

Foreign Currency Market in IRAN

Overview & Forecast

Q1-2016

No.5

Research, Planning and Budgeting Division
Economic Research Unit
June. 2016

All information, analyses, forecasts and data provided by Saman Bank (Public Joint Stock Company) are for the exclusive use of subscribing persons or organizations.

All contents, including forecasts, analyses and opinions have been based on the information and sources believed to be accurate and reliable at the time of publishing. SBC indicates no warranty of any kind as to the accuracy or completeness of any information provided, and accepts no liability whatsoever for any loss or damage resulting from opinions, errors, inaccuracies or omissions affecting any part of the content.

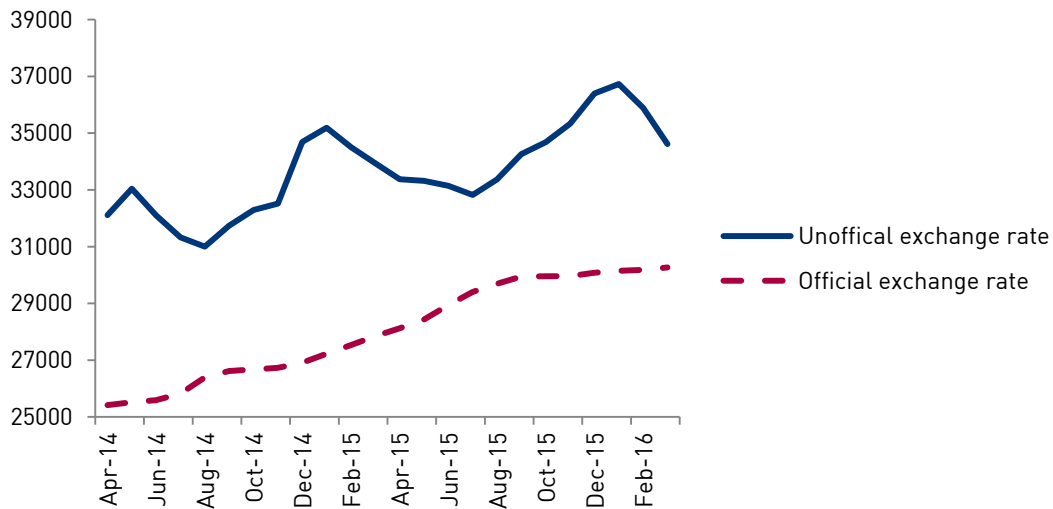
Contents

FX Fluctuation	2
Demand and Supply of FX in March 2016	3
Policy Approach	4
FX Forecast.....	7

FX Fluctuation

In Q1 2016¹, the unofficial exchange rate has increased much less than the official exchange rate. The unofficial exchange rate has risen by 3% in Q1.2016, but the official exchange rate has enlarged by 10% which means higher growth than the free market.

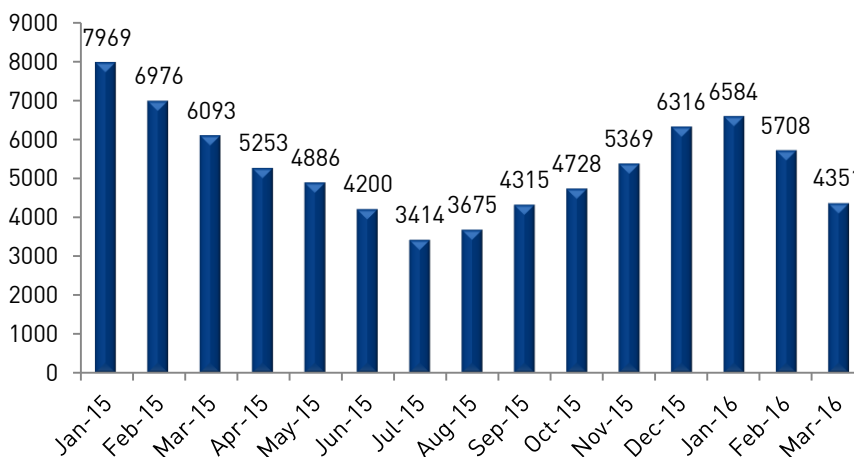
Graph 1- Official and Unofficial FX Evolution (rials per Dollar)



Source: Central Bank of Iran

By above mentioned trend, the difference between official and unofficial market rate has fallen from 6093 rials in March 2015 to 4351 rials by the March of 2016.

Graph 2-The Difference between Official and Un-official Dollar Rates



Source: Central Bank of Iran

¹ - In Iran, the fiscal year starts on March 21 (1st of Farvardin) and concludes on next year's March 20.

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 and official exchange rate had almost upward movement 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 with respect to the Last Year (%)	Exchange Rate (rial)	Growth Rate with respect to the Last Year (%)
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%
Q1 2016	35,747	3%	30,199	10%

Source: Central Bank of Iran

Demand and Supply of FX in March 2016

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 25% by the March 2016. Also, on the supply side, the non-oil export & oil export has fallen by 27.8% with respect to the last year. However, CBI was successful to 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 2016	35,751	41,499	4,056	-9,804	36,124	26,320
March 2015	36,556	53,569	6,985	-23,998	55,352	31,354

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

As mentioned in the previous number of this report, 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 this year. The government could control the market because of final agreement between Iran and 5+1 (JCPOA) and some conservative policies to tackle inflation.

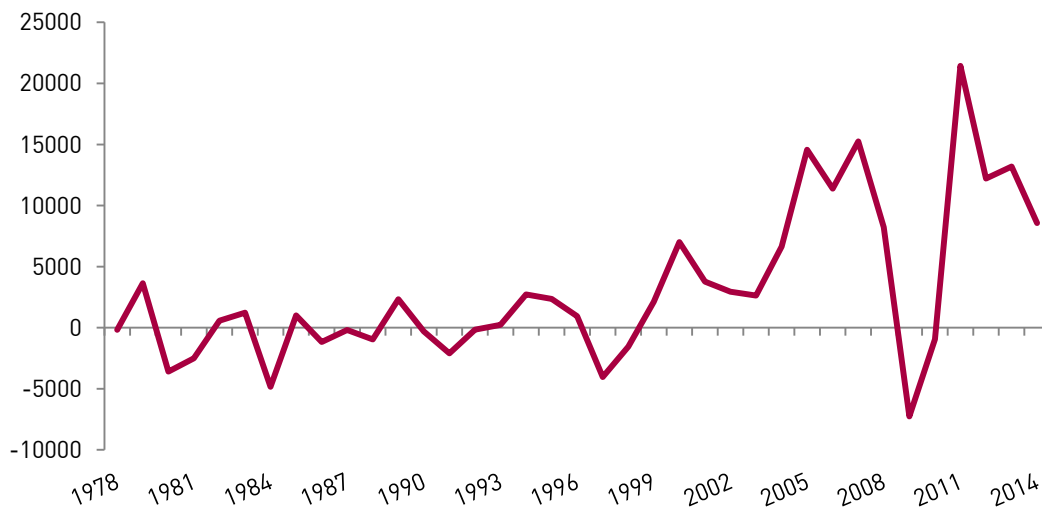
Also, we expect that unification of exchange rate will be done gradually in the second quarter of 2016 by controlling the unofficial exchange rate and increasing the official exchange rate.

There are several arguments which support that CBI has ability to run unification program:

- 1) 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.(The latest data was for 2014)

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

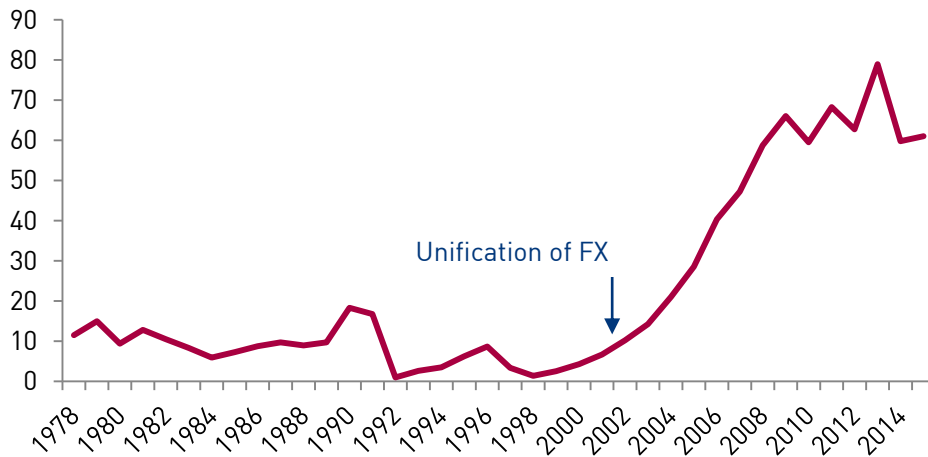


Source: Central Bank of Iran

Foreign Currency Market in 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.

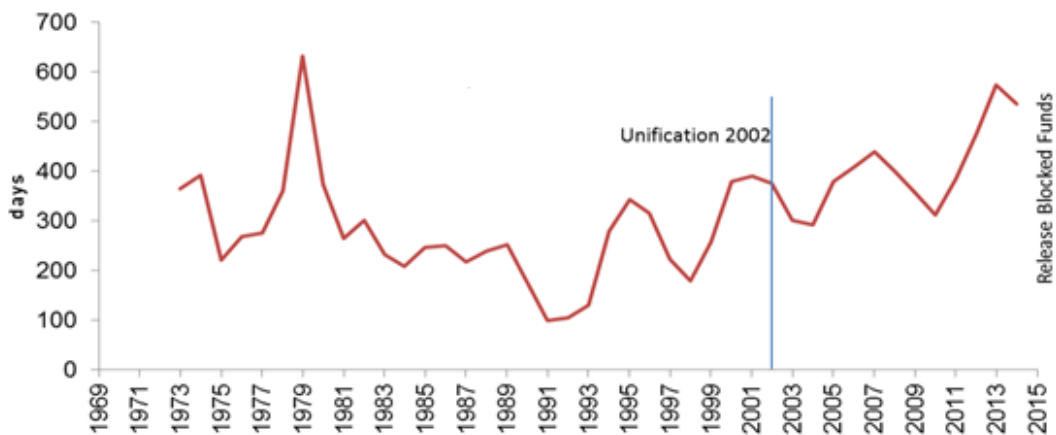
Graph 4-TheNet Foreign Assets (billion dollars)



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, CBI was able to finance import of good 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 midterm.

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 sanctions, releasing Iran’s assets and reducing the transaction costs CBI`s ability to afford unification program will be enhanced. According to published reports blocked assets of the central bank and the government are as follows:

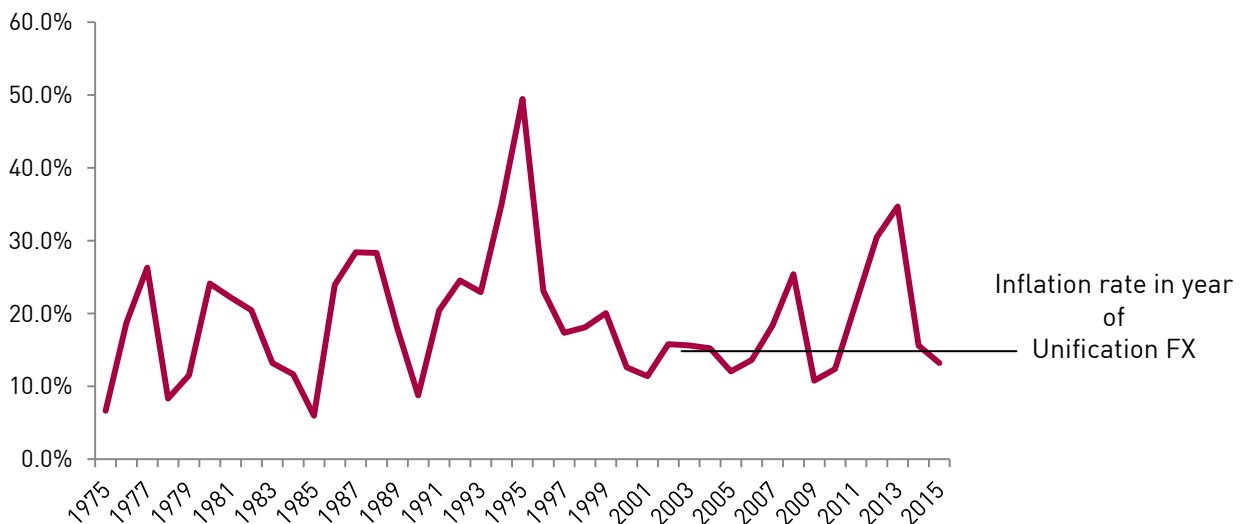
Table 3- The Amount of Blocked Foreign Reserves (Billion dollars)

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

Source: <http://www.Farsnews.com>. 14 July 2015.

- 3) Low 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 12% and the expectation is still to be low. Therefore in terms of inflation there is supporting signals to start unification. (The latest data was March 2016 that inflation rate has been announced 11.9%)

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: 2016

It is expected the exchange rate unification to be run gradually by CBI in this year. This way, CBI will control the unofficial exchange rate and official exchange rate will depreciate to fill the gap between the two markets. Accordingly, it is predicted to increase the dollar exchange rate about 15 percent this year and ***it is estimated to be USD against Rials 39,824 in 2016.***

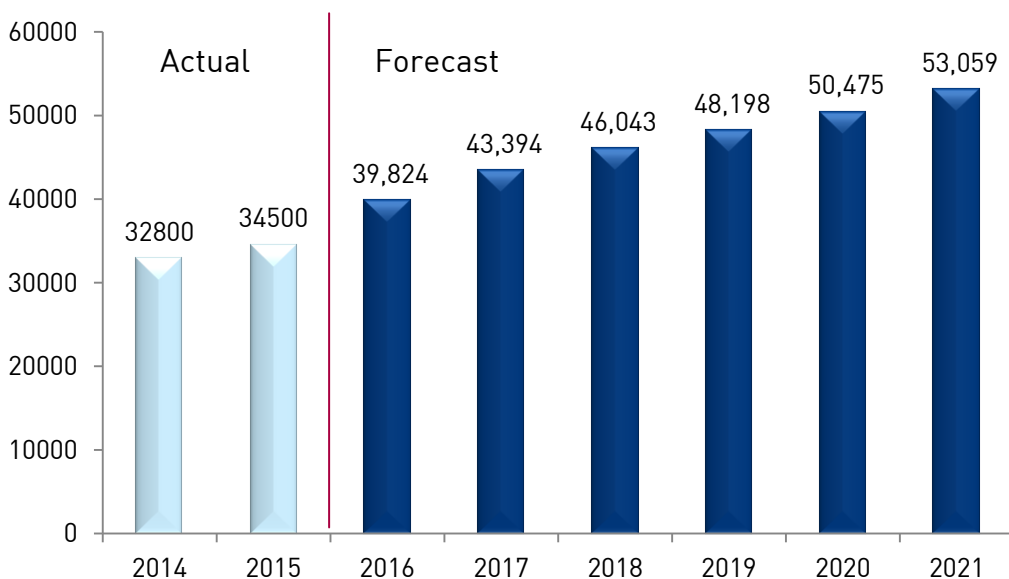
MID term: 2017 - 2018

It is expected that after unification, the exchange growth rate will be reduced to 11 percent in 2017 and 6 percent in 2018.

Long Term: 2019 - 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



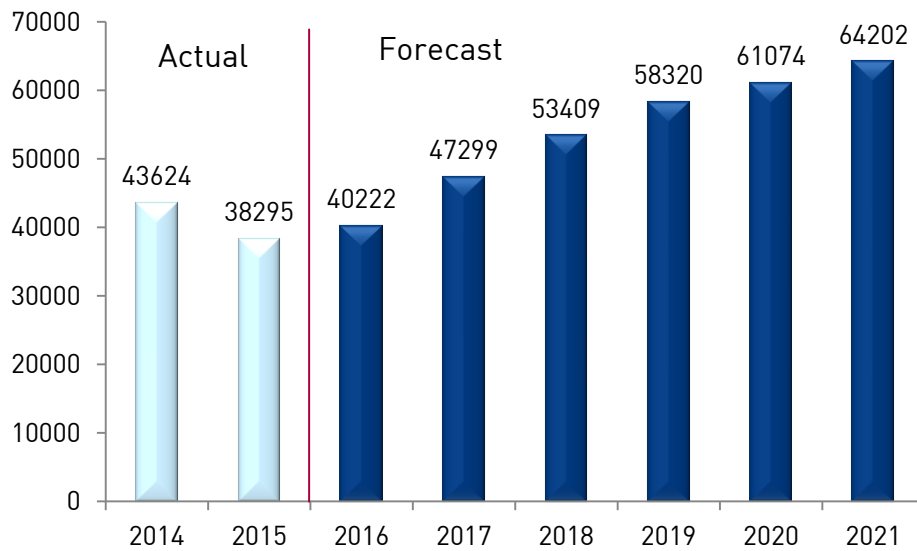
Foreign Currency Market in IRAN

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



*** It should be noted that forecast of exchange rate have been reduced compared to the previous issue of this report because of the outlook of inflation in Iran is dropped.