Iran
Country Partnership Strategy
2017-2018

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I. Main Economic Indicators

	2012-13	2013-14	2014-15	2015-16	2016-17
Population (mid-year; mln)	76	76.9	77.9	79.4	80.4
Average exchange rate (Local cur / USD)	12,260	21,253	26,509	29,580	31,389
Inflation rate (CPI average; %)	30.5	34.7	15.6	11.9	9
GDP at current prices (nat cur. trl)	7,284	9,843	11,260	11,129	12,723
GDP at current prices (USD bln)	389	396	424	376	405
GDP / capita (in cur. prices; USD)	5,118	5,152	5,395	4723	5026
Real GDP growth (%)	-7.7	-0.3	3.2	-1.6	12.5
Unemployment rate (ILO definition; eop; %)	12.1	10.4	10.6	11	12.4
General Gov. Budget balance /GDP (%)	-0.6	-1.12	-1.14	-1.76	-2.2
Gross government debt / GDP (%)	11.8	11.1	12.0	42	35
Direct foreign investment (USD bln)	4.6	3.05	2.1	2.05	3.4
Export (fob, USD bln)	97.3	92.9	89	63	84
Import (fob, USD bln)	68.7	63.6	70.9	57.6	63.1
Trade balance (exp. fob. - imp.fob.; USD bln)	28.6	29.3	18.1	5.4	20.9
Current account balance (USD bln)	23.4	26.5	13.6	1.2	16.4
Current account / GDP (%)	6.0	6.7	3.2	0.3	4.05
Forex reserves (eop; USD bln)	104	107	126.2	128.4	132.3

Sources: Central Bank of Iran, Statistical Center of Iran and IMF.

II. Economic Overview and Outlook

Real Sector

Iranian economy experienced significant fluctuations in the post-global economic crisis era. During the early phase of the great recession Iran's economic growth remained stable on the back of rising international oil prices and pro-cyclical policies adopted by the government. In 2010 and 2011 real GDP grew by 5.7% and 3.1% respectively at par with its long-run average.

As a result of the sanctions imposed on Iran the economy was not able to sustain the positive economic momentum and as result it contracted two years in a row for the first time since 1994. Real GDP shrank by 7.7% and 0.3% in 2012 and 2013, respectively. The oil sector crisis led to a severe reduction in investments which in turn caused the manufacturing and services sectors to contract during this period as well with the exception of agriculture sector. Iran's economy rebounded mildly and showed positive performance in 2014 with real GDP growing by 3.2% on the back of rise in global oil prices. In 2015 the economy again suffered contraction with real GDP contracting by 1.6% as global oil prices crashed to level of below USD 40 per barrel.

In 2016 with lifting of nuclear sanction and the implementation of Joint Comprehensive Plan of Action (JCPOA) the economy expanded significantly and real GDP grew by 12.5% with non-oil economy posting a growth of 3.3%. Increase in growth was mainly due to increased exports of petrochemicals, low-base effect and also utilization of the excess capacity in various sectors.

External Sector

As a result of the adverse external environment which stifled the sale of the most important trade item of the country, the total oil and gas exports collapsed by around 50% in 2012-16 periods to an average USD 60 billion. But the non-oil exports remained strong during the corresponding period. Historically overall exports had grown at average rate of 28% y/y each in 2010 and 2011 to reach USD 109 billion and USD 145 billion respectively supported by the surge in oil exports to slightly above USD 100 billion two years in a row for the first time in country's history.

Exports in 2016 at USD 84 billion rebounded expanding by 33.3% compared to 29% contraction observed last year. Oil exports stood at USD 55.7 billion rising by 66% compared to 7% decline last year.

Imports were relatively much stable in the six years since the 2009 global economic crisis with an annual average level of USD 70 billion a year mostly in the form of agriculture, machinery, and iron/steel. In 2016 imports stood at USD 63.1 billion rising by 9.5% from last year.

As a result trade balance stood at USD 20.9 billion increasing by three times over last year. Trade balance rebounded in 2016 due to global recovery in oil prices compared to declining trend observed in the last two years. The current account surplus in 2016 stood at USD 16.4 billion rising significantly from last year. Gross foreign exchange reserves stood at about USD 132 billion, equivalent to twenty five months of imports on average in 2016.

Fiscal Outlook

The government seeks to maintain a moderate fiscal deficit to continue to support the economy while taking steps to broaden the revenue base away from oil, prioritizing capital spending, and containing the growth of current spending.

Central government deficit in 2016 rose slightly to 2.2% of GDP with rise in expenditure offsetting the increase in revenues. Overall revenues stood at 17.3% of GDP and reached 93.2% of the amount envisaged in the budget. Tax revenues stood at 7.9% of GDP increasing by 28% and reached 97.7% of the amount earmarked in the budget. Oil and current revenue increased by 28% and 34%, respectively. Expenditure which stood at 19.5% of GDP increased by 25% and reached 91.8% of the amount earmarked in budget. The increase in expenditures was mainly due to rise in current expenditures. Iranian government plans to stabilize, and in a phased manner, reduce the role of oil in budget, which as of 2016 stood at 33% of total revenue, with the help of increase in VAT rates.

Monetary Policy and Inflation

Inflation which has been in double digits since last many years due to lax monetary policy, touching a high of 40% in 2013, has been easing since the last two years and in 2016 stood at 9%. Inflation had fallen on account of prudent monetary policy, easing of supply constraints with the lifting of sanctions and implementation of JCPOA, phased reduction in deposit rates and relative stability in exchange rate.

Future Outlook

After recording an impressive growth performance in 2016 the Iranian economy's growth is expected to stabilize at 3.5% as oil production will be capped by OPEC target. Recovery is expected to broaden as spillovers from robust growth in oil sector to non-oil economy takes place coupled with improvements in domestic credit conditions and higher FDI. Going forward implementing the structural reforms as reflected in the 6th five year development plan are also expected to boost growth in the medium to long-term.

III. Review of Bank's Operations

The Bank's operations in Iran are followed through SMEs development program and trade finance facility conducted in cooperation with financial intermediaries. In addition, the direct project and corporate finance loans are progressing towards available opportunities and development priorities of the country. Since the beginning of operations in 2008, the total disbursements of the Bank to various operations in Iran have reached to USD 295 million by the end of September 2017. The Bank was able to contribute mostly to development of irrigation and wastewater management projects in Iran. The Bank's total outstanding portfolio in Iran stands at USD 114.5 million as of end-September 2017. In addition, disbursement of USD 4.6 million commitments to infrastructure projects is continuing according to their progress.

In the forthcoming period, the Bank would also give due consideration to identification of bankable projects and increasing its operations in Iran. Broadly defined, operations would be further directed towards supporting the development of financial sector, SMEs, trade, corporates and development projects in manufacturing and infrastructure. The Bank will also continue to seek opportunities for co-operation with a variety of other lenders including multilateral development banks, bilateral financial institutions, export-credit agencies, official lenders or guarantors, commercial banks, and other financial intermediaries.

(i) Micro, Small and Medium Sized Enterprises (M-SMEs) Development Facility

Micro and SME facilities contribute to support micro, small and medium-sized enterprises, which are critical for the economic and social development in the ECO region. Under this facility the Bank provides loans to local partner banks and other financial institutions which subsequently on-lend to the Micro and SMEs.

This facility is designed in a manner where the Bank's risk is on the Financial Institutions and their expertise to on lend to M-SME sector of the country. M-SME facility plays a vital role in creating jobs and generating income for the low income group in the member countries. It also serves the ETDB mandate in an optimal manner.

The Bank is looking for co-funding from the participating financial institution in each on-lending, in order to strengthen the relationship between the intermediary and its clients, and to increase the intermediaries' interest in the good performance of the credit line. The Bank has specific eligibility criteria which are defined to the selected Financial Institution in order to assure that funds are moving to the Bank's target market. Funds will be allocated to M-SMEs according to following amounts and requirements.

Client Category	Micro	SME
Headcount	**<50**	**51-250**
Annual Turnover	**<EUR 50,000.-**	**EUR 51,000-EUR 15,000,000**

i. Only be applied to SMEs which are bankable, financially sound and will be able to use the funds economically.
ii. Only be applied to finance of SMEs domiciled in the territory of the ETDB member states.

iii. Only be used by SMEs which comply with ETDB's rules on sector eligibility and restrictions as defined in this document.

In addition to above principles final beneficiaries of the SME Development Loan will be filtered according to the negative list of products and sectors and the environmental policy of the Bank. Promoting the knowledge economy/skills and innovation capacity of vibrant SMEs in Iran remains a priority for the Bank. The focus of ETDB in segment has been the agriculture sector in order to support growth, export and employment potentials of the SMEs. The total disbursements of the ETDB under this facility amounted to USD 52 million by the end of September 2017.

The operations of the Bank supported the availability and lengthen the maturity of funding for SMEs, underpinning job creation and growth. However, due to unfavorable international environment limit the financial institutions in Iran to benefit from this facility in an optimum manner and currently the Bank has no active loan in its portfolio under this facility. As soon as the obstacles are removed in the near future for Iranian banks, there will be a huge potentiality to utilize the SME limits for the Iranian FIs. In the coming years, through intermediated financing the Bank will continue to increase the availability of long term funding to SMEs and look for opportunities for further cooperating with banks which are active in SME financing.

(ii) Short Term Trade Finance Facility (STTF)

Trade finance is a distinct core business of the Bank. The program has been designed to strengthen the ability of local banks to provide trade finance to entrepreneurs throughout the country to expand their import and export operations.

Within the STTF facility, the FIs participating in the program have been using these facilities which helped a number of businesspersons in their trade transactions within and outside the ECO region. Each and every transaction is filtered according to the negative list of products and the environmental policy of the Bank.

The Bank has approved short term trade finance limits to banks which are active in trade finance in Iran, however, due to unfavorable international environment, the Iranian FIs are not utilizing these limits actively. Since 2008, the total disbursements of the ETDB under this facility amounted to USD 73.9 million by the end of September 2017. In the light of current progress on ease of respective limitations the Bank expects to cater opportunities to provide short and medium term trade financing to eligible partner banks for trade finance purpose and to the companies for trade transactions under its Trade Finance program.

(iii) Corporate and Project Finance

With a strategy to support economic development and social progress in the Islamic Republic of Iran, the Bank continues to provide medium to long term finance to development projects in key priority areas. The process of selecting projects is based on the assessment of additionality and development impact, with special emphasis on public welfare, sustained economic activity and improvement in quality of life. Contribution to national priorities and promoting complementarities among member states, in particular, tends to preclude a preferential factor in allocation of funds towards projects with the optimum risk/return ratio.

The corporate loans are provided to firms and public sector entities in order to cover their needs such as acquisition of equipment, modernization of plant and structures, trade transactions and other related expenditures. Since 2008, the total disbursement including commitments under corporate and project finance operations have been intensified and amounted to USD 169 million as end of September 2017.

In order to improve the performance of the irrigation systems and the relevant institutions to support agricultural producers in Iran, the Bank has committed a financing amounting to EUR 16,890,000 to the Siazakh irrigation project. It would provide for the agricultural water requirements of land use measuring an area of about 7,680 hectares. The loan agreement was signed in December 2010, having the tenure of 8 years including 3 years grace period. The Bank has been working in close cooperation with project management consultant, relevant authorities and the obligor to accelerate the implementation of the project, where the overall impact of the project would significantly improve the natural resource planning and affect the output of the irrigated area in terms of yield and unit cost.

Another infrastructure project in the portfolio of the Bank in Iran is the Shahriar Waste Water Management Project which was signed in September 2011. The development objective of this project is to improve the efficiency and effectiveness of water and wastewater network and infrastructure, reduce pollution discharges and improve water quality. An 8 year term (including 3 years grace period) loan amounting to EUR 18 million was committed for the construction of a wastewater treatment plant besides the collection networks and the main transmission line for the benefit of more than 180,000 population in the Shahriar, a city located in south west of Tehran Province.

The Bank has also been able to contribute positively to the requirements of major industrial conglomerates in Iran that are active in manufacturing sector and intend to expand their business to export markets.

Another project finance of Euro 16.9 million has been extended for development of Birjand Waste Water Treatment Plant for a tenor of 10 years, inclusive of 3.5 years of grace period. This project shall cater to the water treatment requirements of the city of Birjand in South Khorasan Province of Islamic Republic of Iran which has a population of more than 140,000 people.

Another project finance of Euro 20 million has been extended to the Mazandaran Transmission Lines Project for a tenor of 9 years, inclusive of 2 years of grace period to finance the expansion and update of electricity transmission and distribution infrastructure in Sari / Mehmoodabad areas of Mazandaran & Golestan Provinces, Islamic Republic of Iran.

The Bank has gained valuable experience from the initial projects which are still under implementation stage in Iran. With help of its past experience the Bank would improve its turn-around timings in subsequent projects. On the other hand, the Bank is putting efforts to identify and built up its project pipeline for further operations. In this respect, efforts are intensified to identify mid-size projects that contribute development of urban infrastructure, water management systems, renewable energy, energy efficiency, electric transmission lines and industrial manufacturing. The Bank would be also looking forward to work with medium size enterprises directly to increase their performances and access to finance.

IV. Conclusion

Iran is endowed with rich natural resources. Large reserves of oil and gas has brought valuable foreign exchange into the country but this dependence on primary commodities and international limitations has exposed the economy to volatilities and constrained the development potential. The Government has been striving to diversify the structure of the economy and its exports by placing emphasis on development of non-oil sectors, particularly petrochemicals, manufacturing and agriculture. The transfer of oil revenues to development of relevant infrastructure in the country would ensure the sustainable growth over the coming year. At the same time, increasing number of young educated Iranians are entering the labour force each year and need jobs to contribute to the growth of the economy. A pervasive role of the public sector had, up till now, prevented the private sector to create the jobs needed by the growing population. However, through its privatization program and other incentives to the private sector the government is now affording greater space to this sector.

On the other hand, new horizons would emerge on the economy as positive developments are expected to be materializing as a direct result of improvement in international relations with lifting of nuclear sanction and the implementation of relevant agreement-JCPOA. In 2016, the economy expanded significantly and real GDP grew by 12.5% with non-oil economy posting a growth of 3.3%. Increase in growth was mainly due to increased exports of petrochemicals, low-base effect and also utilization of the excess capacity in various sectors.

The Government has been mapping out strategies to channel funds and accelerate development of key sectors including oil and gas, petrochemicals, mining, manufacturing, banking, tourism, and ICT. The Government's policy to sustain the inflation at single-digit rate and decrease the unemployment rate will be strongly pursued. By and large, it seems that the general performance of the Iranian economy in the coming years in accord with ideals and optimum targets expected to provide better results. Since signing the nuclear deal, Iran has attracted significant investment in a range of sectors including infrastructure, utilities, hospitality and oil and gas. The Government has set the goal of attracting foreign investments amounting to USD 70 billion during the coming five year period to generate employment and boost domestic industries.

This country strategy document is the primary analytical and planning tool that would enable ETDB to design, execute, monitor, review, and evaluate its operations in Iran. The Bank's role and priorities are defined according to (i) country development priorities and (ii) available resources, strategies and policies of ETDB. Accordingly, the efforts of the Bank would be sustained to identify business opportunities consistent with the development priorities of Iran envisioned particularly in the 2025 Vision document and the 6th Five-Year Economic, Cultural, and Social Development Plan (2016-2021). The said development plan is comprised of three pillars, namely, the development of a resilient economy, progress in science and technology, and the promotion of cultural excellence. On the economic front, the development plan envisages an annual economic growth rate of 8 percent and reforming state-owned enterprises, the financial and banking sector, and the allocation and management of oil revenues among the main priorities of the government during the five-year period. The current development with regard to reinstating the favorable international environment is also expected to provide substantial support to the general policies of the said plan.

The Bank will focus on providing support to the implementation of the Government program and priorities, while responding to the market demand. Infrastructure, agriculture, transportation, energy and manufacturing would remain key priority sectors for the Bank's engagement with Iran. Investment opportunities in telecom, mining, tourism, and retail sectors would be also evaluated. Overall, the Bank with the available resources for Iran will continue to be primarily focused on delivering high quality projects and address funding constraints and sustainable development of financial sector.

The Bank will consider undertaking activities and providing services as may advance its purpose, paying special attention to activities promoting export of goods and services and development of infrastructure projects. While noting that Iranian banks face the challenge of delays in establishing correspondent banking relationship with large international banks, foreign direct investment inflows to Iran and trade relationships with the rest of the world are restrained. Nevertheless, through selected local financial intermediaries, the Bank would attempt to expand its financing programs in favor of SMEs. The Bank would also put efforts to directly cater to the financing needs of medium sized enterprises which would promote modernization of equipment and improvement of products and services. Particularly, providing support to the exporting companies would help to improve competitiveness and content of value added in exports. In the coming years, the cornerstone components of the country program would include:

Infrastructure. The Bank will seek investment opportunities for well-designed water supply and wastewater treatment projects. Engage in development of trade related infrastructure projects (particularly enhancing regional connectivity) aimed to improve roads and railways networks and logistics.
Agriculture. Operations shall promote a sustainable, modern and diversified agricultural production. Construction, rehabilitation and modernization of irrigation and drainage systems for more efficient agricultural production and effective use of water resources. Development of agribusiness activities, packing and storage facilities would be encouraged.

Financial sector. Support development of financial services and products of local financial institutions in SMEs finance and trade finance.
Manufacturing and Construction. Strategic focus will be on the enhancement of productivity, efficiency, capacity building, engineering, technological up-gradation and research activities of industrial conglomerates. Support industrial enterprises that are active in manufacturing and mining sector which intend to expand their business to export markets.
Energy. The productive capacity in the oil and gas sector would be enhanced and modernized. Focus on small-medium sized projects aimed at increasing production and efficiency in the energy sector. Development of transport and distribution networks (including emphasis on cross-country networks), and enhancing exports of value-added petrochemical products. Support realization of the untapped potential in renewable energy sources including solar, wind, geothermal.
Trade. Promote export of goods and services. Support expansion & diversification of trade in terms of markets and products.