IRAN, ISLAMIC REPUBLIC

Table 1	2020
Population, million	84.0
GDP, current US$ billion	202.8
GDP per capita, current US$	2414.3
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]	76.7
Total GHG Emissions (mtCO2e)	817.1

Source: WDI, Macro Poverty Outlook, and official data.
(a) Most recent value (2018), 2011 PPPs.
(b) WDI for School enrollment (2017); Life expectancy (2019).

Iran's economy exited a two-year recession in 2020/21, aided by limited COVID-19 mitigation measures and a gradual rebound in oil production in the second half of 2020. Yet, poor economic activity, partly due to US sanctions, low oil revenues and higher recurrent and COVID-19 related expenditures widened the fiscal deficit, leading to significant inflationary pressures and currency depreciation. Growth is expected to remain modest and challenged by further waves of COVID-19 variants, uncertainties in the materialization of sanctions relief, recent tensions in Afghanistan, and climate change impact.

Key conditions and challenges

Having undergone multiple waves of COVID-19 infections, Iran continues to be heavily impacted by the pandemic. With more than 5.3 million confirmed cases and 115K deaths, as of mid-September 2021 (population: 84 million), Iran remains the most affected country in the Middle East and North Africa region. The spread of the Delta variant since August 2021 has led to a new record number of daily cases (50K) and deaths (709). As of September 15, 2021, only 31 percent of the population have received the first dose of a vaccine and about 16 percent were fully vaccinated. As a result, the hospitalization rate remains high.

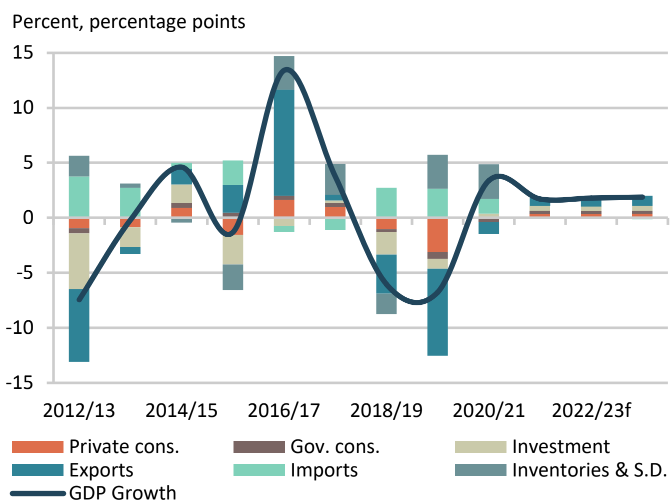
Over the last decade, Iran's real GDP growth has been negligible and has resulted in a drop of real GDP per capita to its 2006 level. Despite some progress towards economic diversification, high public sector presence continues to inhibit private sector job creation and investment. Even prior to recent sanctions, job creation fell short of meeting new labor supply and unemployment remained stubbornly high. The labor market is characterized by low participation and large gender disparities. Adverse events owing to climate change, such as droughts and desertification, have impacted the agriculture sector but also hurt industrial production due to lower hydroelectricity generation. Furthermore, since 2019/20,[1/] a sharp decline in oil revenues due to US sanctions combined with the onset of the pandemic have accentuated the pro-cyclicality of government spending and volatility of the economy.

Income losses have worsened households' welfare. The loss in household incomes due to the pandemic (owing to lockdowns) and rising living costs due to inflation added more pressures on low-income households. Given the large share of vulnerable households, these shocks are likely to have determined a sizeable increase in poverty. While a range of social protection measures were aimed to compensate for the welfare loss, their mitigating impact was eroded by inflation. Inflation has remained high (36 percent YoY on average since 2018/19) largely due to a sharp currency depreciation (over 400 percent since 2018/19) and deficit monetization.

Recent developments

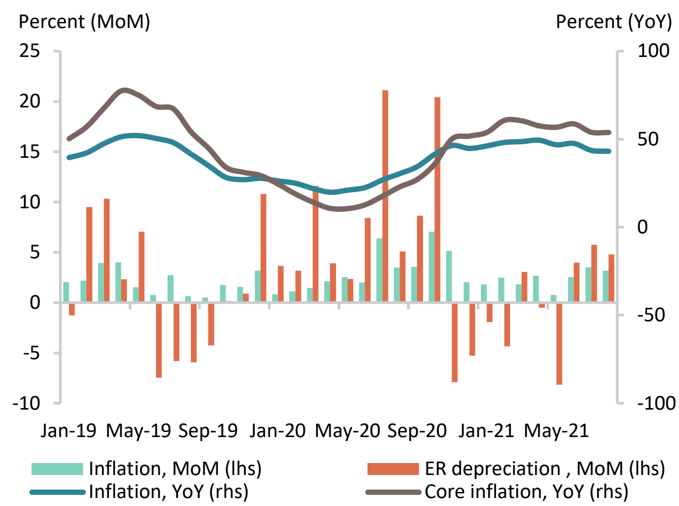
Iran's economy witnessed a moderate recovery in 2020/21 following more than two years of recession. A gradual recovery in global demand and limited COVID-19 lockdowns contributed to stronger growth in the oil sector (11.2 percent) and in manufacturing (7.1 percent) which led GDP to grow by 3.4 percent in 2020/21. On the expenditure side, public and private consumption contracted by 2.3 percent and 0.4 percent, respectively, and import bans led to another year of declining Imports (-29.2 percent) offsetting the decline in exports (-5.4 percent). The latest industrial production data indicates a

FIGURE 1 Islamic Republic of Iran / GDP growth and demand side decomposition



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.

decline in economic activity after the spread of the Delta variant in August 2021, though oil production gradually increased to 2.4 million barrels/day. The employment population ratio in Apr-Jun 2021 remains 2.1 percentage points below the pre-pandemic level of 39.8 percent (Apr-Jun 2019) with a disproportionate negative impact on women.

The government faces challenges in financing a growing fiscal deficit due to declining oil revenues. The fiscal impact of the global oil market recovery in 2020/21 was limited as oil revenues only accounted for under 10 percent of government revenues. Faced with low revenues, the government adjusted expenditures to reduce the adverse impact on the deficit, which increased by almost 2 percentage points to 6.9 percent of GDP. Deficit financing through bond auctions (46 percent lower in Apr-Sep 2021, YoY) was less successful due to heightened economic uncertainties and negative real interest rates. This led the government to exhaust its revolving fund and monetize the remaining deficit as planned sales of public assets also slowed.

CPI inflation rose to 43.2 percent (YoY) in August 2021 driven by inflationary expectations due to uncertainties in the economic outlook and ongoing nuclear talks. This came as the currency depreciated again (16 percent depreciation in Apr-Aug 2021) pushing up the price of imported goods.

In 5M-21/22 (Apr-Aug 2021), non-oil exports recovered to their pre-pandemic level, reaching US$17.6 billion (61 percent YoY growth), while imports reached US$16.6 billion (21 percent YoY growth), leading to a modest non-oil trade surplus. The large growth in exports mainly reflects the impact of boarder closures at the onset of the COVID-19 in 2021. However, Iran's access to foreign exchange reserves continues to be restricted due to US sanctions which complicate trade and international financial transactions.

Outlook

Iran's economic outlook is shaped by the expectations about the course of the pandemic, the recovery in demand from export partners, and geopolitical developments. Average GDP growth is projected to remain under 3 percent per annum in the medium term. Domestically, slow COVID-19 immunization in the face of the large Delta variant and potential lockdowns alongside low investment rates are key drivers of the outlook. The impact of new variants on global demand together with ongoing US sanctions on exports is expected to weigh down on growth in both oil and non-oil sectors. Disruptions to trade with immediate neighbors, such as Afghanistan following the government collapse, could also undermine exports and further restrict availability of much needed foreign currency. In addition, the mounting climatic challenges resulting in water and energy shortages together with high inflation could further increase pressures on the most vulnerable and add to social grievances. Upside risks include the possibility of sanctions relief which could materially boost economic activity, especially since it has operated below potential capacity for several years.

Importantly, in the absence of a rebound in Iran's oil revenues in the medium term, the new government will face a large fiscal deficit. Limited non-oil revenue growth owing to a slow recovery, uncertain prospects for higher oil revenues, and higher wage bill and pensions expenditures are expected to keep the fiscal balance in deficit. The government is expected to continue to issue bonds and sell public assets to finance the deficit. More short-term issuances will increase roll-over risks while monetization will add to inflationary pressures.

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

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

	2018/19	2019/20	2020/21	2021/22 e	2022/23 f	2023/24 f
Real GDP growth, at constant market prices	-6.0	-6.8	3.4	3.1	2.4	2.2
Private Consumption	-2.6	-7.7	-0.4	2.1	1.8	1.5
Government Consumption	-2.9	-6.0	-2.3	2.4	1.7	1.5
Gross Fixed Capital Investment	-12.3	-5.9	2.5	1.2	2.1	2.7
Exports, Goods and Services	-12.5	-29.9	-5.4	12.0	7.1	5.9
Imports, Goods and Services	-29.5	-38.1	-29.2	9.8	4.8	3.9
Real GDP growth, at constant factor prices	-5.4	-6.5	3.6	3.1	2.4	2.2
Agriculture	-0.9	8.8	4.5	1.6	2.1	4.0
Industry	-11.0	-15.9	8.4	3.6	3.5	3.4
Services	-0.7	-0.5	-0.1	2.9	1.6	0.9
Inflation (Consumer Price Index)	31.1	41.3	36.4	42.9	41.6	40.3
Current Account Balance (% of GDP)	9.1	1.5	-0.3	1.4	1.5	1.7
Fiscal Balance (% of GDP)	-1.7	-5.0	-6.9	-7.3	-6.9	-6.8
Gross Public Debt (% of GDP)	38.5	48.0	52.0	53.7	53.2	52.6
Primary Balance (% of GDP)	-1.5	-4.3	-5.9	-6.2	-5.9	-5.8
GHG emissions growth (mtCO2e)	1.7	-4.6	3.4	3.0	2.6	2.6
Energy related GHG emissions (% of total)	70.9	69.7	70.1	70.1	70.0	69.7

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.
Notes: e = estimate. f = forecast.