IRAN, ISLAMIC REPUBLIC

Table 1	2017
Population, million	80.6
GDP, current US$ billion	447.7
GDP per capita, current US$	5554
Upper middle-income poverty rate ($5.5)[a]	10.5
Gini index[a]	38.8
Life expectancy at birth, years[b]	76.0

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2016)

Overall growth moderated to 3.8 percent in 2017/18 as the contribution of oil to growth diminished. With depreciating exchange rate, rising inflation and the looming sanctions, the economy is expected to be negatively affected, contracting annually by 1.4 percent between 2018/19 to 2020/21 on average. There are considerable risks to the outlook depending on the scope of trade disruptions and the impact of domestic economic reforms.

Recent developments

Iran's GDP growth in 2017/18 dropped to 3.8 percent as the effect of a large surge in oil revenues in the previous year dissipated. The overwhelming majority of growth came from the non-oil sectors out of which more than half can be attributed to services growing by 4.4 percent. Oil, agriculture and services sectors are now back above the levels of activity they were prior to UN sanctions in 2012. But in the past two years, there has not been a strong bounce back in key sectors such as construction and trade, restaurant and hotel services following their post-2012 stagnation and the overhang from the problems of the banking sector. The oil and gas sector witnessed a growth of 0.9 percent, limited by the OPEC+ quota for the agreed period.

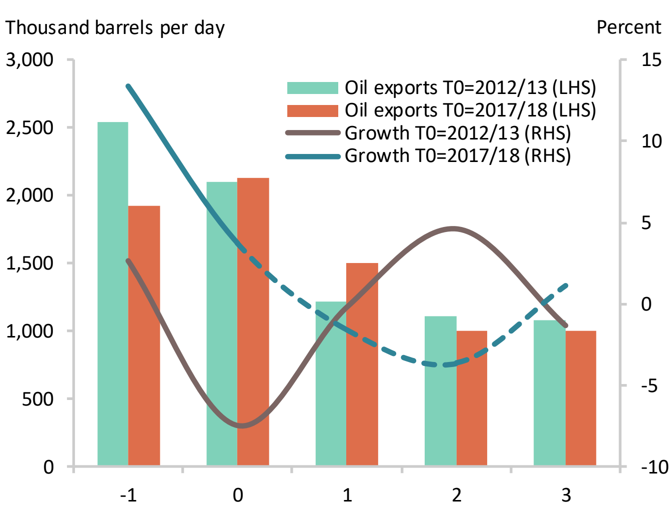
The government managed to narrow the fiscal deficit to 1.8 percent in 2017/18 as oil revenue increased and the growth rate of expenditures eased, especially in real terms. Similar to the previous year, lower than expected realized government revenues came at the expense of lower capital expenditures (5.5 percent of GDP) in 2017/18. Government debt issuances to finance gross borrowing requirements remained high as a share of revenues (13.9 percent) in 2017/18 but lower than the record level in the previous year (19 percent).

The current account surplus fell from 3.9 percent of GDP in 2016/17 to 3.5 percent of GDP in 2017/18, as Iran's oil production initially slowed in 2018. Real export growth of goods and services was 1.8 percent in 2017/18, down from 41.3 percent, while real import growth was 13.4 percent in 2017/18. Iran's non-oil exports have risen in recent years from 6 percent of GDP in 2012/13 to 10 percent of GDP in 2017/18.

In April, the government's unification of the official and parallel rates has short-lived impact. The parallel market rate has fluctuated on expectations of dollar shortage as the U.S. pulled out of the Joint Comprehensive Plan of Action (JCPOA) in May. By August, the rial had devalued by 172 percent over the past 12 months, rising above 100,000 rials per dollar. This has contributed to the measured inflation rate returning to 18 percent in July, a rate last seen in March 2014.

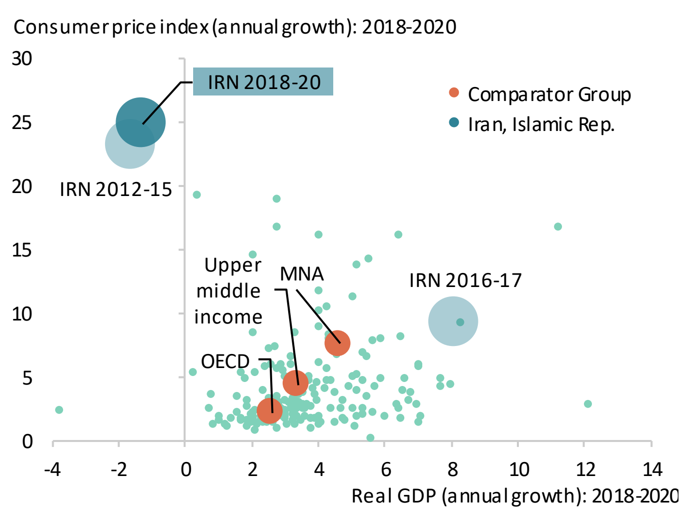
For the quarter ending in June 2018, the unemployment rate improved to 12.1 percent[1] as employment growth has remained above 3 percent year on year for 6 consecutive quarters, leading to more than 790 thousand jobs being created in 2017/18. The labor force participation rate edged up to 41.1 percent in June quarter 2018, its highest level in more than 10 years, while the underemployment rate was 10.4 percent. Youth (15-24 years) unemployment at 28.3 percent in June 2018 remains high compared to earlier periods and regional average. Female labor force participation rate continued to improve to around 19.8 percent in 2017/18. The country ranks among the top countries that improved the participation of females in the labor force, although considerable differences between male and female la-

FIGURE 1 Islamic Republic of Iran / Economic impact of previous sanctions compared to outlook for 2017/18 and beyond



Sources: CBI, OPEC and World Bank staff calculations.
Note: T0 equals to initial year of sanctions.

FIGURE 2 Islamic Republic of Iran / Outlook of CPI inflation vs GDP growth



Sources: Find My Friends using IMF WEO and World Bank staff calculations.

bor force indicators remain.
Poverty is estimated to have fallen from about 13 percent to 8 percent between 2009 and 2013 (US$5.5 a day line in 2011 PPP). This was mainly due to a universal cash transfer program in late 2010, which preceded the elimination of subsidies on energy and bread. The program more than compensated for the increases in energy expenditures of less-well-off households, thus contributing to positive consumption growth of the bottom 40 percent of the population, with overall consumption growth between 2009 and 2013 being negative. Poverty increased in 2014 to 10.5 percent and this is associated with declining social assistance in real terms due to inflation.

Outlook

In the medium term, the economy is set to experience a downward trajectory as oil exports are expected to fall to half of their 2017/18 levels following the phased reintroduction of US sanctions culminating in November 2018 (Figure 1). The economy is expected to contract by 1.4 percent on average between 2017/18-2020/21, experiencing a fall in exports and consumption on the demand side and a contraction of the industry sector on the supply side.
Government balances are also expected to deteriorate as oil revenues account for more than 40 percent of central government revenues. With exports disrupted, the demand for the U.S. dollar to finance imports and savings is expected to rise and the parallel premium is likely to increase further than the current 150 percent gap between the official rate and parallel rate. Higher import prices from the devaluation are expected to push inflation back above 30 percent in the coming years as inflationary expectations spiral and consumer sentiment falls leading to once again a period of stagflation for Iran (Figure 2). Despite the depreciation and drop in imports, the reduction in oil exports is estimated to almost eliminate the current account surplus which is lower than the earlier UN sanctions episode as oil prices are almost half of the levels they were in 2012-2013. The economy's downward trajectory is also likely to put further pressure on the labor market and reverse recent job creation gains.
Given the political and economic uncertainty Iran has been facing since 2009, poverty has been volatile, making forecasts less precise. Nevertheless, the falling real value of cash transfers due to inflation may counterbalance the positive impact on wellbeing from economic growth in 2016 and 2017 and exacerbate the impact of predicted negative growth after 2017.

Risks and challenges

On the external side, there is uncertainty of the impact of US sanctions, depending on the adaptations of other trade partners. Domestically, the government faces the economic and social challenges of completing adjustment to previous shocks, notably the financial sector restructuring, as well as mitigating the evolving impact of oil export decline. Weathering these challenges will be key in continuation of the course of domestic reforms, especially to tap potential in modern services. Combating rent-seeking is now directly linked to macroeconomic challenges given the scarcity of foreign exchange and the administrative complexities of formal sector trade and payments systems.

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

	2015/16	2016/17	2017/18	2018/19 e	2019/20 f	2020/21 f
Real GDP growth, at constant market prices	-1.3	13.4	3.8	-1.5	-3.6	1.1
Private Consumption	-3.5	3.8	2.5	-0.6	-1.8	0.3
Government Consumption	4.8	3.7	3.8	-1.7	-3.8	2.3
Gross Fixed Capital Investment	-12.0	-3.7	1.4	-1.5	-2.2	3.5
Exports, Goods and Services	12.1	41.3	1.8	-11.9	-15.4	1.2
Imports, Goods and Services	-20.2	6.1	13.4	-27.1	-25.3	1.8
Real GDP growth, at constant factor prices	-1.6	12.5	3.7	-1.6	-3.7	1.2
Agriculture	4.6	4.2	3.2	3.5	3.3	3.1
Industry	-1.4	24.7	3.1	-7.0	-7.2	0.6
Services	-2.5	3.7	4.5	2.9	-1.5	1.5
Inflation (Consumer Price Index)	11.9	9.0	9.6	23.8	31.2	19.6
Current Account Balance (% of GDP)	2.3	3.9	3.5	0.6	0.0	1.1
Fiscal Balance (% of GDP)	-1.7	-2.2	-1.8	-4.7	-5.2	-4.8
Gross Public Debt (% of GDP)	41.2	49.0	37.0	41.7	44.4	42.0
Primary Balance (% of GDP)	-1.6	-2.1	-1.6	-4.3	-4.4	-3.6

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