

Liquidity in the Iranian Economy

Liquidity growth has been highlighted as a significant problem for Iran's economy.

The CBI reported liquidity growth to be 42.1% in the last year (to 20th March 2007) when it had been targeted to be 22% in the 4th Plan.

The IMF says liquidity growth results from high government spending combined with low real interest rates and its control should be the top priority. The rise of Iran's oil income (at over US\$50 billion last year) has driven government spending

Payvand's Iran News adds that the mandatory cut in interest rates, from 16% to 14% for government banks and from 22% to 17% for private banks, in April 2006 created liquidity shortages in the banking system and a transfer of bank deposits into other sectors such as property. Property saw a 21% price rise in the second half of the year in Tehran and higher elsewhere – this was partly due also the rise in raw material prices.

On 24th May 2007, the government announced that the interest rate for all banks would be reduced to 12%, a 2% reduction for public banks and a 5% reduction for private banks. The TSE fell on this announcement as financial sector share prices slumped. A cycle of events similar to those last year can be expected.

Banks can expect a surge in loan applications, but loans made may need to be rationed, as there will be a drop in bank deposit levels. Banks will face liquidity shortages. Public banks will need government funding. Some private banks may be forced into liquidation, unless the government provided rescue arrangements: but government rescue would extend government control further – reversing an earlier trend.

Deposit funds withdrawn from banks would be directed at consumption, causing further inflation in consumables, and other sectors, such as the TSE and property. Consumer price inflation will disadvantage further the poor, in particular.

Share prices might strengthen, at least in the short-term. Over a longer term the TSE might be more liquid allowing more privatisation through the Exchange. Further property price inflation can be expected.

However there might be a greater take-up of the CBI's Participation Bonds (interest rate, 15%) or of the mooted Participation Bonds for the development of South Pars – if these are brought to issue.