion.

The sum of operating balance and the net disposal of non-financial assets ran a deficit of Rls. 20,299.6 billion, 20 percent less than the approved budget. This figure, namely budget deficit, was totally financed through net disposal of financial assets, including sales of participation papers, privatization proceeds, principal of domestic loans, unspent cash carried over from previous years and utilization from the OSF.

External sector of the economy faced extensive deregulation in 1381. Successful implementation of exchange rate unification and the continued structural reforms in foreign trade were among the salient achievements in this sector. In order to facilitate this process, the managed float exchange rate regime was applied, amid implementation of exchange rate unification policy and establishment of foreign exchange interbank market. Adjustment in foreign trade rules and regulations and provision of facilities such as granting the exporters more free hand in managing their foreign exchange revenues, extending rial and foreign exchange facilities to foreign trade sector, elimination of LCs surrender requirement, exemption of exports from taxes and levies, allocation of export rewards and subsidies and bringing stability in foreign exchange market altogether facilitated foreign trade and promoted non-oil export. The upshot was a 15.5 percent surge in non-oil exports to reach $ 5,271 million. In this context, imports edged up by 21.6 percent to $ 22,036 million in the review year. Therefore, the trade balance, with the inclusion of oil exports, ran a surplus of $ 6,201 million, up by 7.4 percent compared to the previous year. The current account balance and capital account of BOP registered $ 3,585 and 2,534 million surplus, respectively. This raised the CBI's foreign assets and the OSF by $ 3,883 and 784 million, respectively, bringing $ 4,667 million surplus in the overall balance of BOP. In this year, the amount of foreign exchange obligations from $ 21.8 billion in the beginning of the year (including interest and potential obligations) amounted to $ 27.2 billion at the end of the year, up by 24.9 percent. Although the total external debts rose by 28.2 percent to $ 9,250 million, the share of short-term external debts plummeted drastically.

Developments in money and banking sector were manifested in two domains: First, banks were authorized to extend 25 percent of increase in the outstanding of non-public sector facilities free from sectoral allocations. Thus, considering banks' authority over free uses, the share of facilities in all sectors except for export sector proved higher than the approved shares. Second, expected rates of return on facilities in various economic sectors were reduced by one percentage point. In the review year, a total of Rls. 27,300 billion participation papers were issued by the government, companies and the Central Bank .Of this figure, Rls. 25,631 billion (93.9 percent) were sold. In line with implementation of monetary policies and to control liquidity the CBI issued Rls.18 trillion participation papers of one-year maturity in four placements, Rls. 17,054 billion of which were sold. In this year, all participation papers offered by the CBI amounting to Rls. 9,445 billion substituted for the previously matured ones, while Rls. 7,606.8 billion new participation papers were sold. In this year, liquidity grew by 30.1 percent due to increase in monetary base and money multiplier. Monetary base showed a remarkable growth of 23.1 percent when compared with 15.2 percent growth in the previous year. This was largely due to the rise in CBI's foreign assets. Money multiplier grew at a slower pace (5.7 percent) than the previous year. This was primarily attributable to reduction in the weighted ratio of legal reserves to total deposits, driven by changes in the composition of deposits. The major factor responsible for liquidity growth was increase in banks' claim on non-public sector.

Capital market performed remarkably well in 1381 in the sense that the boom was manifested in all stock indices in the Tehran Stock Exchange (TSE). In this year, share price and cash dividend yield indices enjoyed unprecedented growth of more than 51 percent, and the TSE stood the third among world stock exchanges with respect to growth in total price index.

The number and value of shares traded grew markedly by 143 and 190.8 percent, respectively. This was largely driven by inflationary expectations, excess liquidity growth in recent years, slowdown observed in other markets, inflow of capital with foreign origin (especially capital of Iranians abroad).

In the wake of factors affecting aggregate demand and supply, administrative approvals leading to price rise and public uncertainties resulting in inflationary expectations, the declining trend of inflation rate, which had continued during 1378-80, reversed and climbed to 15.8 percent, 4.4 percentage points more than the inflation rate in 1380.