CHAPTER 11 FOREIGN EXCHANGE AND TRADE POLICY

Balance of Payments

Continued rise in world crude oil price together with facilitation in foreign trade and liberalization of foreign exchange transactions as the targets set in the 4th FYDP affected balance of payments in 1384. The concomitant rise in price and amount of oil and gas export raised export proceeds (including exports of crude oil, oil products, condensates and natural gas) to $53,820 million, up by 48.2 percent.

Extension of facilities (in rial and foreign exchange) to exporters of goods and services, exemption of exports from taxes and levies, and grant of export rewards and subsidies, together with relative stability of foreign exchange market, raised non-oil exports from $7,537 million in 1383 to $10,546 million in 1384, showing a growth of 39.9 percent. Significant rise in the exports of petrochemicals, construction materials and metals, as well as transportation vehicles and their spare parts and mineral-metallic ores were largely responsible for this growth.

Liberalization of foreign trade during the past years in the absence of appropriate exchange rate adjustment resulted in a surge in imports from $38,199 million in 1383 to $43,085 million in 1384. This shows 12.8 percent rise. Imports of mineral products, fuels, industrial oils and grease, with a growth of 37.9 percent and a share of 10.7 percent in total imports as well as surge in imports of machinery and transportation vehicles, with a share of 43.9 percent in total imports, were largely responsible for the changes in the trend of imports in this year. Thus, the trade balance posted a surplus of $21,281 million, indicating a remarkable rise of 276.5 percent compared with the respective figure of the previous year.

BALANCE OF PAYMENTS (million dollars)

	1381	1382	1383	1384
Current account balance	3,585	816	1,442	16,637
Capital account (net)	2,534	4,476	7,388	-184
Changes of exchange rate	-210	-506	1,213	-1,000
Errors and omissions	-1,242	-1,076	-1,312	-1,879
Overall balance (change in international reserves)	**4,667**	**3,710**	**8,731**	**13,574**

Services account ran a deficit in 1384 as before. On the receipts side, freight and insurance and tourism (passenger and travel services), with $2,196 and 1,364 million, respectively, made up 46.1 percent of foreign exchange receipts of services account. On the payments side, freight and insurance, tourism (passenger and travel services) and foreign investment expenses, with $1,240, 4,560 and 1,169 million, respectively, accounted for 53.2 percent of foreign exchange payments of this sector. As a result, the services account ran a deficit of $5,379 million in the review year. This, along with the 7.4 percent rise in the deficit of services account compared with the previous year, represents continued trend of imports of services (net).

Transfers account (net) ran a surplus of $735 million, mostly due to remittances of Iranians residing abroad. Current account registered a surplus of $16,637 million, representing 1,053.7 percent growth as compared with $1,442 million of the year before.

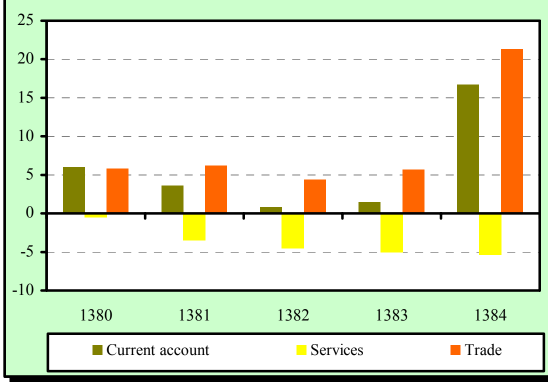
The developments in foreign trade transactions of goods and services led to the growth in the current account balance surplus from $1.4 billion in the previous year to $16.6 billion in the review year. This was basically due to the benign international crude oil market condition. Moreover, deficit in non-oil current account balance went up in 1384.

CURRENT ACCOUNT BALANCE (million dollars)

					Percentage change	
	1381	1382	1383	1384	1383	1384
Current account balance	3,585	816	1,442	16,637	76.7	⊡
Current account balance (non-oil)	-19,381	-26,539	-34,873	-37,183	31.1	6.6

Capital account recorded a deficit of $184 million, which is attributable to $990 million surplus in the long-term and $1,174 million deficit in the short-term accounts. Long-term public account posted a surplus of $658 million, owing to creation of new debts, the main items of which resulted from new buy-back contracts obligations, finances, and debts to the World Bank. In 1384, $2,479 million was paid on account of buy-back contracts, and $2,817 million new buy-back obligations were created out of these contracts. The "other" in the long-term account posted a surplus of $332 million, due to the rise in foreign direct investment. The total of net foreign reserves of the CBI and the OSF (overall balance of payments) surged by $13,574 million.

Figure 11.1. Current Account Balance Components
(billion dollars)



Foreign Trade Performance

Foreign exchange and trade policies of the previous years continued and boosted foreign trade in 1384, assisted with favorable international market for exportable goods. In this line, the value of exports reached a record high of $10 billion while imports appear to have lost some momentum and plummeted to less than $40 billion. Therefore, non-oil sector proved successful in financing 27 percent of imports requirements.

Non-oil exports grew at a brisk pace (53 percent) to $10,474 million in 1384. The weight of exported goods amounted to 24,983 thousand tons, showing 38.2 percent growth compared with what was recorded in the same period last year. The unit value of exported goods, with 10.7 percent rise, stood at $419.

The value of imports (cif) went up by 10.9 percent to $39,248 million, against $35,389 million in the previous year. The weight of imported goods reached 35,466 thousand tons, showing 3.0 percent growth compared with the same figure for 1383. The unit value of imported goods rose by 7.7 percent from $1,027 in 1383 to $1,107 in 1384.

FOREIGN TRADE
(excluding oil, gas and electricity)

				Percentage change		Share (percent)		
	1382	1383	1384	1383	1384	1382	1383	1384
Value (million $)								
1. Imports	26,598	35,389	39,248	33.1	10.9	81.7	83.8	78.9
2. Exports	5,972	6,847	10,474	14.7	53.0	18.3	16.2	21.1
Deficit (2-1)	-20,626	-28,542	-28,773	38.4	0.8	-63.3	-67.6	-57.9
Total (1+2)	**32,570**	**42,236**	**49,722**	**29.7**	**17.7**	**100.0**	**100.0**	**100.0**
Weight (thousand tons)								
1. Imports	30,106	34,448	35,466	14.4	3.0	66.1	65.6	58.7
2. Exports	15,467	18,077	24,983	16.9	38.2	33.9	34.4	41.3
Total (1+2)	**45,573**	**52,525**	**60,448**	**13.1**	**15.3**	**100.0**	**100.0**	**100.0**

Source: Foreign Trade Statistics

Imports

Composition of imports (1) in the review year reveals that the highest growth was related to consumer goods (30.2 percent). Share of this group in total imports grew from 10 percent in 1383 to 11.7 percent in 1384. This trend represents the extent of imports composition susceptibility to exchange rate fluctuations. Thus, a rise in imports of consumer goods could be largely attributed to the appreciation of national currency.

Import of consumer goods and capital goods experienced a downward trend in 1384. Growth in the import of capital goods reached 13.6 percent against 46 percent in 1383 and its share in total imports went up from 22.9 percent to 23.5 percent in the review year. Imports of raw materials and intermediate goods, with 64.8 percent, still took the highest share in imports and in terms of value it grew by 7.1 percent compared with 1383.

(1) As of 1384, the "Broad Economic Classification" prepared by the United Nations (UN) is used.

COMPOSITION OF IMPORTS BY USE (million dollars)

				Percentage change		Share (percent)		
	1382▲	1383▲	1384	1383	1384	1382	1383	1384
Raw materials and intermediate goods	18,520	23,733	25,423	28.1	7.1	64.8	67.1	64.8
Capital goods	5,563	8,120	9,221	46.0	13.6	23.5	22.9	23.5
Consumer goods	2,515	3,536	4,603	40.6	30.2	11.7	10.0	11.7
Total	**26,598**	**35,389**	**39,248**	**33.1**	**10.9**	**100.0**	**100.0**	**100.0**

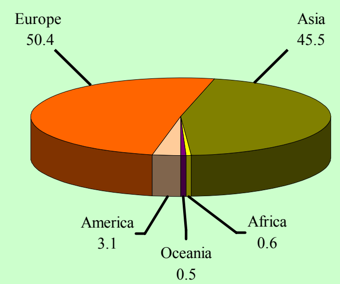
Composition of imports by the international classification of goods indicates that imports of machinery and transportation vehicles, with 43.9 percent share in total imports, enjoyed the highest share in the review year.

The top five exporting countries to Iran were the United Arab Emirates, Germany, France, Italy and China, which together accounted for 51.2 percent of Iran's imports in 1384.

Distribution of imports by continents indicates higher share for Europe and Asia, so that the total value of imports from these two continents amounted to $19,767 million for Europe and $17,845 million for Asia, indicating 50.4 and 45.5 percent share for Europe and Asia, respectively.

Review of imports by group of countries reveals that imports from the European Union, with 7.5 percent growth, grew from $14,649 million in 1383 to $15,752 million in 1384, accounting for 40.1 percent of total imports. The ESCAP member countries, with 25.7 percent share in total imports, ranked the second exporter group with $10,093 million exports to Iran.

Figure 11.2. Distribution of Imports by Continents in 1384
(percent)



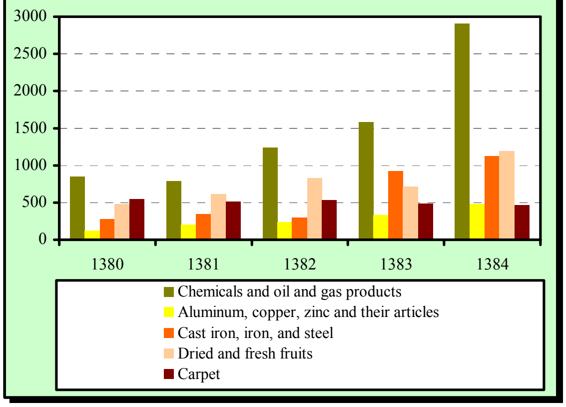
IMPORTS ACCORDING TO INTERNATIONAL CLASSIFICATION OF GOODS (million dollars)

				Percentage change		Share (percent)	
	1382▲	1383▲	1384	1383	1384	1383	1384
Machinery and transportation vehicles	12,005	15,825	17,217	31.8	8.8	44.7	43.9
Goods classified according to their composition	5,445	7,182	8,266	31.9	15.1	20.3	21.1
Mineral products, fuels, industrial oils and grease	1,319	3,044	4,198	130.8	37.9	8.6	10.7
Chemicals	3,391	4,208	4,191	24.1	-0.4	11.9	10.7
Others	4,437	5,130	5,376	15.6	4.8	14.5	13.6
Total	**26,597**	**35,389**	**39,248**	**33.1**	**10.9**	**100.0**	**100.0**

Non-oil Exports

During the review year, a total of 24,983 thousand tons of non-oil goods worth $10,474 million were exported, indicating 38.2 and 53.0 percent rise in weight and value, respectively, compared to the preceding year. Sharp rise in the export value of chemicals, [1] owing to the continued rise in the price of crude oil and oil products as well as metals, were the driving forces behind the surge in non-oil exports to more than $10 billion in 1384.

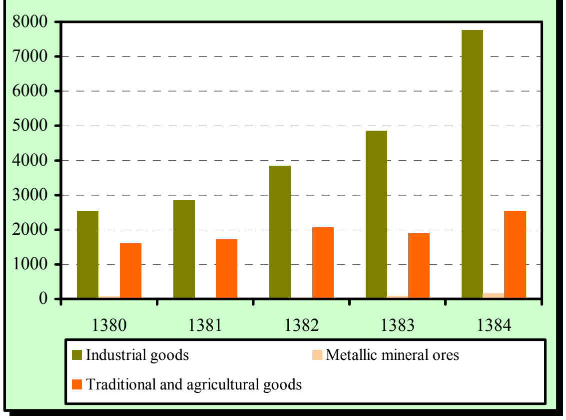
Figure 11.3. Major Non-oil Exports
(million dollars)



According to the data released by the Customs, export of chemicals (comprising oil and gas products, as well as organic and inorganic chemical products) went up by 83.9 percent to $2,910 million in 1384, against $1,582 million in 1383. This growth called for taking into consideration a host of factors including, inter alia, improved global prices, increase in export capacities owing to operation of new production units of chemicals and petrochemicals and the factor of change in the composition of export basket and increase in the share of higher value-added goods in the export basket of chemicals. Moreover, the 27.5 percent rise in export of metals (cast iron, iron, steel, aluminum, copper and zinc) and metallic products, as well as the 66.9 percent growth in the export of dried and fresh fruits in 1384 were other reasons behind the mentioned growth.

Export of industrial goods grew exponentially by 59.7 percent to $7,760 million in 1384, against $4,860 million in 1383. This raised their share in non-oil exports from 71 percent in 1383 to 74.1 percent in 1384. The rapid growth in export of chemicals and iron, cast iron and steel was largely responsible for growth of industrial goods. By and large, significant rise in global price of major exported goods, in tandem with increase in export volume, were the main drivers behind the increasing trend of export of industrial goods.

Figure 11.4. Exports (excluding oil and gas)
(million dollars)



The geographical distribution of non-oil exports reveals that the first five trade partners of Iran (United Arab Emirates, Iraq, India, Japan, and China) together imported a total of $4,599.7 million, i.e. 43.9 percent of total non-oil exports. Moreover, the lion's share of exports went to the ESCAP member countries by 41.3 percent. The share of the Asian Clearing Union (ACU) member countries in total non-oil exports stood at 10.3 percent, although Iran's

(1) As of 1384, the Harmonized System and its subdivisions for description and coding of goods prepared by the World Customs Organization (WCO) are used.

export to these countries grew by 70.7 percent. In addition, the value of exports to EU member countries was limited to $1,282 million (10.3 percent).

Utilization of External Sources and Foreign Exchange Obligations

Total foreign exchange obligations (including actual and contingent obligations) increased from $41,769 million at the beginning of 1384 to $41,853 million at year-end, signifying 0.2 percent growth. Due to changes in the composition of contingent obligations and external debt (actual obligations), share of contingent obligations plummeted from 44.8 percent in 1383 year-end to 42.0 percent at the end of 1384.

EXTERNAL OBLIGATIONS (million dollars)

Year-end	1385	1386	1387	1388	From 1389 onwards
Amount	12,811	2,745	2,449	1,749	4,510

EXTERNAL OBLIGATIONS (million dollars)

	Year-end		Percentage change
	1383▲	1384	1383-84
Contingent obligations	**18,695**	**17,589**	**-5.9**
External debt	**23,074**	**24,264**	**5.2**
Short-term debts	10,253	10,686	4.2
Long-term debts	12,821	13,578	5.9
Project finance	4,624	4,501	-2.7
Finance	4,034	4,258	5.6
Loans extended from abroad without banking system guarantee	1,619	2,243	38.5
Total	**41,769**	**41,853**	**0.2**

External debt grew by 5.2 percent from $23,074 million to $24,264 million. The $1,190 million increase resulted from the rise in short-term debts by $433 million as well as medium- and long-term debts by $757 million. Loans extended from abroad without banking system guarantee, with $624 million increase, and oil prefinance, with $201 million decrease, had the greatest effect on the medium- and long-term external debt fluctuations.

The share of short-term debts, by maturity, plummeted from 44.4 percent in 1383 year-end to 44.0 percent at the end of 1384. This reduction, despite legal restrictions on financing, indicates improvement in flexibility of external debts.

Change in International Reserves

Change in Iran’s international reserves by $13,574 million in 1384 is in part related to changes in the OSF account. Notwithstanding the substantial withdrawals by the government and allocation of resources to finance private sector projects, the balance (cash) of the mentioned account recorded $1,209 million rise.

Oil Stabilization Fund (OSF)

In 1384, management of the OSF passed one of its most difficult years since its establishment. Amid record oil prices, the OSF account amounted to an unprecedented level of

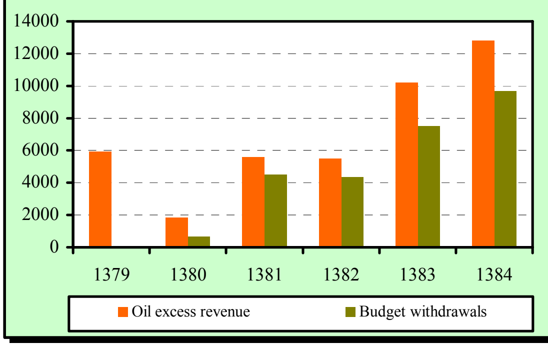
$19 billion. This figure is roughly 40 percent of the total excess oil revenues allocated to the OSF account since its inception.

Considering operation of several projects financed through the OSF, and increase in the amount of matured facilities, $171 million of the principal of the facilities extended was repaid in the review year. Thus, sources of the OSF amounted to $19,628 million at year-end 1384, showing a growth rate of 87 percent when compared with the previous year-end.

Out of total foreign exchange uses in 1384 ($11,996 million), public sector took an 80.7 percent share ($9,682 million). Therefore, the government withdrawals from the OSF increased by 28.9 percent as compared with the previous year.

Figure 11.5. Oil Excess Revenue and Budget Withdrawals from the OSF since its Establishment

(million dollars)



The balance of the OSF at the end of 1384 amounted to $16,401 million, showing 25.7 percent growth compared with the previous year. Of this amount, $10,686 million was in cash and the remaining in the form of claims.

OIL STABILIZATION FUND (million dollars)

	1382▲	1383▲	1384	Percentage change 1383-84
Sources	**5,798**	**10,484**	**13,204**	**25.9**
Oil excess revenue	5,508	10,207	12,805	25.4
Uses	**5,436**	**9,450**	**11,996**	**26.9**
Budget withdrawals	4,361	7,513	9,682	28.9
Extended facilities	1,076	1,937	2,313	19.4
Cash balance (year-end)	**8,443**	**9,477**	**10,686**	**12.8**
Claims re: extended facilities	**1,737**	**3,573**	**5,715**	**60.0**
Balance (year-end)	**10,180**	**13,050**	**16,401**	**25.7**

Foreign Exchange and Gold Markets

The significant growth of foreign exchange revenues, owing to continued oil price rise in the international markets during the past years, could help policy makers to better manage foreign exchange fluctuations than before. Rial parity rate against the US dollar remained relatively unchanged in 1384. The misalignment of nominal exchange rate with the gap of internal and external inflation led to the appreciation of rial against hard currencies. This trend raised the deficit in the current account (non-oil) through reducing real sector's competitiveness. Transactions in the interbank market registered growth in 1384. This was due to the surge in imports and banks' further use of domestic sources, which was in turn owing to rise in international interest rates. The benign position of the OSF against the backdrop of international oil price hikes raised banks' capability to domestically finance, thus reducing the cost of foreign exchange transactions.

Parity Rate of the National Currency against Hard Currencies

Foreign exchange market enjoyed a relatively stable condition in 1384. The annual average rate of US dollar in interbank market (reference rate) equaled Rls. 9,026, showing 3.5 percent growth compared with the previous year figure of Rls. 8,719: 1 US dollar. The annual average rate of rial against euro and pound was devalued by 0.4 percent in this year, while it was slightly strengthened against Japanese yen and Swiss franc.

Standard deviations of reference rate of the mentioned currencies indicate that the highest fluctuations are related to rial parity rate with the pound, with a standard deviation of Rls. 362.6. This was followed by euro with a standard deviation of Rls. 247.4 and Swiss franc with Rls. 169.1.

RATE OF MAJOR CURRENCIES IN THE OFFICIAL EXCHANGE RATE MARKET (MAIN INTERBANK MARKET) (1)

(rials)

	1381		1382		1383		1384		Percentage change 1383-84	
	Annual average	Standard deviation	Annual average	Standard deviation	Annual average	Standard deviation	Annual average	Standard deviation	Annual average	Standard deviation
Dollar	7,958	38.7	8,282	91.9	8,719	107.6	9,026	73.2	3.5	-32.0
Euro	7,892	488.2	9,706	553.9	10,959	566.2	11,004	247.4	0.4	-56.3
Pound	12,315	487.4	13,962	893.0	16,077	567	16,136	362.6	0.4	-36.1
Yen	65	2.2	73	4.0	81	3.1	80	2.6	-1.2	-16.2
Swiss Franc	5,388	331.4	6,280	288.7	7,129	379	7,099	169.1	-0.4	55.4

(1) Main interbank market is located in Tehran.