IRAN, ISLAMIC REPUBLIC

Table 1	2017
Population, million	80.6
GDP, current US$ billion	439.5
GDP per capita, current US$	5452
Upper middle-income poverty rate ($5.5)[a]	10.5
Gini coefficient[a]	38.8
School enrollment, primary (% gross)[b]	108.9
Life expectancy at birth, years[b]	75.7

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2014), 2011 PPPs.
(b) Most recent WDI value (2015)

As the impact of the previous year's boost in oil production and exports dissipates, overall growth rate is expected to stabilize at around 4.2 percent, with a larger contribution from the non-oil sector. Yet, continued high unemployment rate and an expected upward trend in prices are likely to put pressure on household incomes and complicate the space to implement further economic reforms, particularly in the aftermath of widespread protests in January 2018.

Recent developments

Real GDP growth at factor prices is expected to moderate from 12.5 percent in 2016/17 to 4.3 percent in 2017/18 as oil production stabilizes. Unlike in 2016/17, the non-oil sector was the main contributor to the overall growth in the first half of 2017/18 (by 3.2 percentage points of the overall 4.5 percent). Gross fixed capital formation recorded a positive growth rate for the first time since the second half of 2014/15, driven mainly by a pickup in investments in the construction sector. This was supported by a 20 percent growth in outstanding loans as of December 2017, compared to December 2016.

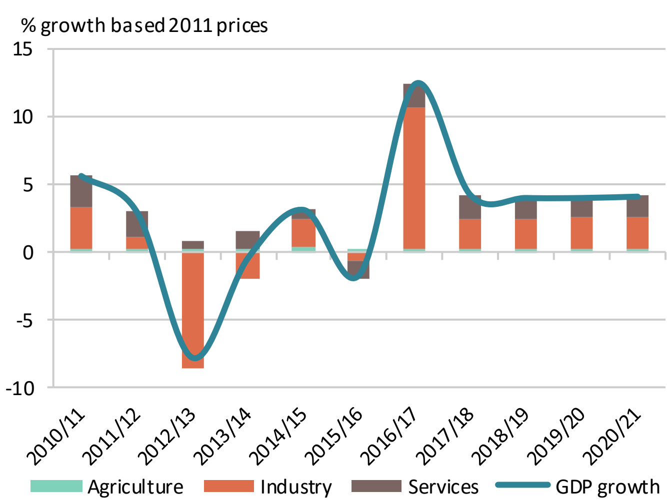
The fiscal deficit is estimated to slightly widen to 2.4 percent as government expenditures growth outpaces the increase in revenues. In the first nine months of 2017/18 tax revenues increased by only 4.4 percent and oil exports receipts surged by 52 percent compared to 25 percent and -6.7 percent respectively in the same period in 2016/17. On the expenditures side, current expenditures increased by 16.8, while capital expenditures surged by 91 percent on the back of a considerably low base and two subsequent years of contraction.

The current account surplus is estimated to slightly improve to 4.1 percent of GDP in 2017/18 (up from 3.9 percent in 2016/17) as oil prices increase while export volumes remain stable around the country's 2.4 million barrels per day and production remains at the amount agreed under the OPEC production cut and 2011/12 daily production level. However, data for the first 10 months of the current year regarding non-oil trade balance indicate a considerable deficit of around US$5.7 billion as imports increased by 22 percent and exports by 1.7 percent on an annual basis.

Following the street protests in Tehran and a number of other cities at the end of December 2017 and early January 2018, sparked by economic concerns, the exchange rate depreciated significantly as uncertainty increased speculative demand for foreign currency. By mid-February Rial's parallel market exchange rate against the US dollar was around 16 percent lower than end-December 2017. In response, CBI announced a temporary increase on bank deposit return rate ceiling to 20 percent (up from 15 percent). As of end-February Rial stood at 6.4 percent lower than its end-December value against the US dollar in the parallel markets. As the gap between the parallel and official exchange rate widened, some critics argued that the government, as the largest supplier of foreign exchange, benefitted from this rate premium as a quasi-fiscal tool to cover the mounting cost of problems with pension funds and cash handouts. Despite the exchange rate turmoil, pass-through remained limited and CPI inflation stayed just below 10 percent in the 12-months prior to February 20th.

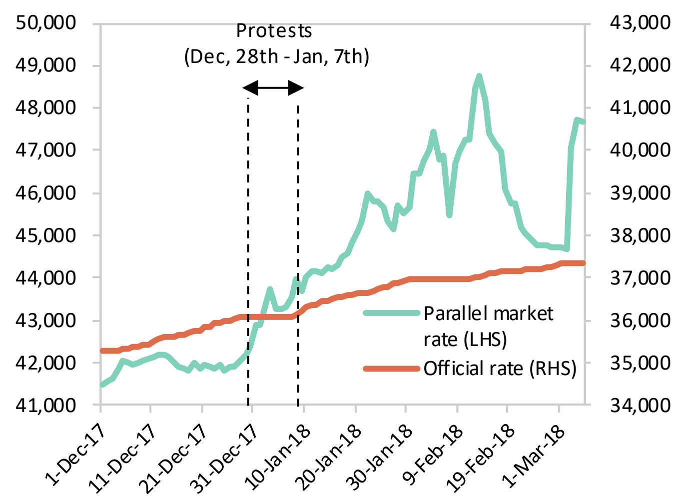
Recent Statistical Center of Iran data puts the unemployment rate for the third quarter of the year (October-December 2017) at 11.9 percent and the labor force participation at 41 percent, which marks a moderate improvement compared to the same quarter a year earlier (12.3 and 38.9 per-

FIGURE 1 Islamic Republic of Iran / Supply side contribution to GDP



Sources: CBI and World Bank staff calculations.

FIGURE 2 Islamic Republic of Iran / Recent Rial to US dollar exchange rates



Sources: CBI, Donya-e-Eqtesad and World Bank staff calculations.

cent respectively). This is in line with a gradual improvement in non-oil sector production.

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 likely due to the introduction of the universal cash transfer program in late 2010, 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 though and this may be associated with a declining social assistance in real terms.

Outlook

The economy is expected to maintain a steady growth of slightly over 4 percent, increasingly based on non-oil sectors, and fueled by a recovery in consumption and investment demand and overtaking the contribution of net exports. Some signs of pick up in construction sector, historically a lead indicator of economic activity, also appear to confirm this trend.

The fiscal deficit is estimated to remain above 2.5 percent of GDP through 2020 as expenditures increase due to the postponement by the Parliament of some reform measures (such as the initially envisioned cash transfer targeting under the initial draft of the 2018/19 budget). Furthermore, increased leveraging of government budget through bonds and other financial instruments and the subsequent higher servicing of debt are likely to add upward pressure on expenditures.

The current account surplus is expected to further strengthen and hover around 5 percent of GDP, mainly due to the steady increase in global energy prices based on current projections and gradual improvement in non-oil trade balance.

In the medium term, inflationary pressures are likely to increase due to widening output gap and further currency depreciation, pushing CPI inflation into double-digit territory again.

Given political and economic uncertainty Iran has been facing since 2009, poverty has been volatile, making forecasts less precise. Nevertheless, falling real value of cash transfers may continue to have negative impact on poverty, while moderate economic growth and planned improved targeting of benefits may contribute to lower poverty after 2017.

Risks and challenges

The lack of job creating growth will continue to be an important challenge. As the unrest in early January 2018 demonstrated there is widespread concern about poverty, corruption and lack of jobs, particularly for the youth. In the aftermath of events and the presence of continued yet more scattered demonstrations, the policy environment in the county has become more challenging for the government's reform agenda, with significantly different views regarding the country's development model. Banking sector reforms are largely pending, which, combined with uncertainties around global banks re-engagement with Iranian banks put pressure on inward investment. The unification of the official and market exchange rates has been further postponed and the gap between the two rates currently stands higher at close to 28 percent. The increasing reliance on issuance of debt instruments for financing government arrears and current expenditures can put additional pressure for rollover of maturing debt, increase borrowing costs and undermine the sustainability of government finances in the coming years.

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

	2015/16	2016/17	2017/18 e	2018/19 f	2019/20 f	2020/21 f
Real GDP growth, at constant market prices	-1.3	13.4	4.3	4.1	4.1	4.2
Private Consumption	-3.5	3.8	5.3	5.0	5.1	4.9
Government Consumption	4.8	3.7	4.0	4.4	3.8	3.6
Gross Fixed Capital Investment	-12.0	-3.7	2.2	1.9	2.4	3.2
Exports, Goods and Services	12.1	41.3	7.3	7.0	6.7	6.9
Imports, Goods and Services	-20.2	6.1	7.8	8.1	8.3	8.5
Real GDP growth, at constant factor prices	-1.6	12.5	4.3	4.1	4.1	4.2
Agriculture	4.6	4.2	4.0	4.0	3.9	3.9
Industry	-1.4	24.7	4.7	4.7	4.8	4.9
Services	-2.5	3.7	3.9	3.5	3.4	3.6
Inflation (Consumer Price Index)	11.9	9.0	9.8	11.4	11.0	10.8
Current Account Balance (% of GDP)	2.3	3.9	4.1	5.4	5.1	4.7
Fiscal Balance (% of GDP)	-1.7	-2.2	-2.4	-2.5	-2.7	-2.6
Gross Public Debt (% of GDP)	41.2	49.0	40.9	53.9	49.2	45.6
Primary Balance (% of GDP)	-1.6	-2.1	-2.3	-0.6	0.0	-0.1

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