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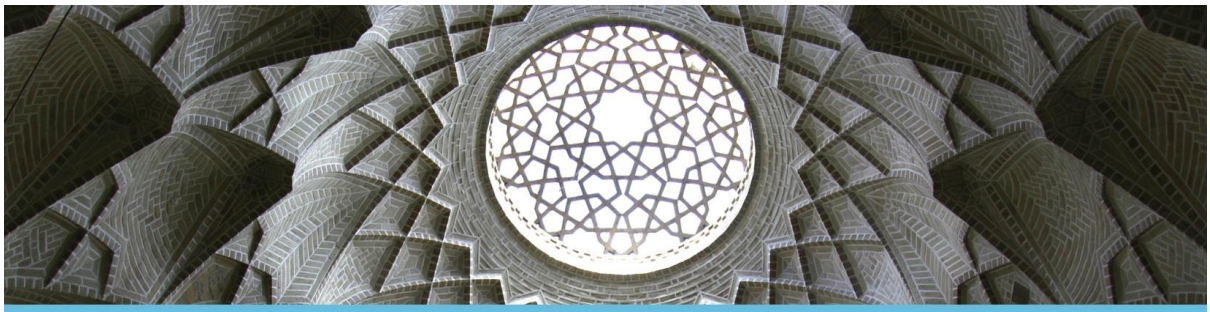

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Iran sets up an alternative foreign exchange market

In April 2018, in a major change in Iran's foreign exchange policy, the government moved away from a dual exchange rate regime (which included a largely market-driven floating rate) to a USD peg set by the Central Bank of Iran (CBI), coupled with capital controls. Since then, several factors including new limits on sale and purchase of foreign currencies, uncertainties surrounding the new regime, currency sale restrictions on exchange houses, a significant divergence between the pegged rate and the rate at which parties were willing to transact, and the reluctance of exporters to repatriate earnings had reduced the availability of foreign currency and the volume of foreign exchange transactions. While the government committed to supply foreign currencies for importation of designated essential goods, importers of other goods and services faced difficulties in meeting their currency needs. At the same time, exporters' options with respect to their foreign currency revenues were considerably restricted by the new obligation to repatriate such revenues at the pegged rate.

The basic framework of the new exchange market

To address the needs of importers and exporters, CBI announced on 10 July 2018 the forthcoming inauguration of an alternative foreign exchange market where importers of non-essential goods could directly purchase foreign currencies from exporters of goods other than petroleum, petrochemical products, condensate, steel products and heavy metals[1]. This alternative forex market should not be viewed as a substitute for an open market because the types of participants, the sources and uses of currencies sold and the available supply will be restricted.

How will the new alternative market work?

The CBI announcement was issued based on a directive[2] by the First Vice-President setting out the details of the alternative foreign exchange market. According to the announcement, this market will operate through two platforms namely, CBI's NIMA platform and the Ministry of Industry, Mines and Trade's Integrated System of Certificates (ISC), described below.

NIMA was created in April 2018 as a platform to regulate and register foreign exchange transactions. For this new market, NIMA will function as a platform for exporters to sell their foreign currency earnings to exchange houses who must then on-sell the currency to

[1] Exporters of these goods are obligated to sell their foreign currency revenues at pre-approved rates (directive number 60/70934 dated 3 June 2018).
[2] Directive number M/97-9911 dated 2 July 2018.

importers of non-essential goods with a valid import registration order in place. On ISC, on the other hand, foreign currency transfers are managed by authorised domestic agent banks, which act as intermediaries between exporters (as sellers of foreign currencies) and importers (as buyers of such currencies).

The key feature of the secondary market on both platforms is that the price for each transaction is to be agreed between the exporter and the importer.

Certain details are known so far on the steps to use the ISC for a foreign currency transfer from an exporter to an importer. These steps are as follows:

- The exporter sends its export license information to the importer, allowing the importer to register an order for foreign currencies.

- The importer then registers the exporter's information at ISC and refers to an agent bank to place its purchase request with the bank.

- The agent bank enquires from CBI as to volume of the exporter's foreign currency and seek further confirmation from the exporter as regards its intention to sell the foreign currency to the importer.

- Upon CBI's approval and the exporter's consent, the importer provides the agent bank with acceptable guarantees of importation. Once such guarantees are provided, the agent bank reserves with CBI the foreign currency which is the subject-matter of the export license. The agent bank must also register the payment method (in form of an unguaranteed bank draft) as well as transportation documents for goods received from the importer in the Foreign Exchange Obligations Management Portal (also known as SAMTAK, according to its Farsi acronym).

- The importer then registers with ISC the information relating to the source of the foreign currency to be transferred.

- The agent bank issues a declaration of foreign exchange supply so that the importer will be able to clear its products at customs using the declaration of foreign currency supply.

Sale of foreign currency earnings by an exporter in this market releases the exporter from the obligation to repatriate those earnings.

What can be expected in the new market?

The exporters who are allowed to participate in the new foreign exchange market generate about 20% of Iran's non-petroleum export revenue. It remains to be seen whether this fraction of export revenues would suffice to address the needs of importers of non-essential goods. If demand substantially exceeds supply in this market, absent other sources of supply, it is reasonable to expect that foreign currencies trading on this market will appreciate.

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Remaining uncertainties

Neither the CBI's announcement nor the First Vice-President's directive address import of services. Hence, it remains to be seen if the new market can be used to purchase foreign currency to pay for services. Moreover, it is uncertain whether parties (including private and governmental entities) to foreign currency-denominated transactions can agree to use the rate indicated in the new market, rather than the CBI pegged rate, to convert foreign currency amounts into rial.

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