

# Iran's Currency Collapse May Not Lead to Diplomatic Desperation

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## ABOUT THE AUTHORS



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Brief Analysis

## The rial keeps plummeting, but policymakers should not assume this will spur Tehran to scale back its nuclear negotiating demands.

Since the beginning of the year, Iran's currency has lost more than 17 percent of its value against the dollar on the open market. The current downward trend began last August and surpassed 600,000 rials to the dollar in late February, setting a new record. Although the rial regained some of these losses in the past few days, President Ebrahim Raisi's government is under intense pressure to stabilize the situation more fully, as Iranians grapple with a toxic mix of high inflation and tepid growth. The challenge will grow as Nowruz approaches later this month, since currency demand typically increases around the holidays as people travel and buy gifts.

Even so, Western policymakers should not assume that this turbulence will force Tehran's hand diplomatically. Rather than seeking international help, the government is trying to calm the currency tumult using its own tools and may be able to ease conditions in the near term—even if this does little to fix the economy's longer-term structural problems.

## Factors Driving the Current Decline

As mentioned above, one key reason for the rial's plummet is [high inflation \(https://djavadsalehi.com/2022/09/05/inflation-in-iran-much-confusion-about-nothing/\)](#). Iran's average consumer prices in February rose more than 53 percent compared to the same month last year, with food, beverages, and tobacco increasing more than 70 percent. The overall inflation rate tracks the rial's depreciation over the past year, and its rise has been driven by a [number of factors \(https://djavadsalehi.com/2021/06/17/the-role-of-external-shocks-in-irans-inflation/\)](#), including a persistently large budget deficit that the government finances in part through [indirect borrowing \(https://www.piie.com/publications/policy-briefs/iran-has-slow-motion-banking-crisis\)](#) from the Central Bank of Iran.

The rial is also especially sensitive to political developments and overall domestic sentiment. Given the [large-scale anti-regime protests \(https://www.washingtoninstitute.org/policy-analysis/human-rights-sanctions-iran-need-more-coordination-and-creativity\)](#) over the past few months, Tehran's [military support for Russia \(https://www.washingtoninstitute.org/policy-analysis/after-ukraine-russias-potential-military-and-nuclear-compensation-iran\)](#), and the [breakdown of nuclear negotiations \(https://www.washingtoninstitute.org/policy-analysis/irans-nuclear-endgame-warrants-change-us-strategy\)](#), public sentiment about the future has been decidedly negative. In all likelihood, the rial's decline since the nuclear talks stalled last fall partly reflects market participants coming to terms with the probability that most U.S. secondary sanctions will remain in place indefinitely—as opposed to the impact of any specific sanctions Washington has imposed recently. Demonstrating how much psychology plays a role, the rial reversed some of its losses in the past few days after International Atomic Energy Agency director-general Rafael Grossi visited Tehran, generating some positive sentiment.

Another likely driver of the currency challenges is the recent enactment of further restrictions on the flow of dollar notes into neighboring Iraq. In November, the U.S. Federal Reserve [enhanced \(https://www.wsj.com/articles/iraq-economy-reels-as-u-s-moves-against-money-flows-to-iran-11674128633\)](#) its compliance conditions for entities seeking to access Iraqi oil revenues, with the goal of combating money laundering to Iran, among other jurisdictions. The move quickly led to a sharp drop in dollars sold in Iraq's daily auction, presumably affecting dollar availability across the border.

On paper, weakness in the rial could actually [benefit Iran's economy \(https://www.al-monitor.com/originals/2019/09/iran-interplay-exchange-rate-inflation.html\)](#) in some ways—such as by making imports more expensive and exports more attractive, or helping the government earn more revenue in rial terms from oil exports, thereby reducing the budget deficit. These factors explain why the IMF often recommends that governments reduce the value of currencies in response to economic crises.

Yet the Iranian public and elite tend to interpret currency depreciation as a sign of government weakness and incompetence. Many citizens also associate these drops with higher inflation, since domestic businesses can use a lower rial as an [excuse to raise prices \(https://www.wsj.com/articles/irans-currency-tumbles-in-new-challenge-to-clerical-leadership-73feb53\)](#) even on goods produced at home. Hence, Raisi has faced growing public and parliamentary criticism as his government struggles to curtail the slide.

## A Tangled Web of Exchange Rates

The government has flailed about for years to [manage the exchange rate \(https://www.rethinkingiran.com/iranundersanctions/mazarei\)](#). It has periodically introduced new rates that are initially designed to fulfill a limited function but later tend to become more important, while older, lower rates are used for fewer purposes. Manipulation of these complex systems has often led to [significant corruption \(https://www.al-monitor.com/pro/memos/iranian-exporters-suffer-impact-frozen-exchange-rate\)](#) benefiting the politically well-connected. These trends have been on full display in recent months.

A year ago, the rial could be traded at three rates: (1) a very cheap rate for [imports of basic goods and medicine \(https://www.al-monitor.com/originals/2021/10/irans-plan-get-rid-subsidized-exchange-rate\)](#), which used to be called the official rate; (2) the rate used by [importers and exporters \(https://static1.squarespace.com/static/54db7b69e4b00a5e4b11038c/t/5e3a95d705d22d3574ebbc12/1580897753459/B%26B\\_ms\\_Special\\_Report\\_Iran\\_Year\\_Under\\_Max\\_Pressure\)](#) in a system called NIMA; and (3) the open market rate. Amid high inflation, many Iranians use dollars purchased on the open market to [store wealth \(https://donya-e-egtesad.com/%D8%A8%D8%AE%D8%B4-%D8%A8%D8%A7%D8%B2%D8%A7%D8%B1-%D9%BE%D9%88%D9%84-%D8%A7%D8%B1%D8%B2-116/3947045-%D8%AA%D8%B5%D9%85%D8%8C%D9%85-%D8%B3%D8%B1%D9%86%D9%88%D8%B4%D8%AA-%D8%B3%D8%A7%D8%B2-%D8%A8%D8%B1%D8%A7%D8%8C-%D8%AF%D9%84%D8%A7%D8%B1\)](#). Yet the open market is not particularly large compared to the NIMA market—indeed, it is small enough that the Central Bank's injection of a rather small amount of dollars could have a pronounced effect. But the bank has limited amounts of dollars and may not always be willing to spend them toward that end.

Over the past year, the government has removed the first rate and added a new one: an [“agreed rate \(https://www.mojnews.com/%D8%A8%D8%AE%D8%B4-%D8%A7%D9%82%D8%AA%D8%B5%D8%A7%D8%AF%D8%8C-4/469007-%D8%AF%D9%84%D8%A7%D8%B1-%D8%AA%D9%88%D8%A7%D9%81%D9%82%D8%8C-%DA%86%DB%8C%D8%B3%D8%AA-%DA%86%D8%B1%D8%A7-%D8%AD%D8%B0%D9%81-%D8%B4%D8%AF\)”](#) that allows citizens to purchase a fixed amount of foreign exchange

from exporters. It has also intervened more aggressively in the [NIMA market \(https://twitter.com/yarbatman/status/127649250774423040?s=20\)](https://twitter.com/yarbatman/status/127649250774423040?s=20) to keep the rate close to 285,000 rials. And in response to the latest crisis, it introduced the [Currency and Gold Exchange Center \(https://donya-e-egtesad.com/%D8%A8%D8%AF%D8%B4-%D8%A8%D8%A7%D8%B2%D8%A7%D8%B1-%D9%BE%D9%88%D9%84-%D8%A7%D8%B1%D8%B2-116/3945975-%D8%AF%D9%88%D8%A6%D9%84-%D8%AF%D9%84%D8%A7%D8%B1%DB%8C-%D8%AF%D8%B1-%D8%B2%D9%85%DB%8C%D9%86-%D8%B3%DB%8C%D8%A7%D8%B3%D8%AA%DA%AF%D8%B0%D8%A7%D8%B1%DB%8C\)](https://donya-e-egtesad.com/%D8%A8%D8%AF%D8%B4-%D8%A8%D8%A7%D8%B2%D8%A7%D8%B1-%D9%BE%D9%88%D9%84-%D8%A7%D8%B1%D8%B2-116/3945975-%D8%AF%D9%88%D8%A6%D9%84-%D8%AF%D9%84%D8%A7%D8%B1%DB%8C-%D8%AF%D8%B1-%D8%B2%D9%85%DB%8C%D9%86-%D8%B3%DB%8C%D8%A7%D8%B3%D8%AA%DA%AF%D8%B0%D8%A7%D8%B1%DB%8C) (ICE), where citizens can buy currency for noncommercial purposes. If implemented successfully, this new system may help cool the open market in the near term.

Specifically, ICE allows citizens to purchase foreign currency that the government has earned from commodity exports. Prospective buyers must prove they need the currency for one of [sixty-three specific purposes \(https://www.tasnimnews.com/fa/news/1401/12/03/2857708/%D8%B3%D8%B1%D9%81%D8%B5%D9%84-%D9%87%D8%A7%DB%8C-%D9%85%D8%B5%D8%A7%D8%B1%D9%81-%D8%A7%D8%B1%D8%B2%DB%8C-%D8%A7%D8%B9%D9%84%D8%A7%D9%85-%D8%B4%D8%AF-%D8%AC%D8%AF%D9%88%D9%84\)](https://www.tasnimnews.com/fa/news/1401/12/03/2857708/%D8%B3%D8%B1%D9%81%D8%B5%D9%84-%D9%87%D8%A7%DB%8C-%D9%85%D8%B5%D8%A7%D8%B1%D9%81-%D8%A7%D8%B1%D8%B2%DB%8C-%D8%A7%D8%B9%D9%84%D8%A7%D9%85-%D8%B4%D8%AF-%D8%AC%D8%AF%D9%88%D9%84), such as students paying tuition, patients needing medical care abroad, or travelers taking flights overseas (e.g., the latter are permitted to withdraw up to 500 euros). This market is closely regulated by the Central Bank. As of this writing, the dollar costs 436,700 rials on the ICE market vs. 493,500 rials on the open market.

The introduction of ICE also highlights Tehran's goal of redirecting as many Iranians as possible from the open market into one the state can control. The government insists that it has enough foreign exchange to cover demand on the regulated market, and it has made a point of [offering more dollars \(https://www.tasnimnews.com/fa/news/1401/12/09/2860724/%D8%B9%D8%B1%D8%B6%D9%87-2-%D9%85%DB%8C%D9%84%DB%8C%D8%A7%D8%B1%D8%AF-%D8%AF%D9%84%D8%A7%D8%B1-%D8%AF%D8%B1-%D9%85%D8%B1%DA%A9%D8%B2-%D9%85%D8%A8%D8%A7%D8%AF%D9%84%D9%87-%D8%A7%D8%B1%D8%B2-%D9%88-%D8%B7%D9%84%D8%A7\)](https://www.tasnimnews.com/fa/news/1401/12/09/2860724/%D8%B9%D8%B1%D8%B6%D9%87-2-%D9%85%DB%8C%D9%84%DB%8C%D8%A7%D8%B1%D8%AF-%D8%AF%D9%84%D8%A7%D8%B1-%D8%AF%D8%B1-%D9%85%D8%B1%DA%A9%D8%B2-%D9%85%D8%A8%D8%A7%D8%AF%D9%84%D9%87-%D8%A7%D8%B1%D8%B2-%D9%88-%D8%B7%D9%84%D8%A7) for sale on the market than are demanded on a daily basis. So long as this dynamic holds and the ICE program functions as expected, it will probably attract some demand away from the open market, restraining the exchange rate. And the government will likely pair this carrot with the usual sticks, such as dispatching the economic police to arrest speculators and perhaps even attempting to ban free-market trades (though the latter approach would be doomed to fail).

## Policy Implications

As noted previously, Western policymakers should not assume that this currency turbulence indicates [a potential weakening in the regime's nuclear stance \(https://thehill.com/opinion/international/3878385-is-iran-ready-to-build-a-nuclear-bomb-or-not/\)](https://thehill.com/opinion/international/3878385-is-iran-ready-to-build-a-nuclear-bomb-or-not/) in the near term, let alone its hold on power. Instead of striving for sanctions relief, Tehran seems intent on bolstering the rial using domestic tools, and other indicators may reassure its leaders that the crisis is manageable. Most notably, Washington has been unwilling to mount a campaign to suppress Iran's oil exports, which have [risen significantly \(https://www.dw.com/en/how-iran-is-boosting-oil-exports-despite-us-sanctions/a-64562167\)](https://www.dw.com/en/how-iran-is-boosting-oil-exports-despite-us-sanctions/a-64562167) and given the regime [more resources \(https://www.washingtoninstitute.org/policy-analysis/irans-oil-exports-are-vulnerable-sanctions/\)](https://www.washingtoninstitute.org/policy-analysis/irans-oil-exports-are-vulnerable-sanctions/) to prop up the rial.

Over the longer term, however, the trajectory of Iran's economy is worrisome, as growth lags, investment dries up, and inflation continues to erode the standard of living. Such trends will create ample triggers for renewed protests in the future, so Western capitals should refine their suite of responses in preparation.

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