Inflation and Gap between Official and Market Exchange rates in Iran

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Abstract
The main goal of this study is to analyze Inflation and Gap between Official and Market Exchange rates in Iran. Literature from previous studies is cited and data is collected. By applying different tests and results, discussion is done. At the End of study conclusions are drawn on the basis of results and discussion.

Keywords: Inflation; Gap; Official; Market Exchange rates in Iran

1. Introduction

During the post-World War II era prior to 1973, major countries maintained implementing a fixed exchange rate regime. Under this system, central banks agreed in advance to finance either surplus or deficit in the balance of payments. By doing this, central banks have to maintain foreign exchange rate reserves, mainly in gold and dollars and also ready to buy or sell dollars as needed for stabilizing currencies. Monetary policy is important, since any increase in the money supply immediately flows abroad and fails to stimulate the domestic economy (Gordon, 2003). Acting as a designated anchor, the exchange rate is utilized by the monetary authorities to fix the value of traded goods, which will directly reduce the price of other related goods, forming a coherent control mechanism.

The floating exchange rate regime has offered some advantages over its fixed counterpart then a flexible exchange rate system allows a nation to freely adopt policies and induce internal economic affairs. The benefits of flexible exchange rates have fourfold. First, this system is free from influenced by foreign economic conditions. Second, this policy encourages economic development and increases employment opportunity as well. These contents are flexible thus amendment can be made in order to achieve national charters or objectives. Third, the implementation of flexible exchange rates will automatically eliminate disequilibrium in payment balances. A deficit in the balance of payments will cause the external value of a country’s currency to