

RELATIONS WITH INTERNATIONAL MONETARY AND FINANCIAL ORGANIZATIONS

Recognizing the importance of a collaborative approach to addressing the opportunities and challenges of a global economy, Iranian financial organizations and institutions, during 1386, continued their efforts to strengthen their cooperation with international financial organizations. The year was marked by a number of developments in this area of cooperation. These included attending annual meetings and sessions, benefiting from technical assistance and consultations, and carrying out research projects.

International Monetary Fund (IMF)

Discussions on Article IV Consultation with IMF were held in Tehran in the review year to assess the monetary, financial, foreign exchange, Special Data Dissemination Standards, policymaking, and institutional aspects of economic decision making process.

During the discussions, the Iranian officials emphasized the need for decreasing inflation through containment of expenditures and encouraging banks to be more conservative on credit extension. Reduction and gradual elimination of subsidies, streamlining of public expenditure management as well as policies on enhancing budgetary revenues were among major structural reforms in government financial operations. Discussions on structural reforms were focused on the need for recapitalization of

banks, conformance of Customs procedures with standards of World Trade Organization, and improvements on business environment.

The 2007 Article IV Consultation mission requested centralization of government efforts on declining the inflation rate and designing a structural reform program aimed at continued economic growth and creation of new job opportunities. The staff pointed to the signs of demand pressures arising from high oil price and expansionary budgetary policies. Therefore, in light of such pressures and the bumpy road of structural reforms, the Article IV Consultation mission stressed the policies for decreasing inflationary pressures, medium-term challenges facing government financial operations, and key growth-oriented structural reforms.

Review on Iran's economic performance in 1386 reveals a positive outlook in the short run; however, the staff projections on inflation rate and economic growth in the medium run remained respectively at 25 and 4-5 percent. Thus, the staff reiterated the need for adopting contractionary macroeconomic policies to curb inflation. The staff report emphasized decreasing budgetary expenditures, as well as increasing banks' deposit rate and nominal exchange rate to improve macroeconomic stability. Moreover, government adherence to reforming financial operations and reduction of inflation rate resulted in greater stability of budget and less vulnerability of economy against exogenous

shocks in the medium run. The staff expects that elimination of administrative controls, reduction in commercial supports, improvement of business environment, and amendment of employment regulations facilitate economic boom and job creation policy.

Based on the staff report, run-up in world crude oil prices, economic boom in the region, and a strong policy stimulus were the main causes of Iran's rising economic growth in recent years.

Higher flexibility of nominal exchange rate, rise in the range of fluctuation of rial, and leaving more room for market forces to affect international value of rial are among other recommendations of the 2007 Article IV Consultation mission. Moreover, it is expected that higher flexibility of exchange rate through reduction of monetary indicators growth results in curbing inflationary pressures.

Based on the staff report, higher operational independence of Central Bank aimed at achieving a lower inflation rate, in line with the main objective of this Bank, facilitates implementation of monetary policy and reduces expectations.

Based on staff mission assessment, should the current system of subsidy payments and administrative controls continue, sustainability of economic growth as well as job opportunity creation and protection become progressively difficult over the course of time.

The government position does not create much anxiety over the long run; however, internal and external considerations call for government budget adjustments over the medium run. Maintaining budget surplus in the medium term facilitates inflation reduction, reduces real appreciation pressures

on rial and increases resiliency of national economy against possible shocks of international oil market; more so, in conditions of reduced availability of foreign financing for Iran. Gradual reform of energy prices in domestic market tantamount to world prices may mobilize larger potential budgetary revenue, particularly at low international oil prices. Moreover, government needs to improve and increase budgetary non-oil revenue share, so that part of revenue arising from energy price reform could be allocated to vulnerable groups.

In order to expand financial intermediation, the IMF mission emphasized the need for strengthening banks' financial position and eliminating administrative rate controls. Furthermore, staff commended recent efforts in improving banks' and financial sectors' supervisory framework, recapitalization and privatization of banks. The staff also recommended setting of prudential regulations by the Central Bank to govern all banking operations.

In light of the technical and specialized needs of economic sectors, in 2007, the IMF launched two technical assistance programs in Iran. These programs were: "Banking Regulations and Supervision" and "Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT)".

The World Bank Group

The representatives from Iranian financial and economic organizations attended joint IMF-World Bank meetings in 2007. Moreover, the plan for the implementation of "A Diagnostic Study of Economic Growth in Iran" and "An Analysis of the Value Chain in Two Industries of Textile and Truck Transportation" were finalized, and several projects were approved, which included: "Reduction of Enduring Pollutants of the Caspian Sea" and "Review of Iran's Business Environment".

Islamic Development Bank (IDB)

In 1386, the IDB group approved a total of €150 million facilities, part of which was extended to Export Development Bank of Iran, Bank Keshavarzi, and Bank Mellat.

Asian Clearing Union (ACU)

The total value of transactions through the ACU registered \$15,830.5 million in 2007, up by 31.4 percent compared with the previous year. Total transactions channeled through the ACU ⁽¹⁾, worth \$31,661 million, recorded the highest over its 32 years of operation.

In 2007, India was at the top by clearing 68.5 percent of its transactions valued at \$14,105.2 million, followed by Iran by \$9,931.9 million, Sri Lanka \$3,054.7 million, and Bangladesh \$2,767.9 million, in terms of volume. Iran, India, and Pakistan were the largest creditors, while India, Sri Lanka, and Bangladesh the largest debtors.

According to the ACU Secretariat, Iran by \$9,932 million ranked the first in trade balance in 2007, experiencing 41.5 percent growth in the value of transactions, and

posting \$9,384 million exports (creditor) and \$547.9 million imports (debtor). Iran's balance of debit/credit transactions was +\$8,836.1 million in the review year. Bhutan by \$11.8 million, Nepal \$3.8 million, and Myanmar \$1.5 million, enjoyed a positive balance, while other countries had a negative balance. Moreover, 5.8 percent of total transactions were cleared, and the remaining were settled in hard currencies.

Islamic Financial Services Board (IFSB)

The 4th Islamic Financial Services Board Summit was held in Dubai on May 15-16, 2007. The Summit discussed challenges and efforts toward standardization and convergence of the global Islamic financial services industry.

Senior economists and managers of major international financial organizations attended this Summit, and spoke on the theme from regulators' viewpoint, displaying varying approaches taken towards intersectoral supervision of Islamic financial institutions. The Summit concluded that adapting a more dynamic and flexible approach to supervision

ACU Transactions Cleared-Settled in Foreign Exchange in 2007 ⁽¹⁾

(million dollars)

	Total debit transactions	Total credit transactions	Balance	Cleared in the system (percent)	Settled in hard currency (percent)
Bangladesh	140.0	2,627.9	-2,487.9	5.3	94.7
Bhutan	11.9	0.1	11.8	0.9	99.1
India	5,736.6	8,368.6	-2,632.0	68.5	31.5
Iran	9,384.0	547.9	8,836.1	5.8	94.2
Myanmar	1.5	0	1.5	0.2	99.8
Nepal	16.3	12.5	3.8	76.4	23.6
Pakistan	342.6	1,416.4	-1,073.8	24.2	75.8
Sri Lanka	197.6	2,857.1	-2,659.5	6.9	93.1
Total ⁽²⁾	15,830.5	15,830.5	±8,853.2 ⁽³⁾	44.1	55.9

Source: The ACU Secretariat, report for 2007

(1) Includes accrued interest.

(2) Components may not sum to total because of rounding.

(3) The ± symbol indicates net debit/credit transactions.

(1) Includes receipts, payments, and accrued interest.

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Total Transactions Channeled through the ACU ⁽¹⁾ (million dollars)

	2006	2007	Share (percent)		Change	Growth rate (percent)
			2006	2007		
Bangladesh	2,277.1	2,767.9	9.4	8.7	490.8	21.6
Bhutan	10.6	12.0	0	0	1.4	13.2
India	10,520.0	14,105.2	43.7	44.6	3,585.2	34.1
Iran	7,017.9	9,931.9	29.1	31.4	2,914.0	41.5
Myanmar	3.3	1.5	0	0	-1.8	-54.5
Nepal	15.6	28.8	0.1	0.1	13.2	84.6
Pakistan	1,675.7	1,759.0	7.0	5.6	83.3	5.0
Sri Lanka	2,579.6	3,054.7	10.7	9.6	475.1	18.4
Total	24,099.8	31,661.0	100.0	100.0	7,561.2	31.4

Source: The ACU Secretariat, report for 2007

(1) Includes total debit/credit transactions as well as their accrued interest.

of Islamic financial institutions is essential in moving the industry forward. A cross-sectoral approach to the supervision of Islamic Financial Services consistent with Islamic Shari'ah principles is deemed necessary, as the industry is moving towards greater convergence. The Summit concluded that a common vision and greater coordination and collaborative efforts among the different industry segments including banks as well as securities and insurance providers are essential towards maintaining the industry's sound and stable growth.

The IFSB discussed various topics in 2007 which include: Globalization of Islamic

Financial Services: Opportunities and Challenges; Cross-border Capital Flows, including the Size and Patterns of such Flows, and the role of Islamic Capital Markets in Facilitating such Flows; Key Issues in Regional Integration of Islamic Financial Markets, including Islamic Capital Markets Promotion and the Catalytic Role of Governments; Rules for Sokuk; etc.

In 2007, several new financial organizations and institutions joined the IFSB, bringing its total members to 150. Moreover, the Compilation Guide on prudential and structural Islamic financial indicators was published in this year.

ACU Transactions Matrix in 2007 ⁽¹⁾ (million dollars)

Debtors \ Creditors									Total
	Bangladesh	Bhutan	India	Iran	Myanmar	Nepal	Pakistan	Sri Lanka	
Bangladesh	0	11.9	2,372.4	3.7	1.1	14.4	198.1	14.8	2,616.4
Bhutan	0.1	0	0	0	0	0	0	0	0.1
India	33.9	0	0	8,192.7	0	0	18.8	111.5	8,356.9
Iran	43.5	0	417.5	0	0	0	60.9	26.0	547.9
Myanmar	0	0	0	0	0	0	0	0	0
Nepal	7.7	0	0	1.0	0	0	3.2	0.6	12.5
Pakistan	47.0	0	951.1	366.2	0.4	1.8	0	44.7	1,411.2
Sri Lanka	7.8	0	1,995.3	779.8	0	0.1	61.6	0	2,844.6
Total	140.0	11.9	5,736.3	9,343.4	1.5	16.3	342.6	197.6	15,789.6

Source: The ACU Secretariat, report for 2007

(1) Components may not sum to total because of rounding.