IRAN, ISLAMIC REPUBLIC

Table 1	2020
Population, million	84.0
GDP, current US$ billion	628.0
GDP per capita, current US$	7472.9
Upper middle-income poverty rate ($5.5)[a]	14.0
Gini index[a]	42.0
School enrollment, primary (% gross)[b]	110.7
Life expectancy at birth, years[b]	76.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2017); Life expectancy (2018).

Years of sanctions and the COVID-19 pandemic have mounted pressures on the Iranian economy. Fiscal space remains constrained due to a decline in oil revenues and the cost of COVID-19 mitigation measures, which caused a surge in government debt. Restricted access to foreign reserves due to US sanctions led to a sharp exchange rate depreciation, which in turn heightened inflation. Job losses through the pandemic and high inflation deteriorated welfare, particularly that of already vulnerable households.

Key conditions and challenges

Over the last decade, bouts of GDP growth have been jobless and primarily driven by the oil sector. Real GDP has declined to the same level of a decade ago and the country failed to benefit from growth opportunities like periods of high oil prices (2010-2014) and a highly educated young population that could boost productivity. Job creation has fallen short of meeting labor supply and despite a persistent low labor market participation rate (44 percent average) the rate of unemployment has been in the double digits. Unemployment has been especially high among the youth, female, and the highly educated (23.7, 15.9 and 14.3, respectively in Q4-2020). Despite some progress towards economic diversification, high public sector presence continues to inhibit job creation and capital formation by the private sector.

Iran is grappling with the COVID-19 health crisis. With more than 1.7 million cases and 61,000 deaths, as of mid-March 2021, Iran remains the worst affected country in the Middle East and North Africa region. After stricter lockdown measures were announced in late-2020 confirmed new cases remained stable and daily deaths fell below 100 persons. A gradual relaxation of measures raises the likelihood of a fourth wave of COVID-19 cases. Vaccinations started in February 2021 for 10,000 frontline medical workers, but full coverage of the 84 million population will take time.

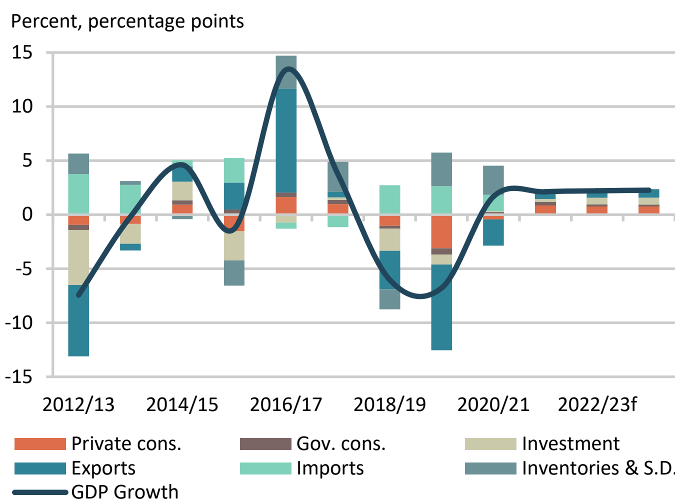
COVID-19 and years of economic sanctions amplify previous economic challenges. The sharp decline in hydrocarbon revenues since 2019/20 combined with the economic and health costs of the pandemic resulted in a large burden on government finances and amplified existing structural challenges. Inflation has remained high since 2018/19 (36 percent YoY on average). The pandemic severely affected jobs and incomes in many labor-intensive activities, including high-contact services and the informal sector.

Recent developments

Despite an initial COVID-19 induced shock to GDP, a strong rebound in mid-2020 led to a modest economic expansion in 2020/21[1] . Iran's GDP is now estimated to expand by 1.7 percent in 2020/21. The COVID-19 output loss since Feb 2020 was less pronounced than in other countries as Iran's economy had already contracted by 12 percent over the previous two years. The economic recovery in Q3 and Q4-2020 was stronger than expected both in oil and non-oil sectors, which grew by 16 percent and 3.1 percent YoY, respectively. The increase in oil GDP vis-à-vis a decline in exports suggests that oil production was largely directed to domestic consumption

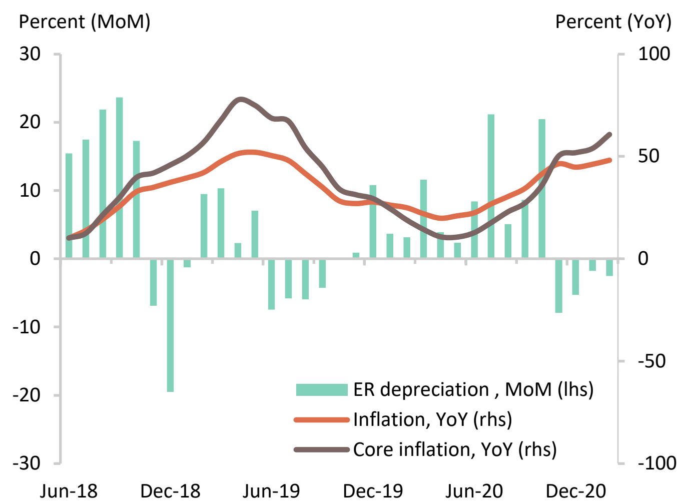
1/ The Iranian calendar year starts on March 21 of every year and ends on March 20 of the following year.

FIGURE 1 Islamic Republic of Iran / Real GDP growth and contributions to real GDP growth



Sources: CBI and World Bank staff calculations.

FIGURE 2 Islamic Republic of Iran / Inflation and parallel market ER



Sources: CBI, SCI and World Bank staff calculations.

and storage in Q3 and Q4-2020. The non-oil sector rebound was driven by the manufacturing sector as the exchange rate depreciation made domestic production more price competitive. Discouragement from the labor market, reflected in lower economic participation, drove the unemployment rate down to 9.4 percent in Q4-2020, despite the employment level falling by over 1 million YoY.

COVID-19 expenditures and plummeting oil revenues increased the fiscal deficit-to-GDP ratio to its highest rate in decades. Government revenues in Apr-Dec 2020 (9M-2020/21) were only 55 percent of the budget approved amount for the entire 2020/21. Similarly, only 14 percent of the anticipated oil income materialized due to both lower oil export volumes and prices. Higher health and social assistance costs from the COVID-19 pandemic pushed total expenditures up by 28 percent YoY. As such, the fiscal deficit is estimated to increase to over 6 percent of GDP and public debt to surpass 50 percent of GDP in 2020/21. The fiscal deficit in 9M-2020/21 was primarily financed through bond issuance (70 percent), followed by sales of assets and withdrawals from strategic reserves.

Inflationary pressures increased in 2020/21 as the rial depreciated due to a limited foreign exchange supply and heightened economic uncertainty. Inflation resurged to over 48 percent (YoY) in February 2021. Since April 2020, the Iranian currency lost half of its value due to US sanctions on accessing reserves abroad. Hopes of sanctions relief after the US elections led the rial to gain about 15 percent of its value. The exchange rate volatility and government financing operations also had negative spillovers in the stock market.

Recent economic developments have added stress on low-income households and stalled poverty reduction. Poverty increased by 1 percentage point from 2017/18 to 2018/19 reaching 14 percent, before the COVID-19 pandemic. The loss in household incomes through the pandemic and rising living costs due to inflation are estimated to raise poverty by 20 percentage points. A range of social protection measures have been introduced in response. While they partially compensate for the lost incomes, their real value will erode with continued high inflation.

Outlook

Iran's economic outlook hinges on the evolution of the COVID-19 pandemic and the pace of global economic recovery. The GDP recovery is projected to be slow and gradual due to a slow vaccination rollout and weak demand from regional trading partners. Inflation is forecast to decrease but remain above 20 percent on average in the medium term. With limited fiscal space and high inflation, economic pressures on poor households will continue. Better targeting of cash transfers can help reduce mitigation costs.

In the absence of a pickup in oil revenues, the fiscal deficit is projected to remain high in the medium term. A slow economic recovery would translate into similarly slow growth in non-oil revenues. Higher reliance on bond issuance, especially in the form of short-term bonds, would increase interest payment and amortizations costs. Further government debt issuance and sales of public assets could increase financial contagion risks in the stock market and place additional stress on the undercapitalized banking sector.

Risks to Iran's economic outlook relate to the recovery path from the pandemic and the prospects of geopolitical developments. The pace of vaccination (purchase and distribution), resurgence in the number of cases such as those from new COVID-19 strains, and subsequent lockdown measures could weigh down on economic activity and prolong the acute phase of the crisis. The burden of further economic deterioration would be felt the most by the poor and vulnerable and increase poverty. Upside risks relate to the possibility of partial sanctions relief which could boost economic activity, as the economy has chronically operated below potential capacity.

TABLE 2 Islamic Republic of Iran / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2018/19	2019/20	2020/21 e	2021/22 f	2022/23 f	2023/24 f
Real GDP growth, at constant market prices	-6.0	-6.8	1.7	2.1	2.2	2.3
Private Consumption	-2.6	-7.7	-1.1	2.2	2.0	2.0
Government Consumption	-2.9	-6.0	2.3	3.2	1.8	1.5
Gross Fixed Capital Investment	-12.3	-5.9	0.7	1.9	3.9	4.1
Exports, Goods and Services	-12.5	-29.9	-12.2	4.0	4.0	4.3
Imports, Goods and Services	-29.5	-38.1	-32.4	1.5	2.5	2.6
Real GDP growth, at constant factor prices	-5.4	-6.5	1.6	2.1	2.2	2.3
Agriculture	-0.9	8.8	4.0	4.0	4.2	4.2
Industry	-11.0	-15.9	4.3	2.9	3.3	3.7
Services	-0.7	-0.5	-0.7	1.2	1.0	0.8
Inflation (Consumer Price Index)	31.1	41.3	36.9	29.3	21.7	18.9
Current Account Balance (% of GDP)	5.9	0.6	-0.8	0.8	1.1	1.3
Net Foreign Direct Investment (% of GDP)	0.6					
Fiscal Balance (% of GDP)	-1.6	-3.7	-6.3	-6.7	-7.0	-7.0
Gross Public Debt (% of GDP)	38.5	47.9	50.3	52.1	54.7	57.4
Primary Balance (% of GDP)	-1.3	-3.0	-5.3	-5.2	-5.0	-4.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.