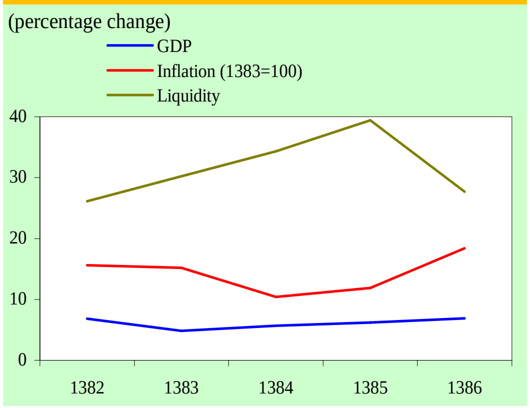
CHAPTER 12

MONETARY AND BANKING POLICY AND PERFORMANCE

Objectives Stipulated in the 4th FYDP

The year 1386 corresponds to the third year of the 4th Five-Year Development Plan in the context of the Twenty-Year Vision Plan. 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 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 scheduled facilities shall be reduced by 20 percent per annum on average over the Plan's period compared with 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. Based on the quantitative targets of the 4th Plan, the average rate of inflation and liquidity growth are determined at 9.9 and 20 percent, respectively, during the Plan's period. Therefore, the inflation rate and liquidity growth for the third year of this Plan are set at respectively 9.1 and 20 percent.

Figure 12.1. Major economic variables



Key Monetary Policies Approved in 1386

According to the Money and Credit Council (MCC) approval, and due to high liquidity growth during the previous year and the ensuing inflationary pressures, the CBI is authorized to issue up to Rls. 40 trillion tax-exempt participation papers (substituted and the new ones) with an annual profit rate of 15.5 percent.

Based on the MCC approval, the lending rate on the facilities extended by public banks for transaction contracts is set at 12 percent. The lending rate on the facilities extended by private banks and credit institutions is determined at one percentage point higher than that of public banks.

According to the said approval, the minimum expected lending rate on the facilities extended for participatory contracts by banks (both public and private) and credit institutions is determined at the rates set for transaction contracts. Moreover, the real profit rates of participatory contracts shall be determined at the end of the period.

Furthermore, 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 long-term investment deposits.

According to the executive bylaw on expansion of Small and Medium Enterprises (SMEs), commercial and specialized agent banks were obliged to extend up to 50 percent of credits worth Rls. 150 trillion in 1386.

In accordance with the Budget Law for 1386, the outstanding scheduled facilities extended by banks may, in observance of the duties stipulated in development plans, increase up to Rls. 1,200 billion in 1386.

Based on the Budget Law for 1386, and in pursuance of the 4th Plan Law, the government was authorized to allocate foreign exchange equivalent of Rls. 84,550 billion out of the OSF for investment and promotion of exports to finance part of the credits needed by non-public sector for the projects, the feasibility study of which is confirmed by the concerned 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.

After deduction of OSF obligations, referred to in Article 1 of the 4th FYDP, according to the Budget Law for 1386, the government was authorized to allocate up to 10 percent of the OSF balance in the form of facilities to public banks at the beginning of the year. These facilities shall be utilized as bank's partnership in the syndicated loan arrangement of non-public sector in line with the Law for Usury Free Banking.

Based on the Cabinet approval and on the recommendation of the Central Bank, as of the beginning of 1387, Iran-checks are solely issued by the CBI and the printing costs are paid by the Central Bank. The CBI receives 100 percent rial equivalent of the mentioned checks from banks.

In the review year, the Cabinet approved the executive bylaw of the Law on Regulating the Unorganized Money Market (enacted in 1383). According to the mentioned executive bylaw, banking operations may be solely exercised by licensed institutions from the CBI. Gharz-al-hasaneh Funds that solely receive Gharz-al-hasaneh deposits and extend Gharz-al-hasaneh loans are excluded from the said bylaw. (These funds are regulated by a separate regulation.)

Banking System [(1)] Performance

Banking system assets and liabilities grew by 32.4 percent to Rls. 4,081,175.5 billion. Claims on non-public sector, with 35.7 percent rise in the assets side, and liquidity, with 27.7 percent growth in the liabilities side, were the main driving forces behind the rise in assets and liabilities, respectively.

Banking System and the External Sector

In 1386, net foreign assets of the banking system increased by 10.8 percent (Rls. 45,748.7 billion) to Rls. 470,779.5 billion). This was mainly due to the rise in the net foreign assets of the CBI by Rls. 67,434.8 billion, while net foreign assets of banks and credit institutions declined by Rls. 21,686.1 billion. Foreign exchange purchases from the government as per the Budget Law, which were partly sold in the market, and frequent withdrawals from the OSF mainly contributed to the rise in CBI's net foreign assets.

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

Banking System and the Public Sector

Banking system's net claims on the public sector decreased by Rls. 20,217.7 billion to Rls. 15,380.7 billion in the review year. Central Bank's claims on the public sector grew by 0.2 percent, due to 24.1 percent rise in public corporations' and institutions' indebtedness, while government indebtedness fell by 6.0 percent.

Of total CBI's claims on the government, 36.9 percent, or Rls. 36,131.6 billion, was related to the deficit in foreign exchange obligations account, which went up by Rls. 0.7 billion compared with the figure for the year before. Public sector deposits with the CBI rose 17.9 percent in 1386, due to 15.5 percent increase in government deposits and 44.6 percent growth in public corporations and institutions' deposits.

Government indebtedness to banks and credit institutions picked up by 61.8 percent (Rls. 34,707.1 billion) to Rls. 90,881.6 billion in the review year, largely due to the rise in its indebtedness by Rls. 24,602.0 billion and an increase in the amount of government participation papers with banks and credit institutions by Rls. 10,105.0 billion.

Change in Net Claims of the Banking System on Public Sector

(billion rials)

	1385	1386
Public sector	**-32,341.9**	**-20,217.7**
Central Bank (1)	-27,086.0	-26,480.5
Commercial and specialized banks	-9,615.5	14,289.9
Private banks and credit institutions	4,359.6	-8,027.1
Government	**-27,678.7**	**-10,788.2**
Central Bank (2)	-31,665.5	-27,668.9
Commercial and specialized banks	-372.8	24,907.8
Private banks and credit institutions (3)	4,359.6	-8,027.1
Public corporations and institutions	**-4,663.2**	**-9,429.5**
Central Bank	4,579.5	1,188.4
Commercial and specialized banks (4)	-9,242.7	-10,617.9
Private banks and credit institutions	0	0

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

(2) Includes deficit in foreign exchange obligations account.

(3) Includes public sector participation papers only.

(4) Includes indebtedness for exchange rate differential.

Major Items in the Assets and Liabilities of the Banking System

(billion rials)

	Year-end balance			Percentage change	
	1384	1385	1386	1385	1386
Assets	**2,359,396.4**	**3,082,209.2**	**4,081,175.5**	**30.6**	**32.4**
Foreign assets	770,170.4	928,552.5	1,184,385.1	20.6	27.6
Central Bank	428,172.1	563,869.5	747,284.2	31.7	32.5
Public banks (1)	323,924.8	349,748.1	413,931.9	8.0	18.4
Private banks and credit institutions (2)	18,073.5	14,934.9	23,169.0	-17.4	55.1
Claims on public sector	235,607.7	256,219.8	280,636.7	8.7	9.5
Claims on non-public sector	865,315.4	1,226,201.0	1,663,725.7	41.7	35.7
Others	488,302.9	671,235.9	952,428.0	37.5	41.9
Liabilities	**2,359,396.4**	**3,082,209.2**	**4,081,175.5**	**30.6**	**32.4**
Liquidity (M2)	921,019.4	1,284,199.4	1,640,293.0	39.4	27.7
Deposits and funds of public sector	167,667.4	220,621.4	265,256.0	31.6	20.2
Foreign liabilities	471,435.8	503,521.7	713,605.6	6.8	41.7
Central Bank	170,605.1	192,674.1	308,654.0	12.9	60.2
Public banks (1)	284,390.1	295,374.7	372,893.5	3.9	26.2
Private banks and credit institutions (2)	16,440.6	15,472.9	32,058.1	-5.9	107.2
Others (3)	799,273.8	1,073,866.7	1,462,020.9	34.4	36.1

(1) Includes Post Bank Iran.

(2) Includes Karafarin, Saman, Eghtesad-e-Novin, Parsian and Pasargad private banks and the Credit Institution for Development. It also includes Bank Sarmaye 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.

Scheduled Facilities Extended according to the Budget Law for 1386 (1)

(billion rials)

	Change in outstanding	
	Budget ceiling	Approved (2)
Social and cultural	150	150
Production and infrastructure	1,050	240
Total	**1,200**	**390**

(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.

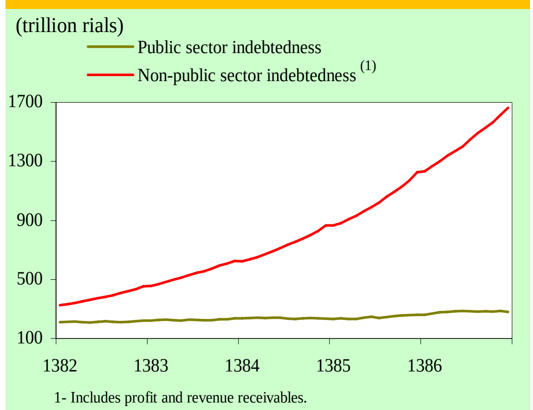
Banks and the Non-public Sector

Banking system credit performance in 1386 indicates that facilities [1] extended to non-public sector (excluding profit and revenue receivables) grew by Rls. 401,749.5 billion (37.7 percent). Non-public sector enjoyed the lion's share (91.4 percent) of total facilities provided by banks and credit institutions [2]. Of these facilities, Rls. 150 trillion were extended on the basis of the executive bylaw on expansion of SMEs. Of note, the outstanding scheduled facilities extended by banks to non-public sector within the framework of the executive bylaw of Note 2 of the Budget Law for 1386 remained unchanged in this year.

Outstanding facilities extended by public commercial banks and specialized banks to the non-public sector, excluding profit and revenue receivables, increased by 36.5 and 23.3 percent, respectively. Outstanding facilities extended by private banks and credit institutions surged by 65.6 percent to Rls. 236,841.6 billion. Therefore, the share of private banks and credit institutions in total facilities extended to the non-public sector rose sharply from 13.4 percent in the previous year-end to 16.1 percent at end-1386, while that of commercial and specialized banks decreased to 65.2 and 18.7 percent from respectively 65.8 and 20.8 percent in 1385.

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, manufacturing and mining, construction and housing, agriculture, and exports sectors.

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



Outstanding Facilities Extended by Banks and Credit Institutions to Non-public Sector (1)

(billion rials)

	Year-end balance			Percentage change		Share (percent)		
	1384	1385	1386	1385	1386	1384	1385	1386
Commercial banks	501,366.3	701,574.1	957,826.6	39.9	36.5	67.3	65.8	65.2
Specialized banks	163,039.5	221,926.2	273,629.8	36.1	23.3	21.9	20.8	18.7
Private banks and credit institutions	80,622.4	143,048.2	236,841.6	77.4	65.6	10.8	13.4	16.1
Total	**745,028.2**	**1,066,548.5**	**1,468,298.0**	**43.2**	**37.7**	**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 Credit Institutions to Non-public Sector [1] (percent)

	1385			1386		
	Public banks	Private banks and credit institutions	Banks and credit institutions	Public banks	Private banks and credit institutions	Banks and credit institutions
Agriculture	19.1	0	15.9	17.0	0.2	14.1
Manufacturing and mining	22.1	15.1	21.0	23.6	16.1	22.3
Construction and housing	23.7	21.8	23.4	17.4	9.9	16.1
Exports	0.7	-0.6	0.5	1.9	0	1.5
Domestic trade, services, and miscellaneous	34.4	63.7	39.2	40.1	73.8	46.0
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 non-public sector.

Composition of outstanding facilities extended by banks and credit institutions based on Islamic contracts reveals extension of 48.6 percent of these facilities in the form of installment sale contracts, as in the previous year.

Composition of Outstanding Facilities Extended by Banks & Credit Institutions to Non-public Sector [1] (percent)

	Banks and credit institutions	
	1385	1386
Installment sale	48.2	48.6
Mozarebeh	7.7	9.0
Civil partnership	15.0	16.0
Gharz-al-hasaneh	3.5	3.1
Hire purchase	3.0	1.8
Forward transactions	4.8	3.9
Legal partnership	1.8	1.4
Direct investment	1.0	0.9
Joaleh	5.1	4.4
Others [2]	9.9	10.9
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 rose 27.7 percent in 1386, compared with the previous year to Rls. 1,640,293 billion. This indicated a fall against the figure for 1385 (39.4 percent), although it was 7.7 percentage points above the target set in the 4th Plan (20 percent). Of special note is that the growth target of inflation rate set in the 4th Plan was 9.9 percent, and liquidity growth was set at 20 percent over the course of the 4th Plan. However, review of the performance of liquidity growth reveals a large deviation from the set target. In the review year, monetary base picked up by 30.5 percent compared with the 26.9 percent growth of the preceding year, mainly due to the rise in CBI's claims on banks. Furthermore, money multiplier reached 4.488 in 1386, down by 2.2 percent against the preceding year.

Among the factors affecting liquidity growth, claims on the non-public sector had a significant share of 31.3 percentage points, and banking system's net foreign assets had a share of 3.6 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 1.5 and 5.7 percentage points, respectively, on raising liquidity.

Contribution of Factors Affecting Liquidity Growth (percent)

	1384	1385	1386
Banks' and credit institutions' claims on non-public sector [1]	**30.5**	**34.9**	**31.3**
Banks' claims on public sector (net)	**-10.6**	**-3.3**	**-1.5**
Government	-11.5	-3.0	-0.9
Public corporations and institutions [1]	0.9	-0.3	-0.6
Net foreign assets of the banking system	**13.4**	**13.7**	**3.6**
Others (net)	**1.0**	**-5.9**	**-5.7**
Liquidity	**34.3**	**39.4**	**27.7**

(1) Excludes profit and revenue receivables.

Liquidity and its Determinants

	Year-end balance			Percentage change	
	1384	1385	1386	1385	1386
Monetary base (billion rials)	220,541.4	279,975.1	365,499.0	26.9	30.5
Money multiplier	4.176	4.587	4.488	9.8	-2.2
Liquidity (billion rials)	**921,019.4**	**1,284,199.4**	**1,640,293.0**	**39.4**	**27.7**

Monetary Base

Monetary base went up by 30.5 percent to Rls. 365,499 billion in 1386, largely due to CBI's claims on banks, which accounted for 29.6 percentage points in raising monetary base. This is indicative of 21 percentage points increase in their share against the previous year level of 8.6 percentage points. CBI's net foreign assets largely contributed to the monetary base growth, leading to 24.1 percentage points increase which indicated a fall of 27.4 percentage points compared to the corresponding figure of 1385 (51.5 percentage points). CBI's net claims on public sector and other items (net) had decreasing effects of respectively 9.5 percentage points and 13.7 percentage points (the highest) on the monetary base growth.

Figure 12.3. Liquidity growth and its determinants

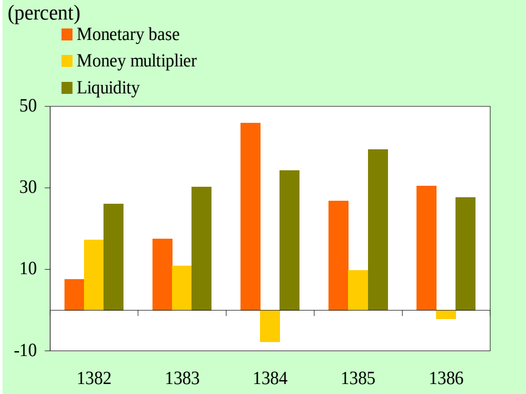
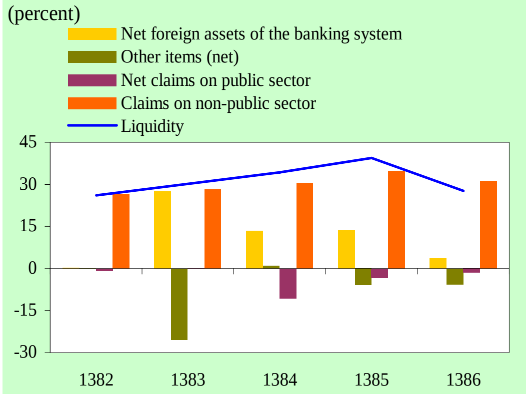


Figure 12.4. Factors affecting liquidity growth



Contribution of Factors Affecting Monetary Base Growth (percent)

	1384	1385	1386
Monetary base	**45.9**	**26.9**	**30.5**
CBI net foreign assets	49.1	51.5	24.1
CBI net claims on public sector	-37.9	-12.3	-9.5
CBI claims on banks	9.5	8.6	29.6
Other items (net)	25.2	-20.9	-13.7

Monetary Base and its Components (billion rials)

	Year-end balance			Percentage change	
	1384	1385	1386	1385	1386
Monetary base	**220,541.4**	**279,975.1**	**365,499.0**	**26.9**	**30.5**
Net foreign assets	257,567.0	371,195.4	438,630.2	44.1	18.2
Net claims on public sector	8,652.1	-18,433.9	-44,914.4	-313.1	-143.7
Claims on banks	35,916.2	54,887.3	137,694.0	52.8	150.9
Other items (net)	-81,593.9	-127,673.7	-165,910.8	-56.5	-29.9
Participation papers	-10,769.1	-21,565.5	-16,371.7	-100.3	24.1

Composition of Liquidity

The share of money in liquidity grew to 32.7 percent at end-1386 from 32.3 percent in 1385 year-end, while share of quasi-money declined to 67.3 percent. Non-public sector deposits with banks and credit institutions rose 27.6 percent to Rls. 1,560,383.8 billion in the review year. Of this amount, Rls. 1,104,585.7 billion was in the form of non-sight deposits.

Composition of Money (percent)

	Year-end		
	1384	1385	1386
Notes and coins with the public	15.9	14.8	14.9
Sight deposits	84.1	85.2	85.1

The provisional profit rates of term investment deposits with public banks remained unchanged at the previous year level, 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, however, share of these deposits declined in 1386, and that of one-year deposits increased. Moreover, share of other term investment deposits, except the four-year deposits, decreased in the review year.

Sources and Uses of Commercial Banks Funds

Non-public sector deposits with commercial banks rose by 24.9 percent (Rls. 212,072.4 billion), 41.9 percent of which was in the form of sight deposits and 58.1 percent non-sight deposits. Commercial banks' blocked resources, due mostly to reserve requirement, surged by Rls. 32,833.2 billion. Besides, commercial banks capital account decreased by Rls. 2,597.7 billion, and public sector deposits and funds picked up by Rls. 11,503.9 billion. Public and non-public sectors indebtedness picked up by Rls. 10,790 and 253,289.7 billion, respectively. Therefore, commercial banks' excess resources dipped by Rls. 75,934.3 billion compared with 1385. These banks posted a large deficit, which was financed through overdraft from the CBI. Thus, CBI's claims on commercial banks soared by 124 percent in 1386.

Composition of Long-term Investment Deposits [1] (percent)

	Year-end		
	1384	1385	1386
One-year	14.7	24.7	36.3
Two-year	16.9	14.4	9.8
Three-year	4.7	4.5	3.8
Four-year	1.4	1.1	1.1
Five-year	62.3	55.3	49.0

(1) Includes credit institutions.

Provisional Profit Rate of Term Investment Deposits with Public Banks [1] (% per annum)

	Year-end		
	1384	1385	1386
Short-term	**7**	**7**	**7**
Short-term (special)	**9**	**7-16**	**7-16**
Long-term			
One-year	13	7-16	7-16
Two-year	13-17	7-16	7-16
Three-year	13-17	7-16	7-16
Four-year	13-17	7-16	7-16
Five-year	17	16	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 Liquidity (billion rials)

	Year-end balance			Percentage change		Share (percent)	
	1384	1385	1386	1385	1386	1385	1386
Money	**317,919.4**	**414,544.9**	**535,707.3**	**30.4**	**29.2**	**32.3**	**32.7**
Notes and coins with the public	50,675.6	61,451.6	79,909.2	21.3	30.0	4.8	4.9
Sight deposits	267,243.8	353,093.3	455,798.1	32.1	29.1	27.5	27.8
Quasi-money	**603,100.0**	**869,654.5**	**1,104,585.7**	**44.2**	**27.0**	**67.7**	**67.3**
Gharz-al-hasaneh savings deposits	93,230.1	133,522.4	152,305.0	43.2	14.1	10.4	9.3
Term investment deposits	489,693.2	707,100.5	915,984.5	44.4	29.5	55.1	55.8
Miscellaneous deposits	20,176.7	29,031.6	36,296.2	43.9	25.0	2.2	2.2
Liquidity (M2)	**921,019.4**	**1,284,199.4**	**1,640,293.0**	**39.4**	**27.7**	**100.0**	**100.0**

Sources and Uses of Specialized Banks Funds

Non-public sector deposits with specialized banks rose by Rls. 21,080.8 billion, 28.4 percent of which was due to the growth in sight deposits and 71.6 percent to non-sight deposits. The specialized banks' blocked resources, due mostly to reserve requirement, went up by Rls. 2,765.7 billion. Free resources out of non-public sector deposits with specialized banks increased by Rls. 18,315.1 billion. Total free resources of specialized banks, comprising other sources, soared by Rls. 54,897.9 billion. Of this figure, specialized banks' claims on public and non-public sectors grew by Rls. 3,194.3 and 51,703.6 billion, respectively. It is worth mentioning that CBI's claims on specialized banks increased by 197.4 percent in 1386.

Banking System Developments

Key policies and measures adopted by the banking system in 1386 are as follows:

- Design and draft of guidelines on licensing, operation, and supervision of regional banks;

- Design and draft of law on establishment of Banks' Association;

- Preparation of draft law on repayment of banks' claims on government and banks capital injection;

- Preparation of guidelines concerning licensing, operation, and supervision of Gharz-al-hasaneh banks;

- Preparation of guidelines on write-offs of credit institutions' doubtful assets;

- Preparation of executive guidelines concerning establishment of private and public banks' branches and subsidiaries abroad;

- Preparation of guidelines concerning establishment of foreign banks' branches in Iran;

- Preparation of guidelines on legal reserve requirements of banks' foreign exchange deposits;

- Preparation of bylaw on divesting non-essential and employees welfare-related banks' assets;

- Preparation of bylaw on the recovery of credit institutions' overdue claims, arrears, and doubtful assets;

- Preparation of bylaw concerning banks' penalties on resettlement of overdue facilities and arrears;

- Preparation of guidelines on banks' lending to arrears institutions;

- Preparation and amendment of guidelines and instructions on banks' book keeping of government deposits; and

- Preparation and circular on mathematical techniques of apportioning principal and profit (interest) of customers' installment payments on non-PLS contracts.

Number of Banking Units

The total number of domestic and foreign Iranian banking units, comprising branches, counters, and representative offices, rose 4.5 percent to 18,711. Bank Saderat Iran and Bank Melli Iran held 18.5 and 18.3 percent of these units respectively, and together accounted for the highest number of domestic banking units.

The number of banking network employees went up by 4 percent to 182,872 persons. Number of public commercial banks' employees increased by 2.3 percent, and that of the specialized banks rose by 5.5 percent. The number of private banks' employees grew by 35.4 percent. The average number of employees at each banking unit was 9.8 persons, and the ratio of population to each banking unit, 3,833 persons.

Banking Units

	1384	1385	1386
Domestic branches	**17,445**	**17,858**	**18,662**
Commercial banks (1)	14,378	14,520	14,991
Specialized banks	2,859	2,897	2,991
Private banks (2)	208	441	680
Foreign branches	**41**	**47**	**49**
Total	**17,486**	**17,905**	**18,711**

(1) Includes Post Bank Iran as of 1386.
(2) Includes Credit Institution for Development since 1386.