# IRAN, ISLAMIC REPUBLIC

| Table 1 | 2018 |
|---|---|
| Population, million | 82.0 |
| GDP, current US$ billion | 413.1 |
| GDP per capita, current US$ | 5037 |
| Upper middle-income poverty rate ($5.5)[a] | 11.6 |
| Gini index[a] | 40.0 |
| Life expectancy at birth, years[b] | 76.0 |

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2016), 2011 PPPs.
(b) Most recent WDI value (2016)

*The Iranian economy has entered a period of stagflation and is expected to contract by more than 2 percent on average between 2018/19-2019/20 due to negative external shocks. Central government fiscal deficit has reached record levels in recent months due to lower realized revenues from a shrinking economic activity base. Unemployment rate remains high at close to 12 percent.*

## Recent developments

Economic growth in Iran continued to slow down in the first quarter of 2018/19 (April-June)[1] as the first part of US sanctions were reimposed in May 2018. On the production side, the economy grew by 1.8 percent yoy in June quarter 2018 substantially lower than growth in the same period a year before (4.6 percent) and heavily relying on the oil sector which accounted for more than two thirds of total growth (1.2 percentage points). Almost all non-oil sector growth, similar to the year before, was attributed to growth in services (transportation, storage and communication) while manufacturing output declined for the first time in the past 8 quarters (-1.5 percent, yoy). On the demand side, exports were the main contributor to growth (3 percentage points), reflecting the increase in oil exports as major importers increased their orders ahead of the second round of US sanctions (on November 2018), targeting the oil sector. Investment shrank (-0.8 percent, yoy) due to increasing uncertainty in the future direction of the economy.

The central government budget deficit for the first nine months of 2018/19 deteriorated to a record high of IRR451.1 trillion (equivalent to 4 percent of 2017/18 GDP for the same period), almost 40 percent more than the approved budget for the entire 2018/19 year, mainly due to a 62 percent shortfall in expected current revenues. However, realized oil revenues were 17 percent higher than the envisioned amount for the period due to higher import demand ahead of November sanctions. The widening fiscal deficit came despite capital expenditures for the same period were at only half of the budget-approved amount for the entire year.

Inflation reached a recent high of 42.2 percent yoy for the month ending February 20, 2019 with food prices up by 62.8 percent in the same period compared to a year earlier. Direct imports of food items such as meat at the official exchange rate and other direct price controls have so far been unable to prevent inflation. Inflationary expectations and uncertainty have kept the pressure on the value of rial (IRR130,000 per 1 USD unofficial rate, mid-February 2019) driving up input costs and imported consumer goods. The non-oil trade deficit for the first 9 months of 2018/19 narrowed to US$2 billion compared to US$12.2 billion in the same period of 2017/18.

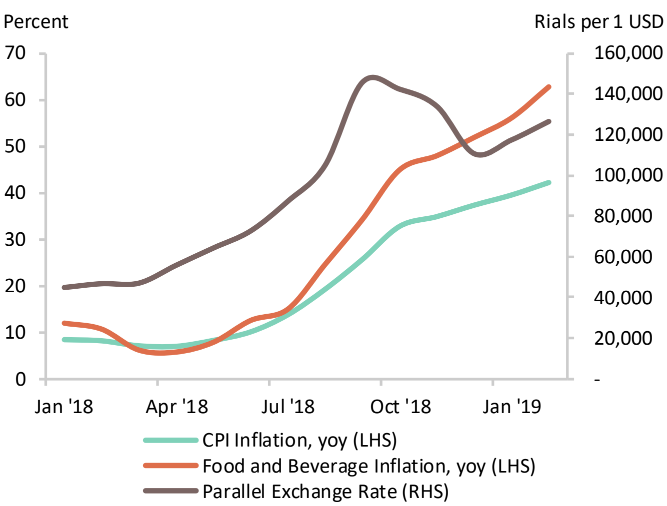
Poverty in Iran, measured at the upper middle-income poverty line of US$5.5 (2011 PPP US$) per day, increased between 2013 and 2016 from 8.0 to 11.6 percent despite positive average GDP per capita growth during this period.

This negative trend in wellbeing was associated with the erosion of the real value of cash transfers. Universal cash transfers were the main driver of poverty reduction during 2009-2012, but due to inflation, the real value of benefits has diminished since, affecting the poor the most.

## Outlook

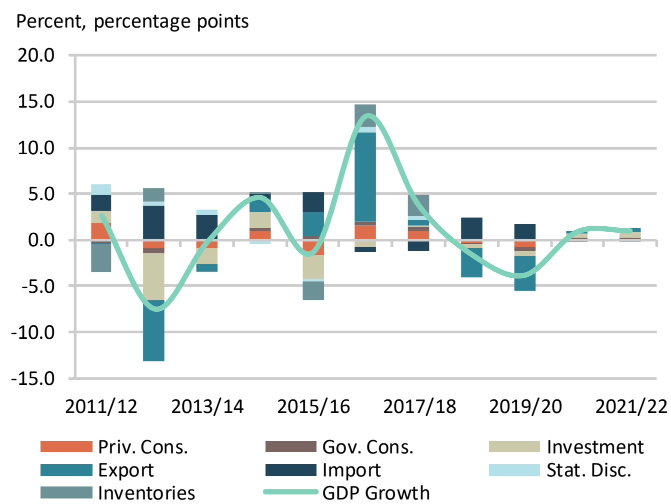
In the medium term, the economy is expected to undergo a period of stagflation

**FIGURE 1 Islamic Republic of Iran** / Recent inflation and parallel exchange rate trends




Sources: SCI and local media.

**FIGURE 2 Islamic Republic of Iran** / GDP growth composition (demand side)




Sources: Based on CBI data and World Bank staff estimations.

until April 2020 as oil output continues to decline along with other mounting external economic challenges. The economy is projected to contract by more than 2 percent in 2018/19 and 2019/20 before returning to a modest recovery path albeit from a smaller base. Inflation is expected to be around 30 percent in 2018/19 and increase further in the following year as the full effect of the exchange rate depreciation is passed on.

The fiscal deficit is projected to widen as incomes continue to fall short of the previous years due to lower tax revenues (as a result of reduced economic activity) and oil exports.

On the external side, Iran's current account surplus is expected to decline to very low levels in the coming years as exports decline in both goods and services categories despite limited US sanctions waivers for some importers of energy and oil from Iran. The shrinking current account balance, along with expected rise in outward flows from the financial account, are likely to raise the challenge of managing the value of the rial and inflation by the CBI.

A decline in real GDP per capita with double-digit inflation are expected to have a further negative impact on poverty through different channels, including the labor market and a further erosion of the real value of cash transfers. Poverty is expected to continue to increase after 2016, reaching 12.8 percent in 2021. The exact poverty trend will also depend on the public policy response of the government. Increasing the value of cash transfers, possibly along with introducing targeting mechanisms, may help the poor and vulnerable population cope with the social and economic shocks.

## *Risks and challenges*

The baseline assumption for the medium-term outlook relies on continued Iranian oil exports with a lower bound of around 1 million barrels per day in the coming years and continued flow of other non-oil trade facilitated through banks and other means at levels required for economic activity to continue. These assumptions are subject to downside risks should oil exports fall below the assumed levels either due to additional oil export restrictions or decline in demand for other trade especially from Iran's traditional trading partners such as China, India and Russia as well as neighbors including Turkey and Iraq. Further restrictions on foreign trade and clearing of trade and debts could also contribute to higher financing costs and inflationary pressures.

1/ Most recent data published by the Central Bank of Iran (CBI). Iranian calendar year starts on March 21.

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

| | 2016/17 | 2017/18 | 2018/19 e | 2019/20 f | 2020/21 f | 2021/22 f |
|---|---|---|---|---|---|---|
| **Real GDP growth, at constant market prices** | 13.4 | 3.8 | -1.6 | -3.8 | 0.9 | 1.0 |
| Private Consumption | 3.8 | 2.5 | -0.9 | -1.9 | -0.2 | 0.1 |
| Government Consumption | 3.7 | 3.9 | -1.5 | -4.0 | 2.4 | 2.6 |
| Gross Fixed Capital Investment | -3.7 | 1.4 | -2.2 | -3.4 | 2.7 | 2.8 |
| Exports, Goods and Services | 41.3 | 1.8 | -11.1 | -15.0 | 1.6 | 2.0 |
| Imports, Goods and Services | 6.1 | 13.4 | -27.1 | -25.4 | 1.3 | 4.3 |
| **Real GDP growth, at constant factor prices** | 12.5 | 3.7 | -1.5 | -3.8 | 0.9 | 1.0 |
| Agriculture | 4.2 | 3.2 | 2.8 | 3.0 | 3.1 | 3.1 |
| Industry | 24.7 | 3.0 | -6.8 | -7.2 | 0.7 | 0.3 |
| Services | 3.7 | 4.5 | 2.9 | -1.8 | 0.7 | 1.3 |
| **Inflation (Consumer Price Index)** | 9.0 | 9.6 | 29.9 | 39.2 | 24.6 | 22.0 |
| **Current Account Balance (% of GDP)** | 3.9 | 3.5 | 0.5 | 0.0 | 0.5 | 0.9 |
| **Fiscal Balance (% of GDP)** | -1.9 | -1.8 | -4.8 | -5.4 | -5.5 | -5.4 |
| **Gross Public Debt (% of GDP)** | 49.0 | 38.2 | 42.4 | 44.8 | 44.6 | 44.4 |
| **Primary Balance (% of GDP)** | -1.8 | -1.6 | -4.5 | -4.8 | -3.9 | -3.7 |
| **Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]** | 11.6 | 10.9 | 11.6 | 12.9 | 12.9 | 12.8 |

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate, f = forecast.
(a) Calculations based on 2016-HEIS. Actual data: 2016. Nowcast: 2017-2018. Forecast are from 2019 to 2021.
(b) Projection using neutral distribution (2016) with pass-through = 0.87 based on GDP per capita in constant LCU.