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LEADING INDEPENDENT ANALYSIS OF IRAN'S ECONOMY

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A run on Bank Saderat, a run on the Rial, and risks to CBI's forex reserves

Our banking analysts have been examining the difficulties at Bank Saderat in Tehran which has accrued debts of USD 2 billion. It appears that Bank Saderat in Tehran is experiencing a bank run as depositors are withdrawing money from the bank. The Iranian authorities have so far succeeded in hiding this problem from the Iranian public because of restrictions on daily withdrawals, so the bank run is gradual rather than sudden. Bank Saderat in Tehran is appealing to the Central Bank of Iran (CBI) for help. The CBI has given assurances that it won't allow Saderat to fail. But what if Saderat is not the only problem? It is clear that Banks Tat and Parsian are also experiencing difficulties.

Bank Saderat's Dubai branch is also in trouble. Customers in Iran are withdrawing money in Rials and taking it to the foreign exchange houses (Hawalas) for conversion to USD and Euros. The foreign exchange houses have been applying for foreign exchange for their customers from Bank Saderat in Dubai. But the CBI is not giving Saderat in Dubai enough liquidity because it fears that if the CBI keeps filling the Iranians' demand for dollars, it will quickly exhaust its USD 80 billion foreign exchange reserves.

If bank confidence in Iran is further eroded, we expect a sharp decline in the CBI's foreign exchange holdings.

And because the foreign exchange shortage persists, the Rial continues to weaken (now IRR14,000:USD1) and the spread between the official and unofficial rates continues to grow. Our analysts wonder whether the CBI is deliberately keeping a wide spread between the official and unofficial rates in order to punish Iranians who convert their dollars into Euros. The fact that Iranians persist in buying USD and Euros is testament to their lack of faith in the currency.

We continue to recommend that Iranians purchase US dollars. We expect the exchange rate to widen to IRR20,000:USD1 by Nowruz.

Banking Costs Continue to Rise

The UN, EU, and US sanctions against twenty-one of Iran's twenty-eight banks double the costs associated with international financial transactions. And we have heard the US is exploring extending the sanctions to the CBI.

Iranian banks now purchase hard currencies at increased cost and experience fund transfer delays because large global banks will no longer do transactions with them.

Instead, Iran's banks rely on little-known correspondent banks to transfer hard currencies to the CBI. To transfer oil money for shipments to most countries, the CBI shifts funds through a series of banks prior to deposit in a safe bank that allows Iran to conduct transactions that will process hard currency transfers in the Ukraine or Azerbaijan. The increased number of transactions raises the cost of procuring hard currencies for the CBI and devalues the Iranian Rial, the value of the oil sales, and the savings of all Iranians.

Further, redundancies are created, such as three separate market prices for the Rial denominated in US dollars. Recently, the open market on foreign exchanges required as much as 14,000 Rials to purchase one US dollar, while the official Iranian exchange rate remained 10,900 Rials for one dollar. Iranian private sector companies exchanging dollars in Iran receive fewer Rials for each dollar than they would in the open foreign exchange market. If the US imposes sanctions against the CBI, it will become progressively more difficult and costly for Iran to attract hard currencies. The increased cost for hard currencies will be tantamount to a devaluation of the Rial and oil revenues, and thus the devaluation of all Iranians savings.

Market Recommendations
Banks: Continue strong sell recommendation
Oil Companies: Move from a buy to neutral
Rial: Short (sell) the currency to take advantage of its weakness

Trading Tips

Recommendation: Overweight USD; underweight Euros
According to many analysts, the USD is substantially undervalued. The weak USD has been assisting a gradual recovery in the USD. Recessionary fears in the US are now abating – the release of August's Institute of Supply Management (ISM) manufacturing index showed continued expansion in domestic manufacturing. Conversely many economists expect zero growth in the Euro zone in the current quarter. Given the continued uncertainty over rescue package for the Eurozone, we expect that the USD will continue to appreciate against the Euro.

Gold loses its sparkle
It is well known that gold often suffers when the USD strengthens. The recent fall in the gold price reflects the fact that investors are adjusting their overweight gold positions in favour of dollars. We believe that this trend will

continue.

Buy Platinum
For the first time a troy ounce of gold costs USD 200 more than a troy ounce of platinum. A recent Bloomberg survey of 12 analysts predicted that Platinum prices will rise 23% over the next year to USD 1,845/oz.

Gold Mining stocks – lacklustre to date; soon to glisten
Value investors who are concerned that gold prices have outrun their fundamentals, may wish to look into gold mining stocks. Gold mining stocks are a good hedge – gold bullion prices will remain high while equities are volatile, gold mining stocks are likely to perform well when equity markets recover.

Over the last 8 months, gold prices have risen by more than 30 per cent while gold mining stocks have declined by 2.7%. While gold bullion prices have risen above USD 1,872/oz, the Net Present Value of gold mining stocks implies a gold price of only USD 1,372/oz. Newmont Mining (NYSE:NEM) has linked its dividend to the gold price since July 2011. For every USD 100 increase in the gold price, the dividend will increase by 20c per share. We also recommend Barrick Gold Corp (NYSE:ABX) and AngloGold Ashanti Ltd (LSE:AGD).

Statistics

GDP growth
-1% (2011 best case estimate)
vs. IMF estimate 2.5%
vs. CBI estimate 3.5–4.5% 1388

Inflation
Currently 40%+
vs. CBI estimate 15.4%–24%
vs. IMF estimate 22.5%

Liquidity growth
21% (Official estimate)

Unemployment
Over 35% in much of the country
vs. Official figure of 11.5%