

Foreign Currency Market in IRAN

Overview & Forecast

Q4-2015

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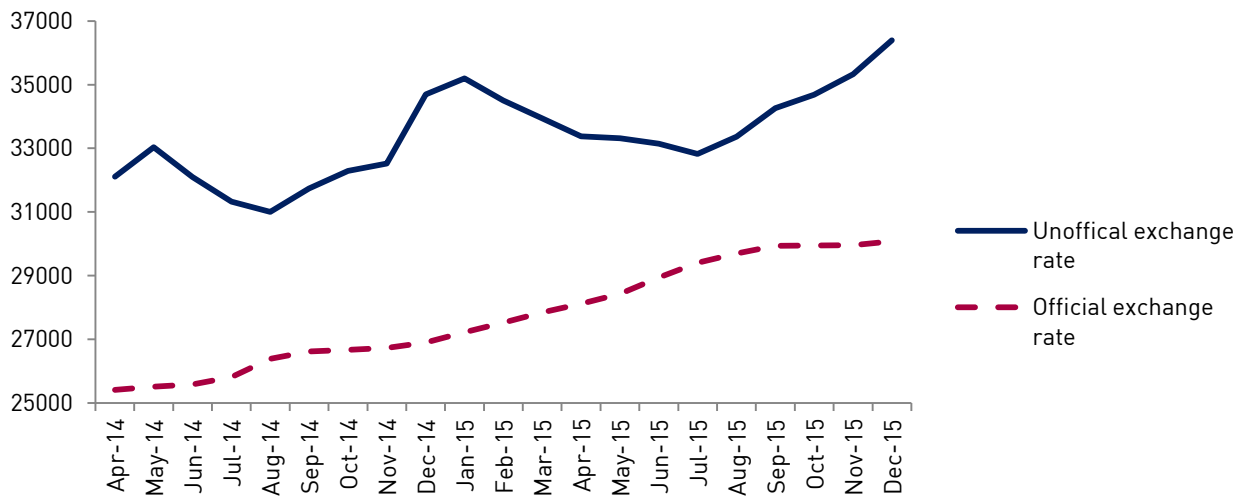
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FX Fluctuation

The unofficial exchange rate has increased by 8% in 2015, but the official exchange rate has enlarged by 12% which means higher growth with respect to the free market. Global dollar appreciation and reduced supply of foreign currency in Iran`s economy (due to drop in oil price) were two major causes of such upward FX trend.

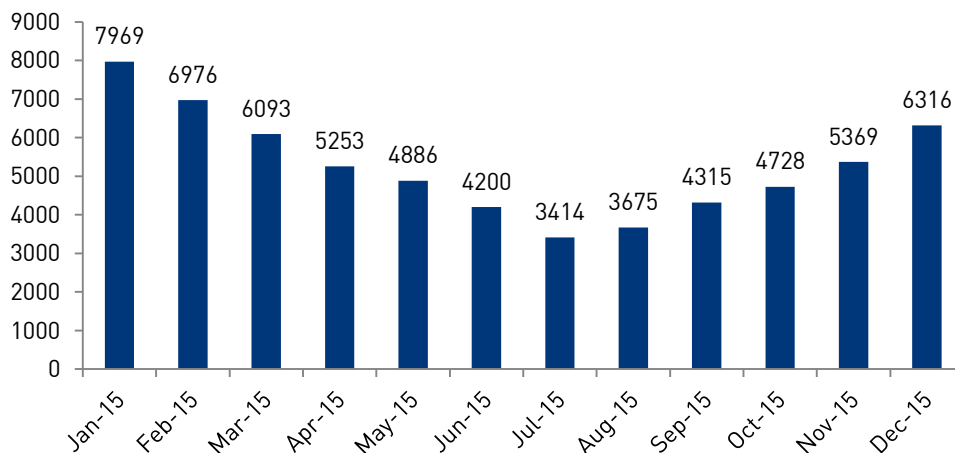
Graph 1- Official and Unofficial FX Evolution (rials per Dollar)



Source: Central Bank of Iran

By above mentioned trend the difference between official and unofficial market rate has fallen from 7,969 rials in the early of 2015 to 3,414 rials by the July of 2015, but after that it increased and the difference became 6,316 rials in December of 2015.

Graph 2-The Difference between Official and Un-official dollar rates



Source: Central Bank of Iran

Foreign Currency Market in IRAN

The following table compares official and unofficial FX rates on the quarterly basis. As it can be seen clearly, the unofficial exchange rate had almost upward movement and it increased 7% in the last quarter of 2015 compared to same period last year.

Table 1- Official and Unofficial D/R on the quarterly basis

	Unofficial market		Official market (Foreign Exchange Market)	
	Exchange Rate (rial)	Growth Rate during the Same Period Last Year (%)	Exchange Rate (rial)	Growth Rate during the Same Period Last Year (%)
Q2 2014	32,417	-6%	25,510	108%
Q3 2014	31,357	2%	26,276	13%
Q4 2014	33,167	11%	26,772	8%
2014	31,603	-3%	25,857	42%
Q1 2015	34,546	17%	27,534	11%
Q2 2015	33,278	3%	28,499	12%
Q3 2015	33,482	7%	28,928	13%
Q4 2015	35,470	7%	29,999	12%
2015	34,194	8%	25,857	12%

Source: Central Bank of Iran

Demand and Supply of FX from March to December 2015

Basically, real supply of FX in Iran includes oil and non-oil export and demand for FX includes import and other retail transactions. Data shows that demand for FX decreased by 17.5% from March to December 2015. On the supply side, the non-oil export & oil export fell by 20% regarding same period in previous year. Therefore, CBI could keep the balance between FX supply and demand by which they could control FX market.

Table 2- FX Inflow and Outflow in 2015 (Million Dollar)

	Exports	Imports	Demand for Cash Foreign Currency	Net Inflow less Oil Income	Oil Exports	Net Inflow plus Oil Income
March to December 2015	26,872	30,150	5,694	- 8,972	30,098	21,125
March to December 2014	25,569	38,462	4,999	- 17,892	45,891	27,999

Source: Customs Administration of Islamic Republic of Iran

*The inflow and outflow of foreign currency excluding Iran's released assets and net capital account

Policy Approach

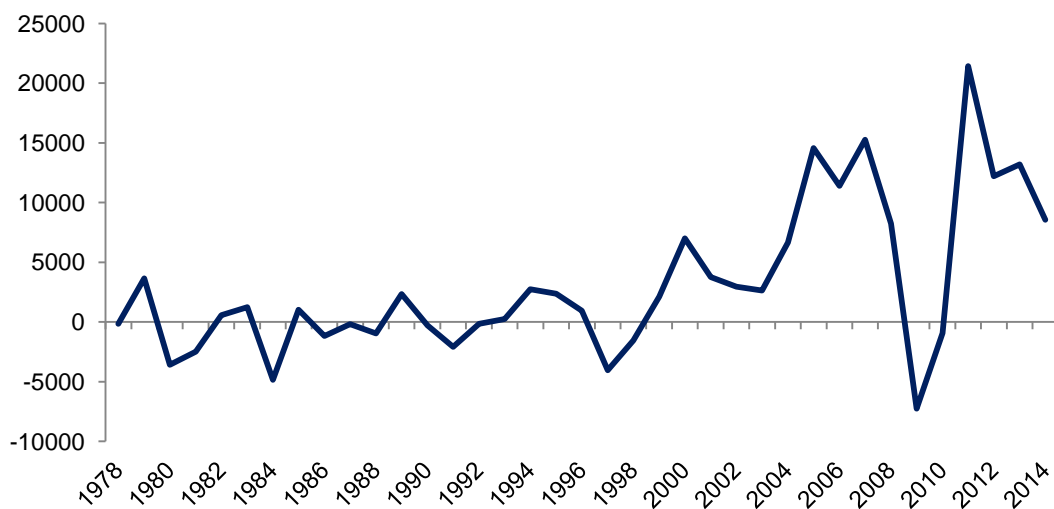
The major approach of policy makers (Government and CBI) was stability in the forex market by reducing speculative demand for foreign currency and decreasing difference between official and unofficial FX rates. It is expected that this policy will continue until the end of the year. The government could control the market because of final agreement between Iran and 5+1 (JCPOA) and some conservative policies to tackle inflation.

It seems that CBI will follow FX unification by the next year; to implement such policy the CBI needs some preliminaries as follow:

- 1) Having enough reserves: Central Bank needs enough reserve to prevent probable shocks and to control unexpected demand and speculation. The ability of the Central Bank could be assessed by the size of the foreign assets of the central bank and the balance of payments.

The trend of balance of payments shows inflow and outflow of foreign currency exchange in the whole economy. Survey of this variable indicates that after 1999 only in 2009 and 2010 outflow of currency was more than the inflow and after 2010, inflow of foreign exchange have been positive despite sanctions.

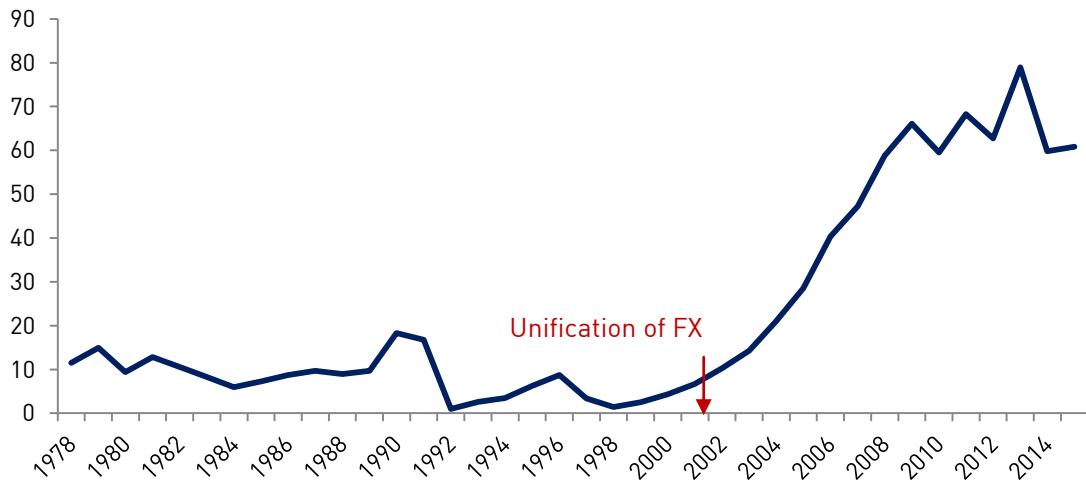
Graph 3-The Trend of Balance of Payment (million dollars)



Source: Central Bank of Iran

In addition, net foreign assets were \$10 billion in 2002 (in this year's successful experience of exchange rate unification occurred) and in September 2015 it was about \$61 billion that the amount is about 6 times more than 2002.

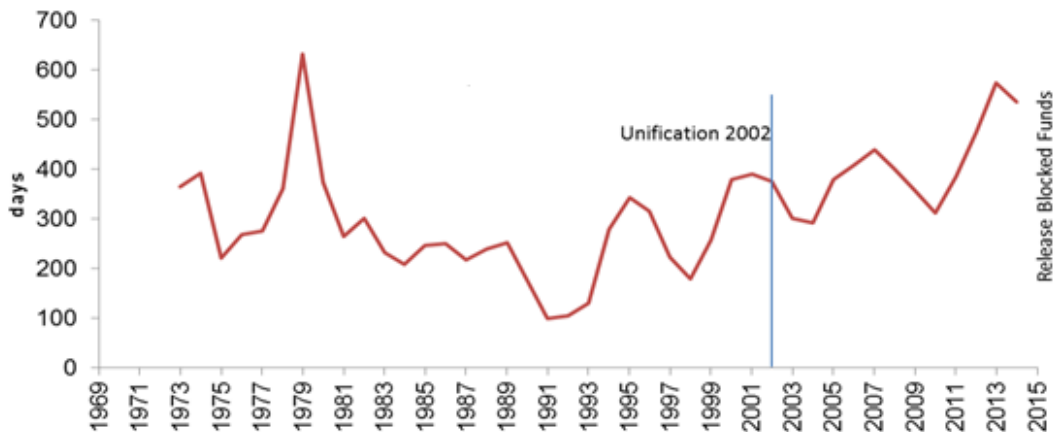
Graph 4-TheNet Foreign Assets (billion dollars)



Source: Central Bank of Iran

To assess the ability of CBI to control probable FX market fluctuations after unification, it is important to find out how long foreign exchange reserves of CBI would afford the cost of Iran’s import. On the basis of CBI foreign exchange reserves, import cost of Iran supported for 365 days in 2002, while this figure has increased to 500 days in 2015. It means that the Central Bank can control any fluctuation followed by unification negative outcomes for a while.

Graph 5-Number of Days that CBI Can Afford Import Needs



Source: The calculation of research

- 2) The removal of sanction against Iran: despite having enough reserve, by lifting the sanction, releasing Iran’s assets and reducing the transaction costs the power of CBI will increase to implement unification of FX. According to published reports blocked assets of the central bank and the government are as follows:

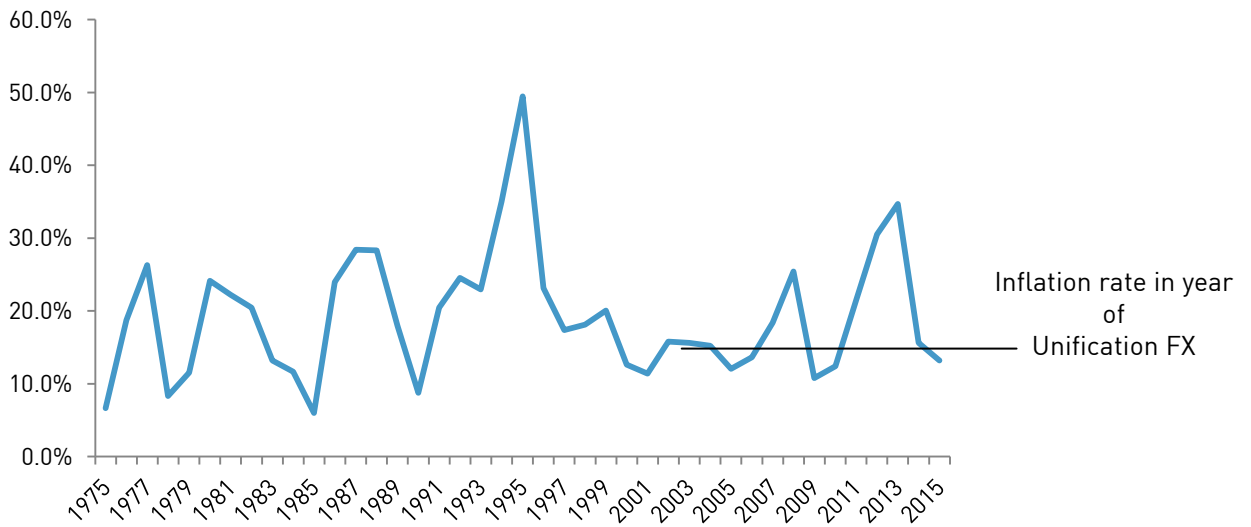
Table 3- The Amount of Blocked Foreign Reserves (Billion dollars)

Central Bank	23
Government	6
Collateral in China for financing	22.4
National Oil Company for investing	24.5

Source: <http://www.donya-e-eqtesad.com>

- 3) The control of inflation: Since the unification could increase inflation, the best time of implementation is when inflation is at the lowest level. After 18 months conservative monetary policy, now the inflation rate is less than 15% and the expectation is still to be low. Therefore in terms of inflation there is supporting signals to start unification.

Graph 6-The Trend of Inflation (%)



Source: Central Bank of Iran

FX Forecast

To project the exchange rate, three time horizons by short, mid and long term have been framed:

Short term: March 2016:

Four factors are considered in determining the exchange rate by this time horizon:

- 1) Signing of JCPOA agreement: Closing the Iranian nuclear case has created a positive vision about the future and therefore speculative demand has diminished and it would prevent a sharp rise in the exchange market.
- 2) The dollar exchange rate against other key currencies: the US economy has prospered and the Federal Reserve interest rate increased; it can appreciate dollar globally.
- 3) Reduction in government revenue: the oil income of government declined very strongly this year and the government had to increase the official exchange rate for compensating the drop in income. (According to statistics, oil revenues declined about 22% in March to September 2015 compared to the same period last year)
- 4) Preparing conditions for FX unification: As it is mentioned in the previous sections, the government and CBI seek to implement the exchange rate unification in the future. So, CBI has prevented a sharp rise in the exchange rate by selling its foreign assets.

Accordingly, it is predicted that the average dollar exchange rate March 2016 to be 34,500 rials

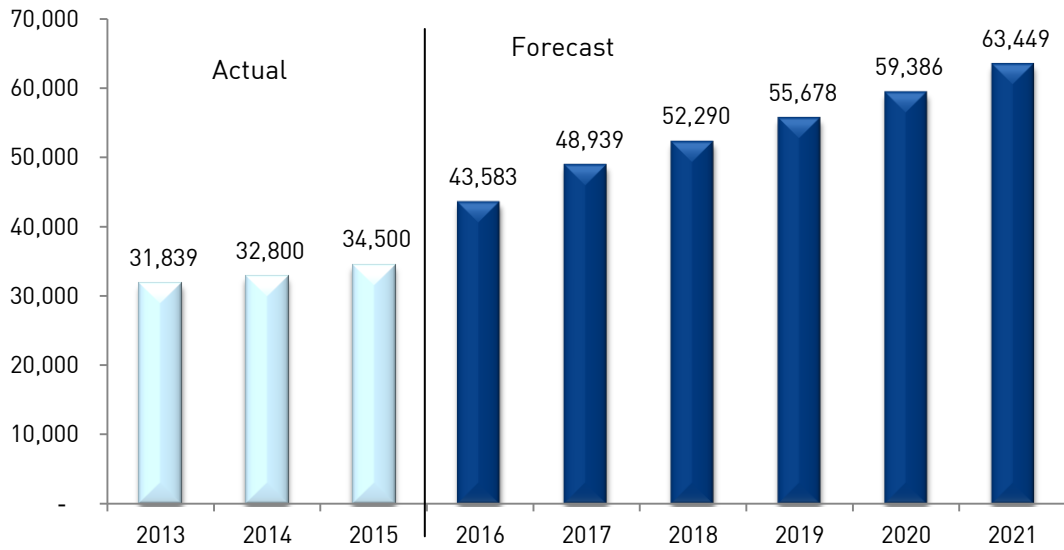
MID term: 2016 by 2017

It is expected that the exchange rate unification will run in next year. Accordingly, it is predicted to increase the dollar exchange rate about 26 percent next year and it is estimated to be **USD against rials 43,583 in 2016 and 48,939 in 2017**

Long Term: 2018 by 2021

It seems that policy makers will not pursue fixing exchange rate and the exchange rate will grow but less than inflation. The chart below shows the forecast of dollars over the coming years.

Graph 7- Dollar Vs Rial: Forecasts



To project Euro against Rial, first the exchange rate of Euro against USD was projected and based on that, Euro against Rial was estimated. The main important variables in projection model are the interest rate of Euro area and USA, inflation of Euro area and USA, economic growth rate of Euro area and USA and oil price. Table below shows the result.

Table 4- Euro Vs USD: Forecasts

	2014	2015	2016	2017	2018	2019	2020	2021
Euro vs USD	1.33	1.11	1.01	1.09	1.16	1.21	1.21	1.21

Graph 8- Euro Vs Rial: Forecasts

