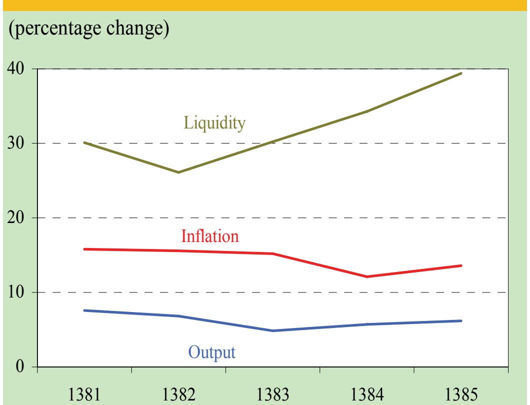
CHAPTER 12

MONETARY AND BANKING POLICY AND PERFORMANCE

Objectives Stipulated in the 4th FYDP

The 4th FYDP in the post-revolutionary era and the first of the four Plans of the 20-Year Vision Plan passed the second year of implementation in 1385. According to the 4th FYDP Law, allocation of banking facilities by the government in the form of sectoral or regional, as well as priorities concerning the sectors and regions shall be carried out through giving incentives to the banking system. Obligations of banks to provide facilities at lower rates are permissible provided that they are financed by the government subsidy or administered funds. In accordance with the 4th Plan, at least 25 percent of the facilities extended by all banks shall be allocated to water and agriculture sector, and the increase in the outstanding directed facilities shall be reduced by 20 percent per annum on average over the Plan's period compared to the approved figure for 1383. Moreover, the government is obliged to reduce its indebtedness to Central Bank and banks through inclusion of the repayment amounts in annual budgets. According to quantitative targets of the 4th Plan, the average rate of inflation and liquidity growth are set at 9.9 and 20 percent, respectively, over the Plan's period. Therefore, the inflation rate and liquidity growth for the second year of the Plan are set at 11.5 and 22 percent, respectively.

Figure 12.1. Major economic variables



Key Monetary Policies Approved in 1385

In accordance with the Parliament's approval of "Rationalization of the Rate of Return on Banking Facilities", the government and the CBI are obliged to administer the mechanisms to mobilize and allocate banking resources in a manner that the expected rate of return on the banking facilities for contracts with fixed return decreases during the 4th FYDP. Such decrease shall lead to realization of a single-digit rate of return on banking facilities by the end of the said Plan. On this basis, rates of return were set by the Money and Credit Council (MCC) as follows:

1. For transaction contracts such as hire purchase, installment sale, forward transactions, and joaleh, the rate of return on extended facilities for public banks was determined at 14 percent and for private banks and non-bank credit institutions at 17 percent.

2. The provisional profit rate of banking deposits with public banks was set within a range of 7 percent for short-term to 16 percent for five-year long-term deposits.

3. Based on the Cabinet approval on Ordibehesht 17, 1385, the rate of return on the facilities extended to the agriculture sector was set at 2.5 percentage points less than the rate approved by the MCC. Moreover, the Management and Planning Organization, as government's representative, was required to finance the 11.5 percent differential rate of agriculture sector with other sectors to agent banks.

4. According to the Budget Law for 1385, an increase in the outstanding directed banking facilities, observing other objectives stipulated in development plans, was authorized up to Rls. 1,800 billion. The share of public sector out of this increase is 25 percent and that of cooperative and private sectors 75 percent.

5. According to the executive by-law on expansion of Small and Medium Enterprises (SMEs), commercial and specialized agent banks were obliged to extend up to 35 percent of credits worth Rls. 180 trillion to SMEs in 1385.

6. In accordance with the Parliament's approval and in pursuance of the 4th Plan Law, the CBI was authorized to issue participation papers up to Rls. 20 trillion to mop up excess liquidity. Moreover, the CBI was authorized to issue participation papers worth Rls. 10 trillion, in the second half of 1385, to substitute the previous papers which would be matured during the last four months of the year. The provisional profit rate of CBI participation papers was 15.5 percent.

7. Based on the Budget Law for 1385, and in pursuance of the 4th Plan Law, the government was allowed to allocate up to $8 billion out of the OSF account for investment and promotion of exports to finance part of the credits needed by the non-public sector for the projects, the feasibility study of which is confirmed by the related specialized ministries. This could be achieved through domestic banking network and Iranian banks abroad in the form of foreign exchange facilities which require necessary guarantee for their repayment.

8. The MCC approved the increase in the minimum required capital for establishment of private banks and non-bank credit institutions to Rls. 3,500 and 1,500 billion, respectively, on the recommendation of the Central Bank.

9. In accordance with the Cabinet approval, and by virtue of the Monetary and Banking Law of Iran, the capital of the Central Bank was increased from Rls. 2,500 billion to Rls. 3,800 billion.

Banking System [1] Performance

Banking system assets and liabilities rose 30.6 percent to Rls. 3,082,209.2 billion. Claims on the non-public sector, with 41.7 percent growth in the assets side, and liquidity, with a rise of 39.4 percent in the liabilities side, contributed significantly to the rise in assets and liabilities, respectively.

(1) Banking system includes Central Bank, public commercial and specialized banks, private banks, and non-bank credit institutions.

MAJOR ITEMS IN THE ASSETS AND LIABILITIES OF THE BANKING SYSTEM

(billion rials)

	Year-end balance			Percentage change	
	1383	1384	1385	1384	1385
Assets	**1,787,300.5**	**2,359,396.4**	**3,082,209.2**	**32.0**	**30.6**
Foreign assets	592,646.9	770,170.4	928,552.5	30.0	20.6
Central Bank	299,677.9	428,172.1	563,869.5	42.9	31.7
Public banks (1)	289,365.2	323,924.8	349,748.1	11.9	8.0
Private banks and non-bank credit institutions (2)	3,603.8	18,073.5	14,934.9	401.5	-17.4
Claims on public sector	235,940.9	235,607.7	256,219.8	-0.1	8.7
Claims on non-public sector	625,714.9	865,315.4	1,226,201.0	38.3	41.7
Others	332,997.8	488,302.9	671,235.9	46.6	37.5
Liabilities	**1,787,300.5**	**2,359,396.4**	**3,082,209.2**	**32.0**	**30.6**
Liquidity (M2)	685,867.2	921,019.4	1,284,199.4	34.3	39.4
Deposits and funds of public sector	97,773.4	167,667.4	220,621.4	71.5	31.6
Foreign liabilities	385,919.7	471,435.8	503,521.7	22.2	6.8
Central Bank	116,398.5	170,605.1	192,674.1	46.6	12.9
Public banks	265,882.9	284,390.1	295,374.7	7.0	3.9
Private banks and non-bank credit institutions (2)	3,638.3	16,440.6	15,472.9	351.9	-5.9
Others (3)	617,740.2	799,273.8	1,073,866.7	29.4	34.4

(1) As of Shahrivar 1384, it includes Post Bank.

(2) Includes Karafarin, Saman, Eghtesad-e-Novin, and Parsian private banks and the Non-bank Credit Institution for Development. It also includes Pasargad private bank as of Bahman 1384 and Sarmayeh private bank since Shahrivar 1385.

(3) Includes capital account of the banking system, advance payments on public sector LCs and import order registration deposits of the non-public sector.

Banking System and the External Sector

Net foreign assets of the banking system grew by 42.3 percent (Rls. 126,296.2 billion) to Rls. 425,030.8 billion, due to Rls. 113,628.4 billion rise in CBI's net foreign assets and Rls. 12,667.8 billion growth in net foreign assets of banks and non-bank credit institutions. Increase in CBI's net foreign assets was largely attributable to foreign exchange purchases from the government based on the Budget Law, which were partly sold in the market, as well as frequent withdrawals from the OSF.

Banking System and the Public Sector

Banking system's net claims on the public sector dipped by Rls. 32,341.9 billion to Rls. 35,598.4 billion in 1385. Central Bank's claims on the public sector grew by 6.7 percent, owing to 2.8 percent rise in government indebtedness and 24.5 percent growth in public corporations' and institutions' indebtedness.

Of the total CBI's claims on the government, 34.7 percent, or Rls. 36,130.9 billion, was related to the deficit in foreign exchange obligations account, which went up by Rls. 10.6 billion as compared with the previous year. Public sector deposits with the CBI rose 30.8 percent owing to 33.4 percent increase in government deposits and 7.1

CHANGE IN NET CLAIMS OF THE BANKING SYSTEM ON PUBLIC SECTOR

(billion rials)

	1384	1385
Public sector	**-70,227.2**	**-32,341.9**
Central Bank (1)	-57,342.6	-27,086.0
Commercial & specialized banks	-16,126.8	-9,615.5
Private banks and non-bank credit institutions	3,242.2	4,359.6
Government	**-78,543.8**	**-27,678.7**
Central Bank (2)	-54,589.1	-31,665.5
Commercial & specialized banks	-27,196.9	-372.8
Private banks and non-bank credit institutions (3)	3,242.2	4,359.6
Public corporations & institutions	**8,316.6**	**-4,663.2**
Central Bank	-2,753.5	4,579.5
Commercial and specialized banks (4)	11,070.1	-9,242.7
Private banks and non-bank credit institutions	0	0

(1) To net this item, advance payments on public sector LCs are not deducted from public sector indebtedness.

(2) It includes deficit in foreign exchange obligations account.

(3) It includes public sector participation papers only.

(4) It includes indebtedness for exchange rate differential.

percent growth in public corporations' and institutions' deposits.

DIRECTED FACILITIES EXTENDED ACCORDING TO THE 1385 BUDGET LAW (1) (billion rials)

	Change in outstanding	
	Budget ceiling	Approved (2)
Social and cultural	230	224
Job creation	1,140	409
Market regulation	0	0
Production and infrastructure	430	149
Total	**1,800**	**782**

(1) Figures only point to change in outstanding facilities, not to the amount of extended facilities.
(2) The approved figures are equal to actual figures.

Government indebtedness to banks and non-bank credit institutions surged by 62.6 percent (Rls. 21,634.9 billion) to Rls. 56,174.5 billion in 1385, mainly owing to the rise in its indebtedness by Rls. 12,008 billion, and an increase in the amount of government participation papers with banks and non-bank credit institutions by Rls. 9,626.8 billion.

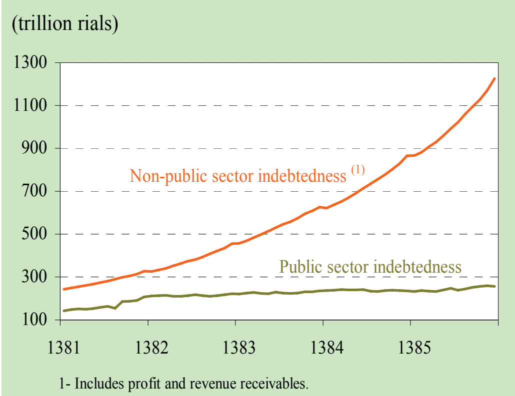
Banks and the Non-public Sector

Banking system credit performance in 1385 reveals that facilities [1] extended to the non-public sector, excluding profit and revenue receivables, grew by Rls. 321,520.3 billion (43.2 percent). Non-public sector enjoyed the lion's share of 90.4 percent of total facilities provided by banks [2]. Of these facilities, Rls. 180 trillion were in the form of directed facilities and extended on the basis of the executive by-law on the expansion of SMEs.

Outstanding facilities extended by public commercial and specialized banks to the non-public sector, excluding profit and revenue receivables, went up by 39.9 and 36.1 percent, respectively. Outstanding facilities extended by private banks and non-bank credit institutions soared by 77.4 percent to Rls. 143,048.2 billion. Therefore, the share of private banks and non-bank credit institutions in total facilities extended to the non-public sector grew markedly to 13.4 percent at end-1385, against 10.8 percent at end-1384.

According to the 4th Plan Law, at least 25 percent of banking facilities were allocated to water and agriculture sector. The largest amount of facilities extended to the non-public sector belonged to domestic trade, services and miscellaneous, construction and housing, manufacturing and mining, agriculture, and exports sectors.

Figure 12.2. Outstanding facilities extended by banking system to public and non-public sectors



OUTSTANDING FACILITIES EXTENDED BY BANKS AND NON-BANK CREDIT INSTITUTIONS TO NON-PUBLIC SECTOR (1) (billion rials)

	Year-end balance			Percentage change		Share (percent)		
	1383	1384	1385	1384	1385	1383	1384	1385
Commercial banks	385,069.0	501,366.3	701,574.1	30.2	39.9	71.8	67.3	65.8
Specialized banks	114,298.6	163,039.5	221,926.2	42.6	36.1	21.3	21.9	20.8
Private banks and non-bank credit institutions	36,782.8	80,622.4	143,048.2	119.2	77.4	6.9	10.8	13.4
Total	**536,150.4**	**745,028.2**	**1,066,548.5**	**39.0**	**43.2**	**100.0**	**100.0**	**100.0**

(1) Excludes profit and revenue receivables.

(1) Includes overdue and non-performing claims.
(2) Excludes profit and revenue receivables.

SHARE OF ECONOMIC SECTORS IN INCREASE IN OUTSTANDING FACILITIES EXTENDED BY BANKS AND NON-BANK CREDIT INSTITUTIONS TO NON-PUBLIC SECTOR (1)

(percent)

	1384			1385		
	Public banks	Private banks and non-bank credit institutions	Banks and credit institutions	Public banks	Private banks and non-bank credit institutions	Banks and credit institutions
Agriculture	18.0	0	14.3	19.1	0	15.9
Manufacturing and mining	25.5	32.6	27.0	22.1	15.1	21.0
Construction and housing	22.9	23.6	23.1	23.7	21.8	23.4
Exports	1.8	-0.1	1.4	0.7	-0.6	0.5
Domestic trade, services, and miscellaneous	31.8	43.9	34.2	34.4	63.7	39.2
Total	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

(1) Excludes profit and revenue receivables, and includes increase in outstanding Gharz-al-hasaneh facilities extended to the non-public sector.

Composition of outstanding facilities extended by banks and non-bank credit institutions according to Islamic contracts points to the extending of 48.2 percent of these facilities in the form of installment sale contracts.

COMPOSITION OF OUTSTANDING FACILITIES EXTENDED BY BANKS AND NON-BANK CREDIT INSTITUTIONS TO NON-PUBLIC SECTOR (1)

(percent)

	Banks and non-bank credit institutions	
	1384	1385
Installment sale	49.9	48.2
Mozarebeh	6.9	7.7
Civil partnership	11.2	15.0
Gharz-al-hasaneh	4.4	3.5
Hire purchase	3.7	3.0
Forward transactions	5.2	4.8
Legal partnership	2.5	1.8
Direct investment	1.0	1.0
Joaleh	6.3	5.1
Others (2)	8.9	9.9
Total	**100.0**	**100.0**

(1) Includes profit and revenue receivables.

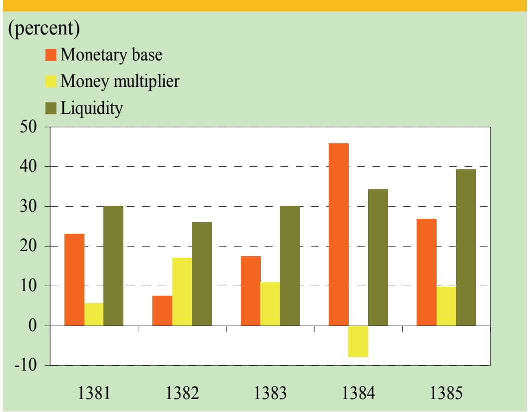
(2) Includes debt purchase, overdue and non-performing claims, and machinery and housing units transacted under Islamic contracts.

Liquidity

Liquidity grew markedly by 39.4 percent in 1385, an unprecedented level in the post-revolutionary era. This was 17.4 percentage points above the target set in the 4th Plan (22 percent) and pointed to a rise compared with the figure for the previous year (34.3 percent). It should be mentioned that to achieve the growth target of inflation rate set in the 4th Plan at 9.9 percent, liquidity growth was set at 20 percent during the course of the 4th Plan and 22 percent for 1385. Monetary base picked up by 26.9 percent compared with 45.9 percent of the preceding year, mainly due to the rise in CBI's net foreign assets. Moreover, money multiplier reached 4.587 in 1385, up by 9.8 percent compared with the year before.

Among the factors affecting liquidity growth, claims on the non-public sector had a noticeable share of 34.9 percentage points, and banking system's net foreign assets had a share of 13.7 percentage points in raising liquidity. Among the constituents of net domestic assets, net claims on the public sector and others (net) had decreasing effects of 3.3 and 5.9 percentage points, respectively, on raising liquidity.

Figure 12.3. Liquidity growth and its determinants



LIQUIDITY AND ITS DETERMINANTS

	Year-end balance			Percentage change	
	1383	1384	1385	1384	1385
Monetary base (billion rials)	151,200.0	220,541.4	279,975.1	45.9	26.9
Money multiplier	4.536	4.176	4.587	-7.9	9.8
Liquidity (billion rials)	**685,867.2**	**921,019.4**	**1,284,199.4**	**34.3**	**39.4**

CONTRIBUTION OF FACTORS AFFECTING LIQUIDITY GROWTH (percent)

	1383	1384	1385
Banks' and non-bank credit institutions' claims on non-public sector (1)	**28.1**	**30.5**	**34.9**
Banks' claims on public sector (net)	**0.1**	**-10.6**	**-3.3**
Government	-1.3	-11.5	-3.0
Public corporations and institutions (1)	1.4	0.9	-0.3
Net foreign assets of the banking system	**27.4**	**13.4**	**13.7**
Others (net)	**-25.4**	**1.0**	**-5.9**
Liquidity	**30.2**	**34.3**	**39.4**

(1) Excludes profit and revenue receivables.

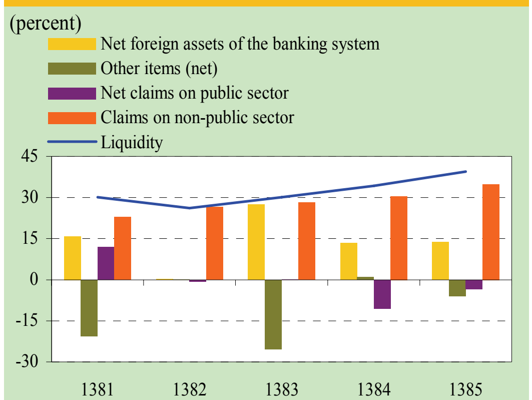
Monetary Base

Monetary base grew by 26.9 percent to Rls. 279,975.1 billion in 1385, mainly due to the CBI's net foreign assets which accounted for 51.5 percentage points in raising monetary base. Increase in CBI's net foreign assets was mostly due to the CBI purchase of foreign exchange from the government to finance rial sources of budget, while not selling the whole purchased amount in the market, as well as frequent withdrawals from the OSF (according to the four Supplements to the Budget Law for 1385, the OSF was withdrawn 3 times). On the other hand, reduction in CBI's claims on the public sector (net) by 12.3 percentage points had a decreasing effect on the monetary base while other items (net) by 20.9 percent had the highest share in reducing monetary base. Furthermore, CBI's claims on banks had an increasing share of 8.6 percentage points in monetary base growth. These factors pushed up monetary base by 26.9 percent.

CONTRIBUTION OF FACTORS AFFECTING MONETARY BASE GROWTH (percent)

	1383	1384	1385
Monetary base	**17.5**	**45.9**	**26.9**
CBI net foreign assets	50.7	49.1	51.5
CBI net claims on public sector	-9.3	-37.9	-12.3
CBI claims on banks	-1.6	9.5	8.6
Other items (net)	-22.3	25.2	-20.9

Figure 12.4. Factors affecting liquidity growth



MONETARY BASE AND ITS COMPONENTS (billion rials)

	Year-end balance			Percentage change	
	1383	1384	1385	1384	1385
Monetary base	**151,200.0**	**220,541.4**	**279,975.1**	**45.9**	**26.9**
Net foreign assets	183,279.4	257,567.0	371,195.4	40.5	44.1
Net claims on public sector	65,994.7	8,652.1	-18,433.9	-86.9	-313.1
Claims on banks	21,493.2	35,916.2	54,887.3	67.1	52.8
Other items (net)	-119,567.3	-81,593.9	-127,673.7	31.8	-56.5
Participation papers	-20,250.3	-10,769.1	-21,565.5	-46.8	-100.3

Composition of Liquidity

The share of money in liquidity decreased from 34.5 percent at end-1384 to 32.3 percent at end-1385, while share of quasi-money grew to 67.7 percent.

Non-public sector's deposits with banks and non-bank credit institutions went up by 40.5 percent to Rls. 1,222,747.8 billion in 1385. Of this amount, Rls. 869,654.5 billion was in the form of non-sight deposits.

The provisional profit rates of term investment deposits with public banks decreased in 1385 compared with the previous year and was set within a range of 7 percent for short-term to 16 percent for five-year investment deposits. Among term investment deposits, five-year deposits had the largest share. It is worth mentioning that in 1385, share of five-year term investment deposits out of long-term investment deposits declined and that of one-year investment deposits rose. Meanwhile, shares of other term investment deposits decreased.

PROVISIONAL PROFIT RATE OF TERM INVESTMENT DEPOSITS WITH PUBLIC BANKS [1] (% per annum)

	1383	1384	1385
Short-term	**7**	**7**	**7**
Short-term (special)	**9**	**9**	**7-16**
Long-term			
One-year	13	13	7-16
Two-year	13-17	13-17	7-16
Three-year	13-17	13-17	7-16
Four-year	13-17	13-17	7-16
Five-year	17	17	16

(1) Profit rates of short-term, short-term (special) and one-year deposits with Bank Maskan (Housing Bank) are higher by one percentage point.

COMPOSITION OF LONG-TERM INVESTMENT DEPOSITS [1] (percent)

	Year-end		
	1383	1384	1385
One-year	12.7	14.7	24.7
Two-year	15.1	16.9	14.4
Three-year	4.6	4.7	4.5
Four-year	1.0	1.4	1.1
Five-year	66.6	62.3	55.3

(1) Includes non-bank credit institutions.

COMPOSITION OF LIQUIDITY (billion rials)

	Year-end balance			Percentage change		Share (percent)	
	1383	1384	1385	1384	1385	1384	1385
Money	**252,815.1**	**317,919.4**	**414,544.9**	**25.8**	**30.4**	**34.5**	**32.3**
Notes and coins with the public	44,772.0	50,675.6	61,451.6	13.2	21.3	5.5	4.8
Sight deposits	208,043.1	267,243.8	353,093.3	28.5	32.1	29.0	27.5
Quasi-money	**433,052.1**	**603,100.0**	**869,654.5**	**39.3**	**44.2**	**65.5**	**67.7**
Gharz-al-hasaneh savings deposits	69,806.2	93,230.1	133,522.4	33.6	43.2	10.1	10.4
Term investment deposits	349,149.3	489,693.2	707,100.5	40.3	44.4	53.2	55.1
Miscellaneous deposits	14,096.6	20,176.7	29,031.6	43.1	43.9	2.2	2.2
Liquidity (M2)	**685,867.2**	**921,019.4**	**1,284,199.4**	**34.3**	**39.4**	**100.0**	**100.0**

Sources and Uses of Commercial Banks Funds

Non-public sector deposits with commercial banks went up by 34 percent (Rls. 215,839.2 billion), 33 percent of which was in the form of sight deposits and 67 percent in non-sight deposits. Commercial banks' blocked resources, due mostly to reserve requirement, soared by Rls. 38,647.3 billion. Furthermore, commercial banks capital account increased by Rls. 33,538.5 billion, and public sector deposits and funds increased by Rls. 14,574.0 billion. Public and non-public sectors indebtedness grew by Rls. 1,093.9 and 199,781.6 billion, respectively. As a result, commercial banks' excess resources rose by Rls. 24,428.9 billion compared with the year before.

Sources and Uses of Specialized Banks Funds

Non-public sector deposits with specialized banks grew by Rls. 49,235 billion, 17 percent of which was due to the rise in sight deposits and 83 percent to non-sight deposits. The specialized banks' blocked resources, due mainly to reserve requirement, picked up by Rls. 3,917 billion. Free resources out of non-public sector deposits with specialized banks went up by Rls. 45,318 billion. Total free resources of specialized banks, including other sources, rose sharply by Rls. 60,558.1 billion. Of this figure, specialized banks' claims on public and non-public sectors increased by Rls. 1,671.4 and 58,886.7 billion, respectively.

Banking System Developments

Key policies and measures undertaken by the banking system in 1385 are as follows:

1. Preparation of an Instruction for Classification of Credit Institutions' Assets: Based on the mentioned instruction, credit institutions under the supervision of the Central Bank are required to classify their assets by the quality thereof into current, overdue, non-performing, doubtful, and non-receivable. Quality of bank assets is influenced by time, financial position of the credit recipient, and field of the activity concerned. Such instruction virtually leads to transparency in banks' financial statement disclosures.

2. Preparation of an Instruction for Method of Calculating Reserves of Credit Institutions' Claims: According to the mentioned instruction, credit institutions are obliged to allocate general and special reserves with regard to the Instruction for Classification of Credit Institutions' Assets to compensate losses incurred by default of credit recipients. Therefore, at the end of each financial year, credit institutions shall allocate 1.5 percent of total facilities extended as general reserve. The necessary levels of special reserve are respectively 10, 20, and 50-100 percent of the outstanding facilities classified as overdue, non-performing, and doubtful.

Number of Banking Units

The total number of domestic and foreign Iranian banking units, including branches, counters and representative offices, rose 2.4 percent to 17,905. Bank Saderat Iran and Bank Melli Iran respectively held 19.3 and 18.9 percent of these units, and together accounted for the highest number of domestic banking units.

The number of banking network employees reached 175,820 persons, up by 2.6 percent. Number of commercial banks' employees declined by 1.2 percent, while that of the specialized banks increased by 14.6 percent. The number of employees at private banks indicated a remarkable growth of 90.2 percent. The average number of employees at each banking unit reached 9.8 persons, and the ratio of population to each banking unit was 3,946.3 persons.

BANKING UNITS

	1383	1384	1385
Domestic branches	**17,145**	**17,445**	**17,858**
Commercial banks	14,242	14,378	14,520
Specialized banks	2,774	2,859	2,897
Private banks	129	208	441
Foreign branches	**56**	**41**	**47**
Total	**17,201**	**17,486**	**17,905**