IRAN ECONOMIC MONITOR

Weathering the Triple-Shock

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Iran Economic Monitor

Weathering the Triple-Shock

With a Special Focus on
Welfare impacts of inflation and the COVID-19 outbreak in Iran

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ABBREVIATIONS AND ACRONYMS

Bbl	Barrel of oil
CAB	Current account balance
CBI	Central Bank of Iran
COVID-19	Corona Virus Disease 2019 (Novel Coronavirus)
CPI	Consumer price inflation; Consumer price index (Special Focus chapter)
ER	Exchange rate
EMDE	Emerging Market and Developing Economies
FDI	Foreign direct investment
GDP	Gross domestic product
GoI	Government of Iran
HCI	Huma Capital Index
HIES	Household Income and Expenditure Survey
IEM	Iran Economic Monitor
IPO	Initial public offering
IMF	International Monetary Fund
IMF DOTS	International Monetary Fund's Direction of Trade Statistics database
IRR	Iranian Rial
LHS	Left-hand-side
mbpd	Million barrels per day
MENA	Middle-East and North Africa
MoCLSW	(Iran's) Ministry of Cooperatives, Labor and Social Welfare
m-o-m	Month-on-month
NDFI	National Development Fund of Iran
NIMA	Unified system of foreign exchange transactions (Persian acronym)
OPEC	Organization of petroleum exporting countries
PBO	Plan and Budget Organization
pp	Percentage point(s)
PPP	Purchasing Power Parity
RHS	Right-hand-side
SCI	Statistical Centre of Iran
SME	Small and medium-sized enterprise
SOE	State-owned enterprise
TEDPIX	Tehran Stock Exchange main index
TSE	Tehran Stock Exchange
UMC	Upper middle-income countries
US(A)	United States of America
USD	United States Dollar
WB WDI	World Bank World Development Indicators database
y-o-y	Year-on-year

PREFACE

The Iran Economic Monitor (IEM) provides an update on key economic developments and policies. It examines these economic developments and policies in a longer-term and global context, and assesses their implications for the outlook for the country. Its coverage has ranged from the macro-economy to financial markets to indicators of human welfare and development. It is intended for a wide audience, including policy makers, business leaders, financial market participants, and the community of analysts and professionals engaged on Iran.

The Iran Economic Monitor is a product of the World Bank's Global Practice for Macroeconomics, Trade and Investment team. The seventh issue of the IEM was prepared by Majid Kazemi (Economist, Task Team Leader) under the general guidance of Eric Le Borgne (Global Practice Manager) and Saroj Kumar Jha (Regional Director). The Special Focus Section on poverty was written by Laura Rodriguez Takeuchi (Young Professional, Poverty) and under the guidance of Johannes Hoogeveen (Global Practice Manager).

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EXECUTIVE SUMMARY

The Iranian economy entered a third consecutive year of recession following the triple-shock of sanctions, oil market collapse and COVID-19. Gross Domestic Product (GDP) contracted by 6.8 percent in the Iranian calendar year 2019/20[1] as a result of expiration of US sanctions waivers on Iran's oil exports. The spread of COVID-19 and the subsequent collapse in oil markets also impacted the last quarter of the year's GDP (ending March 2020) as oil production reached a three-decade low of 2 mbpd (million barrels per day). Despite the expansion of US sanctions to other key industries, non-oil GDP grew by 1.1 percent in 2019/20 driven by agriculture and manufacturing sectors. Price competitiveness of products in these sectors increased following the currency depreciation. On the demand side, GDP contraction was broad-based as all sectors contracted. GDP shrank at a slower annual rate (2.8 percent) in the first quarter of 2020/21 (Apr-Jun 2020) as COVID-19 health measures were limited and were relaxed in mid-April. The recent weak growth performance adds to a decade-long stagnation. During 2010/11–2019/20 GDP grew at an annualized rate of –0.1 percent and Iran's per capita GDP fell below regional and income group averages.

High inflation placed additional economic stress on lower income households following a sharp depreciation of the currency. In Apr-Nov 2020, inflationary expectations and geopolitical and economic uncertainties sharply increased demand for safer assets, leading the rial to lose 43 percent of its value against the dollar year-on-year (YoY). Iran's ability to buttress the exchange rate pressures was hampered by limited reserves and restricted access to exports proceeds abroad. The currency depreciation impacted consumers as imported goods became more expensive and domestic production prices, especially for tradable goods, increased. Consumer price inflation reached 30.6 percent (YoY) during Apr–Nov 2020 and climbed to a 16-month high of 46.4 percent (YoY) in November 2020. Similar to 2019/20, inflation was led by sharp price increases in food and housing which disproportionately affect lower income deciles.

The decline in revenues led the Government of Iran (GoI) to meet its financing needs through extensive debt issuance and sales of assets on the stock market. The fiscal deficit-to-GDP ratio is estimated to have more than doubled to 3.7 percent in 2019/20 as oil revenues halved and their share in budget revenues fell to a historic low. Oil revenues deteriorated further in 2020/21 following the global oil market collapse leading to only a fraction of budgeted oil revenues (6 percent) in Apr–Jul 2020 being realized. Tax revenues performed better in part due

[1] The Iranian calendar year starts on March 21 of the Gregorian calendar year and ends on March 20 the following year.

to improved collection and price effects. Expenditures grew faster in 2020/21 due to wage bill and pension payment adjustments as well as new transfers to households to counter the negative impact of high inflation and recession. This limited fiscal space led the government to heavily rely on bond issuance and sales of assets in the stock exchange as well as withdrawals from the sovereign wealth fund for emergency expenditures.

Multiple years of recession and high inflation have strained household livelihoods and stalled poverty reduction. In 2018/19, the national poverty rate measured at the international poverty line of USD 5.5 purchasing power parity (PPP) was 12.3 percent, up 1.5 percentage points from the previous year. Inequality (measured by the Gini index) was 35.6 points and continued to increase after 2016/17. Rising living costs eroded the value of cash transfers and labor incomes in real terms. Poverty mitigation measures including cash transfers helped partly mitigate pressures on the poor but also placed additional pressure on fiscal balances due to lack of adequate targeting.

As COVID-19 cases surged, stricter measures were enforced in Fall 2020 and new social transfers were announced. In November 2020, stricter health containment measures were introduced after Iran registered over 1 million COVID-19 cases and the death toll climbed above 49,000 deaths.[2] The economic shock of the COVID-19 pandemic pushed more households into poverty. In response, the authorities unveiled new rounds of cash transfers and consumption loans for lower income deciles and households without a permanent source of income.

Iran's economic outlook remains highly uncertain, especially given the COVID-19 evolution and the continuation of US sanctions. Iran's GDP in 2020/21 is estimated to contract by 3.7 percent due to a dual contraction of the non-oil and oil sectors. The projected contraction remains moderate compared to other countries due to a shorter initial period of domestic containment measures and neighbor countries move to more growth focused mitigation strategies. It also reflects the fact that the economy was already operating well below capacity prior to the pandemic. Oil production is projected to remain close to the first quarter level of 2 mbpd. Overall economic contraction is projected to increase in the second half of 2020/21 (Oct 2020–Mar 2021) as stricter health measures are enforced due to a resurgence of cases in the colder season. In the absence of a vaccine widely adopted in the country until end-2021, recovery in 2021–2022 is projected to be weak and be primarily driven by the non-oil sector.

Fiscal pressures are forecast to increase due to lower revenue growth and higher financing costs. Government revenues are projected to reach a trough in 2020/21 as economic activity contracts before improving in the outer years with the moderate economic recovery and gradual pick up in oil revenues. COVID-19 healthcare cost and social assistance transfers are forecast to add to government expenditure growth which will be dominated by subsidies and labor compensation in 2020/21 and beyond. Extensive bond issuance in 2020/21 is forecast to continue and higher interest payment is projected to lead to a growing overall fiscal deficit in the medium term while the primary fiscal deficit-to-GDP ratio marginally improves.

The Special Focus chapter of this report presents recent poverty figures and assesses the welfare and poverty impacts of the COVID-19 pandemic in Iran. A microsimulation analysis based on shock scenarios included in the Special Focus chapter shows that poverty could substantially increase, by up to 21 percentage points, as a combined result of the fall in household incomes and high inflation through the pandemic. Iranians in the bottom half of the welfare distribution, working in services and high-contact economic sectors, and those in rural areas are disproportionately affected.

Risks to Iran's economic outlook relate to the evolution of the COVID-19 pandemic and geopolitical developments. The economic outlook is subject to significant risks if large resurgences of COVID-19 outbreak force stringent lockdown measures or a reliable vaccine is not widely distributed in 2021. Higher government reliance on debt issuance

[2] As of December 3, 2020.

and stock market sales of assets increase financial contagion risks and could place additional stress on the undercapitalized banking sector. External balances could worsen if further trade restrictions are imposed or demand in China and other main export partners do not recover in the medium term. Upside risks to Iran's economic prospects include a stronger recovery in the oil market. The lifting of US sanctions would have a large positive impact, as it did following the Joint Comprehensive Plan of Action (JCPOA) in 2015. With the economy operating at a lower base and below potential output, recovery in the outer years could be stronger.

The scope of challenges facing Iran's economy raises the urgency of implementing deeper economic reforms complemented with more targeted social protection mitigation strategies. Multiple years of recession has severely undermined the welfare of the Iranians and put unprecedented strain on the most vulnerable which raises the urgency of reforms. Mitigation measures have partly offset these pressures in the past but remain insufficient due to lack of accurate targeting mechanisms and fiscal constraints. The newly piloted Welfare Information Platform of Iranians could be a crucial tool in the implementation of future interventions and social protection strategies. Cash transfers alone would be insufficient to protect the most vulnerable if high inflation continues to reduce the real value of distributed cash transfers. The sustainability of such measures and overall economic recovery will ultimately depend on a package of deeper economic reforms that addresses the economy's structural challenges.

چکیده مدیریتی

اقتصاد ایران به‌دلیل شوک ناشی از سه عامل تحریم‌ها، بحران در بازار نفت و کووید-19 وارد سومین سال پیاپی رکود اقتصادی شده است. تولید ناخالص داخلی ایران در سال 1398 به دلیل پایان یافتن معافیت‌های تحریم آمریکا بر صادرات نفت این کشور، به میزان 6/8 درصد کاهش یافته است. شیوع کووید-19 و بحران متعاقب آن در بازار نفت نیز بر تولید ناخالص داخلی در سه ماهه آخر سال تأثیر گذاشت، چرا که تولید نفت ایران در این مدت به کمترین مقدار در سه دهه اخیر یعنی 2 میلیون بشکه در روز رسید. در سال 1398 علیرغم اعمال تحریم‌های ایالات متحده بر دیگر صنایع کلیدی، تولید ناخالص داخلی بدون نفت، در اثر رشد بخش‌های کشاورزی و تولید، به میزان 1/1 درصد رشد یافت. توانایی رقابت تولیدات این بخش‌ها به‌دلیل کاهش ارزش پول ملی افزایش یافت. در سمت تقاضا، به دلیل رشد منفی تمامی بخش‌ها، انقباض تولید ناخالص داخلی افزایش یافت. با کاهش محدودیت‌های اعمالی ناشی از کووید-19، و همچنین پایدار شدن وضعیت بیماری در اوایل اردیبهشت، سرعت کاهش تولید ناخالص داخلی در فصل بهار سال 1399 (فروردین تا خرداد 1399) کمتر شد (2/8 درصد). رشد ضعیف اخیر به رکود بلندمدت یک دهه گذشته اضافه شده است. در طول بازه زمانی 1398– 1388، مقدار رشد تولید ناخالص داخلی به‌صورت میانگین سالانه 0/1– درصد بوده و سرانه تولید ناخالص داخلی و درآمد ایران به زیر میانگین منطقه‌ای سقوط کرده است.

تورم بالا در اثر کاهش شدید ارزش پول ملی موجب وارد آمدن فشار اقتصادی مضاعف بر خانوارهای کم‌درآمد شده است. در بازه زمانی فروردین تا آذر 1399 انتظارات تورمی و بلاتکلیفی اقتصادی و ژئوپلتیکی منجر به افزایش شدید تقاضا برای دارایی‌های امن شد که در نتیجه آن ارزش ریال در برابر دلار نسبت به مدت مشابه سال قبل 43 درصد کاهش یافت. توانایی ایران برای مقابله با فشار کاهش ارزش مبادله‌ای پول ملی به‌دلیل محدودیت منابع و محدودیت دسترسی به درآمدهای صادراتی، کاهش یافت. کاهش ارزش پول ملی موجب افزایش هرچه بیشتر قیمت کالاهای وارداتی و همچنین کالاهای تولید داخلی به‌خصوص تولیدات داخلی قابل تجارت شد، و در نتیجه فشار به مصرف‌کنندگان افزایش یافت. تورم قیمت مصرف‌کننده در بازه فروردین تا آذر 1399 نسبت به‌مدت مشابه سال قبل به 30/6 درصد رسید و در آذر 1399 به بالاترین مقدار در 16 ماه گذشته (46/4 درصد) رسید. مشابه سال 1398، بخش بزرگی از تورم ناشی از افزایش قیمت مواد غذایی و همچنین اجاره مسکن می‌باشد که در نتیجه فشار تورم به‌صورت نامتناسب توزیع شده و بیشتر بر دهک‌های درآمدی پایین وارد می‌شود.

کاهش درآمدها منجر به این شده است که دولت ایران نیازهای مالی خود را از طریق انتشار گسترده اوراق قرضه و فروش دارایی‌ها در بازار بورس تأمین کند. درآمدهای نفتی ایران نصف شده و سهم آن‌ها در درآمدهای بودجه به کمترین مقدار خود در تاریخ بودجه‌بندی ایران رسیده است، که در نتیجه آن نسبت کسری بودجه به تولید ناخالص داخلی در سال 1398 برآورد می‌شود که بیش از دو برابر شده و به 3/7 درصد رسیده است. با بروز بحران در بازار نفت در سال 1399 درآمدهای نفتی بیشتر کاهش یافت و در نتیجه آن در بازه فروردین تا تیر 1399 تنها بخشی از درآمدهای نفتی بودجه (6 درصد) محقق شد. درآمدهای مالیاتی به دلیل جمع‌آوری مالیات بهتر و همچنین افزایش قیمت‌ها، افزایش یافت. به‌دلیل افزایش حقوق و دستمزد و مستمری بازنشستگی و همچنین کمک‌های معیشتی جدید پرداختی به خانوارها برای مقابله با اثرات منفی تورم بالا و رکود، سرعت رشد هزینه‌ها در سال 1399 بیشتر شده است. محدودیت‌های شدید مالی منجر به این شده است که دولت به انتشار مقادیر زیادی اوراق قرضه و فروش دارایی‌ها در بازار بورس و همچنین برداشت از صندوق ذخیره ارزی برای هزینه‌های اضطراری اقدام کند.

سال‌های متمادی رکود و تورم بالا معیشت خانوار و توقف کاهش فقر را با تنگنا مواجه کرده است. در سال 1397 نرخ فقر در سطح کشور با توجه به خط فقر جهانی که معادل برابری قدرت خرید با 5/5 دلار ایالات متحده، می‌باشد 12/3 درصد بود که 1/5 درصد بیشتر از سال قبل آن بود. نابرابری (برحسب ضریب جینی) برابر با 35/6 بود و مقدار آن پس از سال 1395 همواره افزایشی بوده است. افزایش هزینه‌های زندگی موجب کاهش اثر پول نقدی توزیع شده و همچنین درآمدهای

بخش کارگری شده است. اقدامات برای کاهش فقر مانند توزیع پول نقدی موجب کاهش فشار فقر بر قشر ضعیف شده است ولی در مقابل به دلیل نبود هدف‌مندی کافی موجب وارد آمدن فشار مضاعف به تراز مالی دولت شده است.

با موج جدید موارد ابتلا به کووید-19، محدودیت‌های شدیدتر در پاییز 1399 اعمال شده و اقدامات کنترلی اجتماعی جدید اعلام شد. پس از اعلام گذر ایران از 1 میلیون مورد کووید-19 مثبت تأیید شده و همچنین گذر موارد مرگ و میر ناشی از این بیماری از عدد 49،000[3]، در آذر 1399، اتخاذ اقدامات کنترلی شدیدتری اعلام شد. شوک اقتصادی ناشی از همه‌گیری کووید-19 موجب فقیر شدن خانوارهای بیشتری شد. در مقابل، مسئولین توزیع بسته جدید کمک‌های معیشتی و وام را برای دهک‌های با درآمد کمتر و خانواده‌های بدون منبع درآمد دائمی اعلام نمودند.

چشم‌انداز اقتصادی ایران به‌خصوص با مهار نشدن کووید-19 و ادامه تحریم‌های ایالات متحده به‌شدت نامشخص است. پیش‌بینی می‌شود که به دلیل رشد منفی هر دو بخش نفت و غیرنفتی تولید ناخالص داخلی ایران در سال 1399، 3/7 درصد کاهش یابد. به دلیل مدت زمان کوتاه‌تر اقدامات مهار داخلی اتخاذ شده، رشد منفی پیش‌بینی شده در مقایسه با دیگر کشورها در حد ملایم باقی می‌ماند و کشورهای همسایه به سمت استراتژی های کاهش بیماری با تمرکز بر رشد حرکت می‌کنند. این پیش‌بینی همچنین ناشی از این حقیقت است که اقتصاد در حال حاضر به‌میزان قابل توجهی پایین‌تر از ظرفیت آن قبل از همه‌گیری کرونا کار می‌کند. پیش‌بینی می‌شود که مقدار تولید نفت در سطح سه‌ماهه اول سال به میزان 2 میلیون بشکه در روز باقی بماند. پیش‌بینی می‌شود که با شدیدتر شدن محدودیت‌های ناشی از موج جدید کرونا در فصل‌های سرد سال، رشد منفی اقتصادی در نیمه دوم سال 1399 بیشتر شود. در صورت عدم توزیع گسترده واکسن در کشور تا انتهای سال 2021 میلادی (آذر 1400)، پیش‌بینی می‌شود که بهبود اقتصادی در سال 1400 ضعیف بوده و بار آن در درجه اول بر دوش بخش غیرنفتی باشد.

انتظار می‌رود که به‌دلیل افزایش هزینه‌ها و رشد کمتر درآمدها، فشار اقتصادی افزایش یابد. پیش‌بینی می‌شود که درآمدهای دولت در سال 1399 در مقدار کمینه خود قرار گیرد چرا که فعالیت‌های اقتصادی قبل از بهبود شرایط در سال‌های پیش‌رو حالت انقباضی به خود گرفته‌اند و از طرف دیگر سرعت بهبود اقتصادی متوسط بوده و بازگشت درآمدهای نفتی تدریجی و با سرعتی پایین می‌باشد. پیش‌بینی می‌شود که هزینه‌های مراقبت‌های بهداشتی مربوط به کووید-19 و کمک‌های معیشتی اجتماعی منجر به افزایش سرعت رشد هزینه‌های دولت شوند. بیشترین بخش این هزینه‌ها مربوط به یارانه‌ها و پرداختی‌ها به کارگران بیکار شده می‌باشد که در سال 1399 و پس از آن ادامه خواهد یافت. پیش‌بینی می شود انتشار گسترده اوراق قرضه در سال 1399 ادامه یابد و انتظار می‌رود که پرداخت سود بیشتر به کسری هر چه بیشتر بودجه در میان‌مدت بیانجامد و نسبت کسری بودجه به تولید ناخالص داخلی به‌مقدار اندکی افزایش یابد.

فصل ویژه این گزارش آمار جدید در مورد فقر و ارزیابی اثرات همه‌گیری کووید-19 بر سطح رفاه و فقر در ایران پرداخته است. یک تحلیل شبیه‌سازی خُرد برمبنای سناریوهای شوک که در فصل ویژه آورده شده است، نشان می‌دهد که در اثر کاهش همزمان درآمد خانوار و تورم بالا در طول دوره همه‌گیری، فقر می‌تواند به‌میزان قابل توجهی تا 21 درصد افزایش یابد. ایرانیانی که در نیمه پایین سطح رفاه قرار دارند، و غالباً در بخش خدمات و بخش‌های اقتصادی پرتماس کار می‌کنند، و آن‌هایی که در مناطق روستایی زندگی می‌کنند به میزان نامتناسبی تأثیر می‌پذیرند.

ریسک‌هایی که چشم‌انداز اقتصادی ایران را تهدید می‌کنند مربوط به گسترش بیماری کووید-19 و همچنین تغییرات ژئوپلتیکی می‌باشد. در صورتی که موج جدید کووید-19 به اتخاذ تصمیمات تعطیلی سخت‌گیرانه بیانجامد و یا واکسن قابل اعتمادی در سال 1400 توزیع نشود، چشم‌انداز اقتصادی ایران در معرض ریسک قابل توجهی خواهد بود. تکیه هرچه بیشتر حکومت بر انتشار اوراق قرضه و فروش دارایی‌ها در بازار سهام خطر تسری مشکلات اقتصادی را افزایش داده و می‌تواند موجب وارد شدن فشار هرچه بیشتر به بخش بانکی شود که در حال حاضر با مشکل کمبود سرمایه روبرو است. اگر محدودیت‌های تجاری بیشتری اعمال شود و تقاضای چین و دیگر شرکای صادراتی اصلی در میان‌مدت به سطح قبلی برنگردد، تعادل اقتصادی خارجی می‌تواند بدتر هم بشود. بهبود بیشتر در بازار نفت نیز به‌عنوان یک فرصت و ریسک مطلوب برای اقتصاد ایران می‌باشد. برداشته شدن تحریم‌های ایالات متحده می‌تواند اثرات مثبت قابل توجهی بر اقتصاد ایران، مشابه زمان تصویب برنامه جامع اقدام مشترک (برجام) در سال 1394 داشته باشد. از آن‌جایی که اقتصاد در حال کار در سطحی پایین‌تر از میزان بالقوه خود می‌باشد، بهبود اقتصادی در سال‌های پیش رو می‌تواند با قوت بیشتری روی دهد.

دامنه چالش های پیش روی اقتصاد ایران ، فوریت اجرای اصلاحات اقتصادی عمیق تر همراه با استراتژی های هدفمندسازی یارانه‌ها و حمایت‌های اجتماعی را بیشتر می‌کند. رکود اقتصادی عمیقی که در سال‌های متمادی ادامه داشته است سطح رفاه در جامعه ایران را به‌شدت پایین آورده و فشار بی‌سابقه‌ای را بر قشرهای آسیب‌پذیر وارد کرده است که این مسئله فوریت اجرای اصلاحات را برجسته‌تر می‌کند. اقدامات حمایتی تا حدی این فشار را در سال‌های گذشته خنثی کرده است ولی به‌دلیل نبود استراتژی‌های هدفمندسازی و محدودیت‌های مالی، ناکافی بوده است. پایگاه داده ایرانیان که به‌تازگی به‌صورت آزمایشی اجرایی شده است می‌تواند ابزاری حیاتی در اجرای طرح‌های آینده و راهبردهای حمایت اجتماعی باشد. چنانچه تورم بالا و در نتیجه کاهش ارزش یارانه نقدی توزیع شده ادامه یابد، توزیع این یارانه‌ها به تنهایی برای حمایت از طبقه آسیب‌پذیر کافی نخواهد بود. پایداری این اقدامات و بهبود کلی اقتصاد در نهایت به اجرای بسته‌ای از اقدامات اصلاحات عمیق‌تر اقتصادی برای رفع چالش‌های ساختاری اقتصاد وابسته خواهد بود.

[3] تا تاریخ 13 آذر 1399.

1

RECENT ECONOMIC AND POLICY DEVELOPMENTS

Introduction

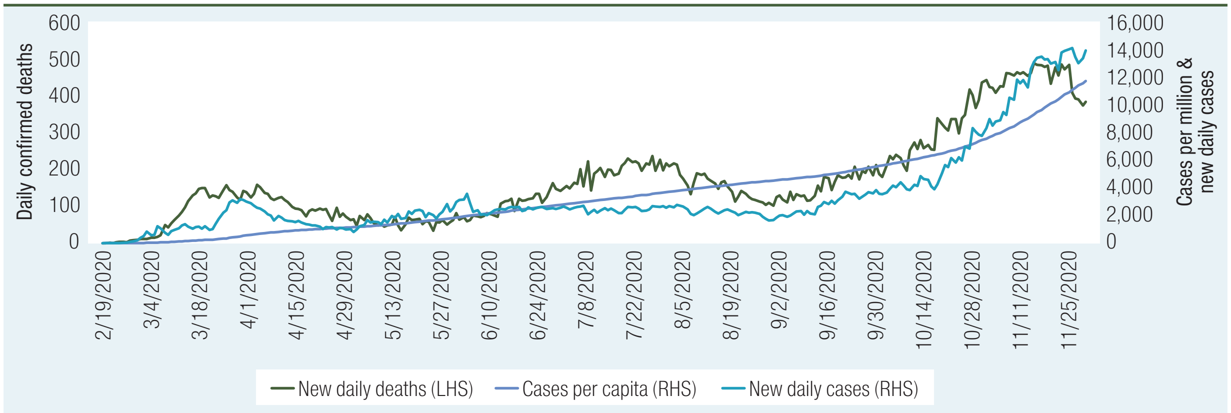
Iran's economy stagnated over the last decade, a legacy of economic sanctions and high dependence on the oil sector. Iran's economy underwent a lost decade (2010/11 to 2019/20).[4] Gross Domestic Product (GDP) grew at an annualized rate of -0.1 percent and key opportunities such as record high oil prices were missed. Economic activity in this period was volatile as the economy experienced various stages of economic sanctions and oil price cycles. This high economic volatility has led to a less favorable investment climate and heightened inflationary expectations. While Iran's economic base is relatively diversified for an oil exporting country, non-oil sector growth remained slow and was also shaped by both oil sector developments and economic sanctions. The marginalization of the private sector has also led to inadequate job creation and undermined economic participation, especially for youth and women. The country's strong economic base thanks to a high human capital wealth (a large young educated population; see, Box 2) and ample natural resources (e.g., hydrocarbon, mineral and strategic geographic location) present vast potential for growth.

The global Coronavirus 2019 (COVID-19) pandemic and US sanctions amplified existing economic challenges since February 2020. The decline in oil exports increased pressures on government revenues and the response to the pandemic's health and economic crisis. Even before the pandemic, large subsidy expenditures, wage bill and pensions expenditures restricted implementation of counter-cyclical fiscal policy. Recent progress in tax effort and debt issuance have helped contain the deficit and meet financing needs, respectively. However, the increasing reliance on bond issuance and asset sales in the stock market has increased exposures of these markets to government financing operations. The large public sector has also marginalized the private sector leading to inadequate job creation and undermined economic activation of the country's young population.

A new wave in COVID-19 cases led to the introduction of stricter measures in Fall 2020 and a new rescue package for the most vulnerable households were announced. After the first COVID-19 cases were confirmed in February 2020, the spread has intensified and claimed over 49,000 lives and over 1 million people contracted the virus as of

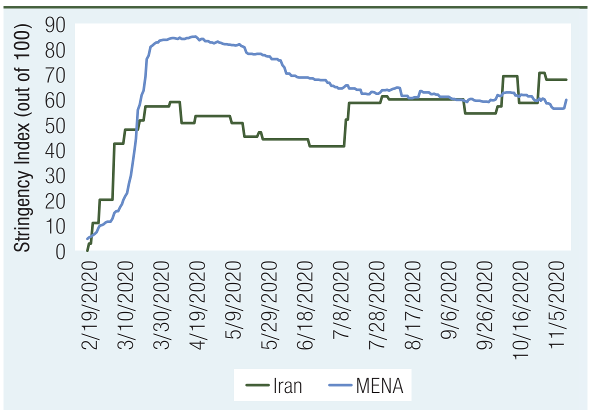
[4] The Iranian calendar year starts on March 21 of the Gregorian calendar year and ends on March 20 the following year.

FIGURE 1 • Confirmed COVID-19 Cases have Risen Sharply Since Sep-2020...



Source: Johns Hopkins CSSE.

FIGURE 2 • ...while Policy Reponse was Initially Less Stringent than MENA Average



Source: Coronavirus Government Response Tracker, University of Oxford and World Bank staff calculations.

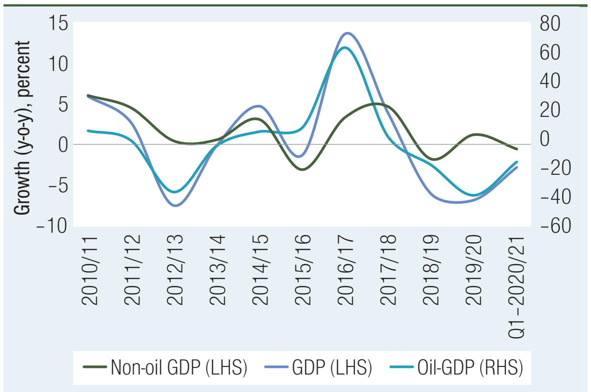
December 2, 2020 (Figure 1). Iran remains the country with the highest number of reported cases, accounting for more than a quarter of cumulative confirmed cases in Middle East and North Africa (MENA). Initial health mitigation measures were relaxed in mid-April and remained less stringent than most other MENA countries facing even lower levels of spread (Figure 2). The surge in daily cases in November 2020 to more than double of the previous peak in July 2020 led to the introduction of stricter containment measures including overnight curfews. The Government of Iran (GoI) also announced additional cash transfers and low interest consumption loans for the bottom deciles to mitigate the impact of these restrictions on the most vulnerable (See Box 2 for a summary of GoI COVID-19 economic relief measures). As the recent World Bank COVID-19 approach paper argues, health measures to save lives and livelihoods need to be at the heart of the policy response to the pandemic around the world.[5]

Output and Demand

Over two years of economic recession, following the reintroduction of US sanctions, has taken a toll on Iran's economy. Iran's real GDP contracted by 6.8 percent in 2019/20 after US sanctions were reintroduced on the oil sector which lead oil sector value-added to shrink by 38.7 percent (Figure 3). Despite the expansion of US sanctions to other key industries, non-oil GDP grew by 1.1 percent in 2019/20 driven by agriculture and manufacturing sectors as the exchange rate (ER) depreciation made domestic production more competitive. The non-oil sector rebound could have been larger in the absence of trade and financial transaction which constrained production and commerce. The recent economic contraction widens the gap between Iran

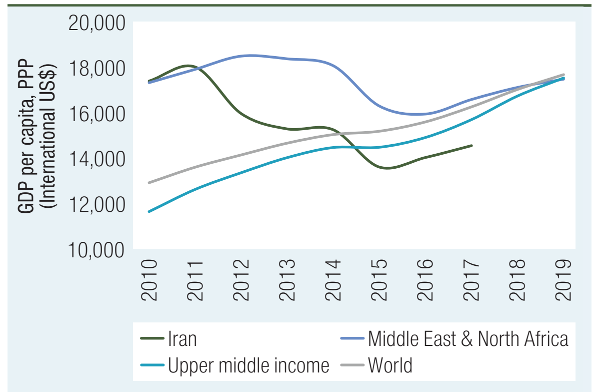
[5] Bank Group COVID-19 Crisis Response Approach paper, available at: http://documents1.worldbank.org/curated/en/136631594937150795/pdf/World-Bank-Group-COVID-19-Crisis-Response-Approach-Paper-Saving-Lives-Scaling-up-Impact-and-Getting-Back-on-Track.pdf.

FIGURE 3 • GDP Contraction Continued, Albeit at a Slower Pace in Q1 2020/21…



Source: CBI and World Bank staff calculations.

FIGURE 4 • …Amplifying Economic Divergence from Regional and Income-Group Benchmarks



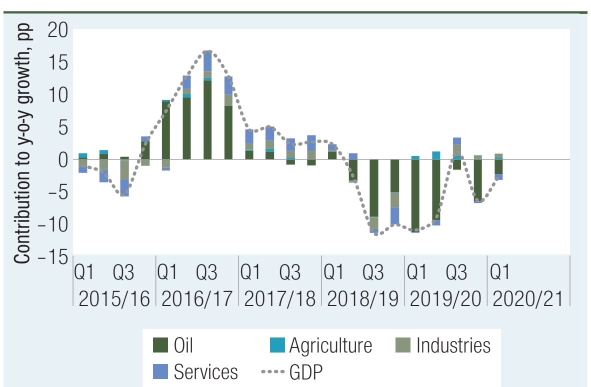
Source: World Bank WDI.

and its income and regional peers, a trend which has deteriorated significantly since 2011 (Figure 4).

Domestic and international COVID-19 restrictions led to a contraction in Apr-Jun 2020, albeit a relatively modest one, partly reflecting the initial economic weakness. The GDP decline continued in the first quarter of 2020/21 (Q1-20/21) as COVID-19 border closures and containment measures in March and April contributed to GDP contracting by 2.8 percent (y-o-y) (Figure 5). This limited impact primarily stems from the US sanctions that had already hit the economy and Iran's limited economic integration with the rest of the world due to decades of sanctions (Box 1 looks at the COVID-19 growth impact in Iran within the global context). In contrast to past recessions, services were much more impacted; a reflection of the large impact that COVID-19 has had on services sectors across the world. Higher government consumption expenditures (1.2 percent y-o-y, real) also contributed to partially offset other sectors' contraction in Q1-20/21.

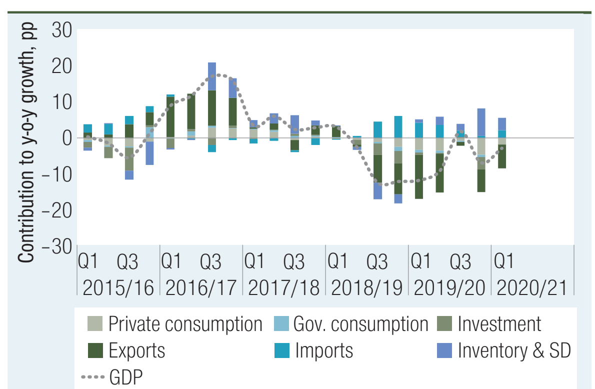
The price competitiveness of tradable sectors partly offset the overall negative impact of the downturn in Q1-20/21. The overall manufacturing production index grew by 1.5 percent (y-o-y) in Apr-Jun 2020 despite lockdowns and trade restrictions. While the growth rate was markedly lower than the previous quarter (10.5 percent, y-o-y,

FIGURE 5 • COVID-19 and Sanctions Hit Oil and Services Hard…



Source: CBI and World Bank staff calculations.

FIGURE 6 • …while Investment and Consumption Continued to Decline



Source: CBI and World Bank staff calculations.

BOX 1. GDP GROWTH UNDER COVID-19, FIRST OBSERVATIONS

Iran's GDP Growth in Q1 2020/21 (Apr–Jun 2020)

Latest available CBI data for Iran's GDP confirms that the COVID-19 crisis contributed to the economic contraction in Q1 2020/21 (Q1-20/21) by 2.8 percent. Figure B1.1 and Figure B1.2 show that the recession was broad based. On the production side, the largest contributor to the contraction was the oil sector followed by services. Part of the oil contraction reflects the carry-over effect from the US sanction waivers which expired in April 2019. Services contraction was significant as the sector had only started to recover in the second half of 2019/20. However, industries (non-oil) and agriculture production both grew despite border closures and weak domestic demand. This could reflect the profitability of domestic production due to local currency depreciation which led to an increase in production in anticipation for a resumption in trade. On the demand side, lower exports and private consumption was partly offset by a sharp decline in imports.

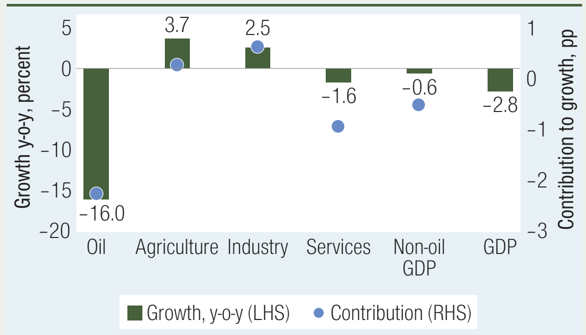
The global context

Around the world, the COVID-19 pandemic and the mitigation measures triggered the deepest global recession since the great depression. The pandemic shocked an already slowing global economy into a deep recession; the World Bank's Global Economic Prospect's baseline forecast of a 5.2 percent contraction in global GDP in 2020 is the deepest in eight decades and almost three times as steep as the 2009 global recession. Despite unprecedented support, advanced economies are forecast to shrink by 7 percent in 2020, while emerging market and developing economies (EMDE) are projected to shrink by 2.5 percent, well below the trough in EMDE growth of 0.9 percent in 1982 and the lowest since 1960.

Countries in the Middle East and North Africa (MENA) have been disproportionally affected by the crisis, with oil producers contracting the most. The sharp fall in demand for oil is curtailing exports in the region's oil exporters, with negative spillovers to non-oil sectors. Moreover, the region continues to suffer from challenges related to longstanding security strains and refugees, as well as large structural impediments to growth. The region's GDP is projected to shrink by 4.2 percent in 2020, significantly constrained by renewed policy cuts in oil production. Among oil exporters, GDP is projected to contract by 5 percent in 2020. Economic activity in the region's oil importers is projected to drop by 0.8 percent, due to spillovers from weakness in advanced economies and major EMDEs, pandemic-related disruptions and falling tourism.

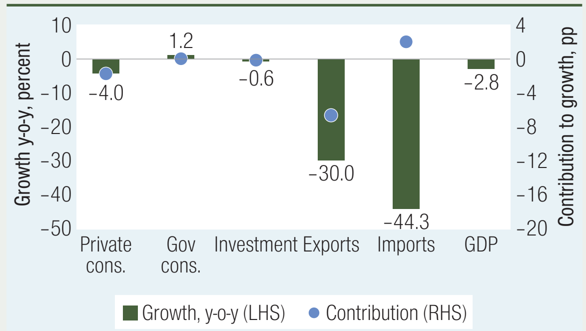
The growth performance of selected countries relative to Iran in Q2 2020 shows that Iran's economy experienced a relatively modest contraction in this period (Figure B1.3). A number of factors could explain the lower GDP contraction in Iran compared to other countries in Apr–Jun. First, Iran's mitigation measures were (initially) not as long-lasting and less stringent than most countries and hence led to a lower shock domestically. Second, while Q1-20/21 was the first full quarter under COVID-19, the direct impact materialized in Iran in February 2020. Indirect impacts likely started even before that (e.g., through lower demand from China). GDP contraction was larger over the two quarters (Jan-Jun 2020 at 11.9 percent, y-o-y). Third, Iran's GDP experienced COVID-19 at an already lower base. Following over two years of recession and multiple round of sanctions, GDP in 2019/20 was only 0.9 percent larger than in 2010/11. Finally, the limited integration of Iranian economy with the international markets at the same time could also translates to lower magnitude of global shocks.

FIGURE B1.1 • Supply-Side GDP Components (Q1-20/21)



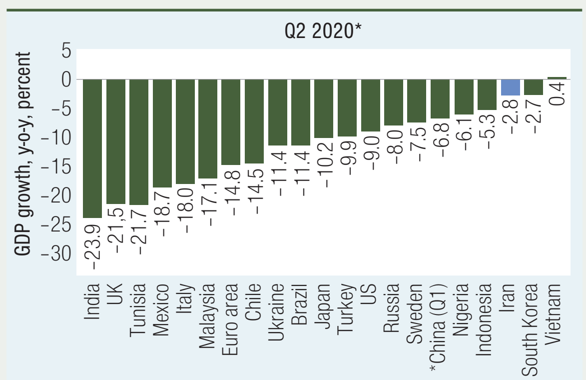
Source: CBI and World Bank staff calculations.

FIGURE B1.2 • Demand-Side GDP Components (Q1-20/21)



Source: World Development Indicators.

FIGURE B1.3 • Q2 2020 GDP Contraction in Iran was Significantly Smaller than Most other Countries



Source: CBI (for Iran) and country statistics agencies.

in Q4-19/20), it marks the third consecutive quarter of positive industrial production, a reflection of the sharp depreciation of the rial in the same period. In the non-tradable sectors such as construction higher prices has weighed on output as domestic consumer purchasing powers deteriorated. In Q1-20/21, construction permits in major cities has fallen by 5 percent (y-o-y) while construction material and services prices rose by over 30 percent (y-o-y).

Weaker global demand and sanctions led Iran's oil production to remain weak in the first half of 2020/21. The decline in production started in earnest in June 2018 shortly after US sanctions on Iran's oil exports were announced. Based on OPEC secondary sources data in the first half of 2020/21 (H1-20/21), Iran's oil production flatlined at just under 2 mbpd, the lowest amount in decades. Iran was exempt from the OPEC+ production cut agreement in April 2020 in response to the collapse in oil prices following COVID-19. Production had remained stable at around 3.8 mbpd for two years prior to the re-imposition of oil export sanctions.

Since mid-2018/19, demand-side GDP components have contracted sharply highlighting a broad-based recession. Even before COVID-19, all expenditure-side components of GDP were declining in 2019/20. Consumption contracted at the second fastest rate in recorded history while investment fell to 60 percent of its peak in 2011/12 as economic uncertainties mounted. Quarterly data shows that as trade restrictions have increased and domestic demand weakened, inventories growth and reduction in imports have been the only sectors with a positive contribution to GDP growth since October 2019 (Figure 6). Private consumption, investment, exports and import contraction in Q1-20/21 marks the eighth consecutive quarter of contraction (y-o-y) across these components.

External Sector

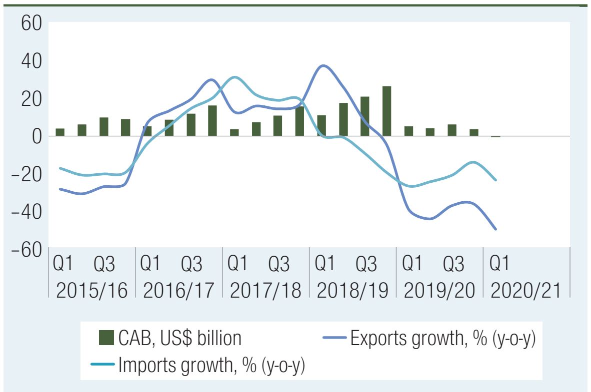
The rapid decline in net exports led to Iran's current account balance (CAB) register a deficit in Q1-20/21. Oil exports fell below 0.7 mbpd in 2019 after US sanction waivers for major importers of Iran's oil ended in April 2019. Import contraction was also large at 38.1 percent (real) in 2019/20 due to rationing of limited foreign exchange (FX) reserves and US secondary sanctions on banking transaction related to trade with Iran. Overall, trade restrictions led to a real net exports decline of 26.9 percent in 2019/20 and the current account surplus declined to 0.9 percent of GDP. Non-oil trade contraction accelerated to 20 percent (y-o-y, nominal) in Apr-Nov 2020 due to COVID-19 and the authorities' widening the list of goods subject to import prohibition. The rial's depreciation was not enough to offset the full impact of weak demand and export restrictions. Iran's CAB registered a US$622 million deficit in Q1-20/21 (0.1 percent share of GDP)—Figure 7.

The large magnitude of oil exports contraction drove CAB dynamics despite its declining share in overall exports (Figure 8). Based on the last publicly available data from Iranian authorities (2017/18) implicit domestic oil consumption, calculated as the difference between production and exports, averaged around 1.5 mbpd. Even in the absence of substantial growth in consumption over the period since then, this indicates that Iran's oil export volumes fell below their 2019 levels (0.651 mbpd, as reported by OPEC), and reached record lows. According to China's customs data, Iran's oil exports to China, its largest oil export destination, was 83.8 percent lower in the first 10 months of 2020 than the same period in 2019/20.[6] Trade restrictions also led to goods transit through Iran to fall by 15 percent (y-o-y) in the first 8 months of 2020/21 (8M-20/21; i.e., Apr–Nov 2020).

US secondary sanctions and COVID-19 trade measures led to a sharp reduction of Iran's exports to major traditional export partners. Iran's exports to its traditional partners including India and China has drastically declined since 2019. China's customs data report that the total value of trade with Iran contracted by 36.5 percent (y-o-y) in Jan–Nov 2020. This followed a 7.3 percent decline in Iran's imports from China and a staggering 56 percent decline in Iran's exports transforming Iran to a net importer from China in contrast to its net trade surplus in previous years. Iran's exports to India plummeted to US$118 million in the

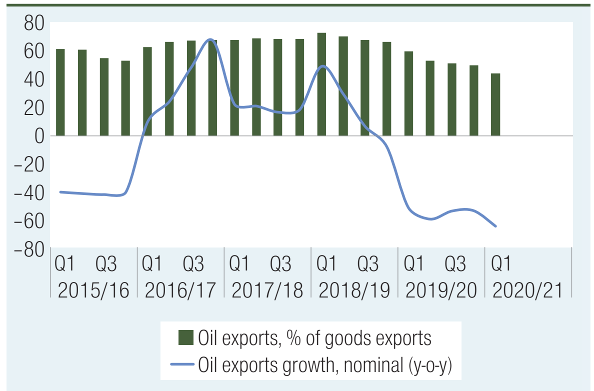
6 Exports of HS 27 goods consisting mainly of crude oil, reported in US$ million.

FIGURE 7 • The CAB Registered a Deficit, Despite Much Lower Imports…



Source: CBI and World Bank staff calculations.

FIGURE 8 • … as Oil Export Revenues Tumbled



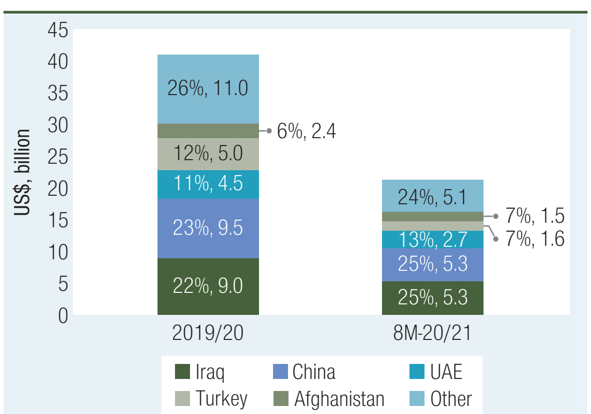
Source: CBI and World Bank staff calculations.

first half of 2020, an insignificant amount (less than 2 percent) compared to its peak in the first half of 2018 (IMF DOTS). As such, Iran's non-oil exports share to Iraq, Afghanistan and United Arab Emirates increased in 8M-20/21 compared to the previous year (Figure 9).

Iran's main import partners remained the same in 2020/21 but imports level were substantially lower. Iran continued to import goods from the same countries as before in 8M-20/21 (Figure 10). However, trade restriction and limited accessible exchange reserves led to Iran's imports to fall to much lower levels in 2020/21. Import substitution measures including bans on goods that are domestically produced continued in 2020/21 and the Ministry of Industries updated the list of import prohibited goods on a regular basis. The majority of Iran's imports, even before the sanctions, consisted of capital goods or intermediate inputs especially used in manufacturing and agriculture sectors. The import control policy, including allocation of preferential exchange rates for essential goods, has proved challenging[7] and contributed to a prevalence of lower

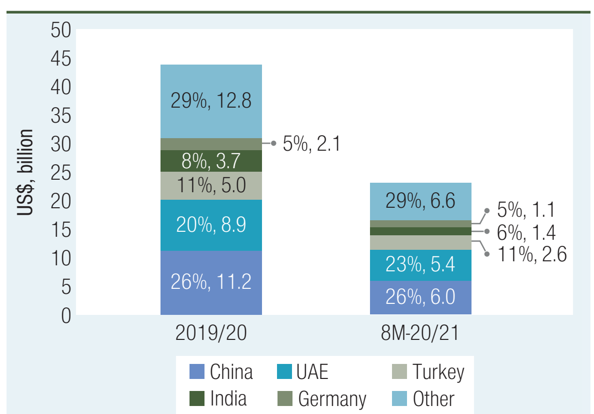
[7] In response to part of these challenges with the aim of increasing transparency, the Central Bank of Iran started publishing information on individuals and companies who received FX at preferential rates on its website.

FIGURE 9 • Non-Oil Exports Fell Sharply and Concentrated on Closer Neighbors…



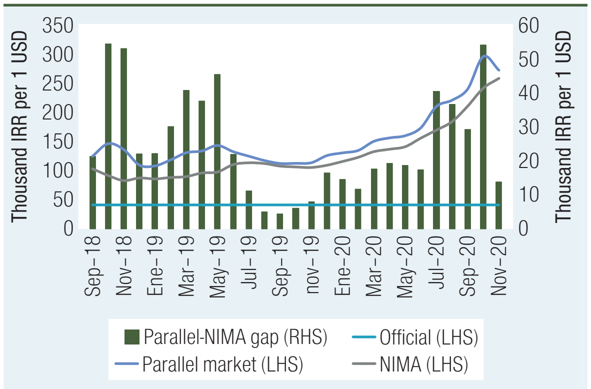
Source: IRICA and World Bank staff calculations.
Note: First number represents country's share (%) in total exports.

FIGURE 10 • …while Origin of Imports Remained Unchanged



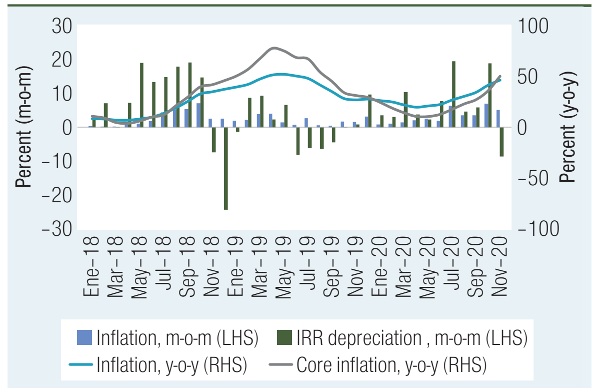
Source: IRICA and World Bank staff calculations.
Note: First number represents country's share (%) in total imports.

FIGURE 11 • The Rial has Depreciated Sharply…



Source: CBI, media and World Bank staff calculations.

FIGURE 12 • … Leading to a Renewed Surge in Inflation



Source: CBI, SCI and World Bank staff calculations.

quality goods and inputs in some sectors (e.g., in parts and machinery or medicine).

Declining international reserves and restrictions on access to existing funds abroad impacted the policy response to external account pressures. The deterioration of Iran's CAB and increased economic certainty have added to existing challenges of accessing reserves held in trading partner countries banks. Iranian exporters also faced challenges and disincentives in repatriating their exports proceeds despite announced deadlines by the Central Bank of Iran (CBI). According to the CBI Governor, more than US$19 billion of export proceeds from 2017/18 and 2019/20 had not still been returned or used for imports as of mid-October 2020. These developments led to a sharp depreciation of the rial in the parallel market (Figure 11). In response, since mid-October 2020 the CBI intervened directly to counter the pressure on the rial with larger direct FX injections in the secondary ER market. These measures along with expectation adjustments following the US elections contributed to the parallel ER experience a downward correction in November 2020.

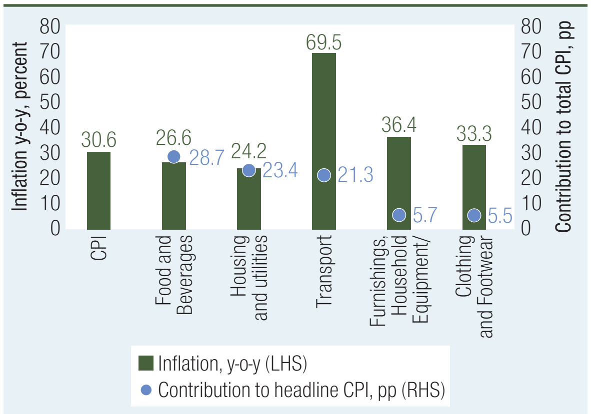
Monetary Policy and Prices

The sharp depreciation of the rial contributed to inflationary pressures in 2019/20, a trend which accelerated in 8M-20/21 (Figure 12)**.** Consumer price inflation (CPI) increased by 10 percentage point (pp) to 41.2 percent in 2019/20 due to a combination inflationary expectations and higher cost push factors. The latter was primarily driven by higher trade transaction costs and a sharp depreciation of the rial. In Apr–Nov 2020, the rial lost 43 percent (y-o-y) of its value against the dollar as restricted access to exports proceeds added to the impact of COVID-19 and geopolitical uncertainties. In tandem with the ER trend, the inflation peaked at 7 percent (MoM) in October 2020 (a 2-year high) as core inflation steadily accelerated. As such, the CBI missed its inflation target of 22 percent for the year after it announced its new inflation targeting policy and open market operations in May 2020.

Headline inflation was led by higher food and housing costs which disproportionately impact lower income deciles. Inflation in the first 8M-20/21 reached 30.6 percent (y-o-y) as price pressures initially eased, due to weak COVID-19 induced demand, before picking up again in May 2020 and steadily rising to a high of 46.4 percent in November 2020 (Figure 12). Similar to 2019/20, CPI was led by price increases in essential goods and services (Figure 13). Food and housing alone account for more than 75 percent of the consumption basket of the bottom 40 percent of the population, versus 51 percent for the highest decile. as defined by the CBI. Price increases in 8M-20/21 were especially high for transportation services (69.5 percent, y-o-y) as the impact of the gasoline price hike of November 2019 materialized.

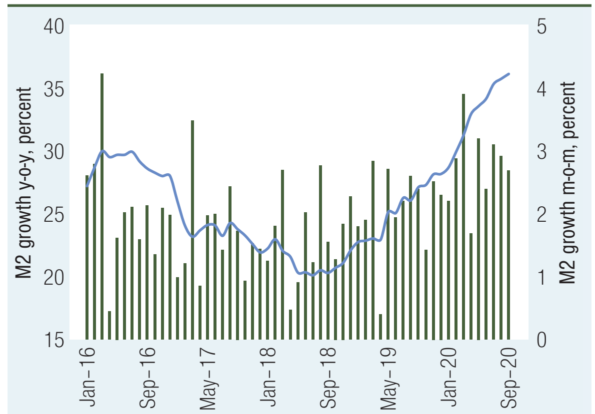
Monetary policy remained loose due to multiple economic shocks and constraints facing the banking sector. Broad money (M2) growth

FIGURE 13 • Lockdowns and Restrictions have Increased Prices of Health and Education Services



Source: SCI and World Bank staff calculations.

FIGURE 14 • Monetary Policy Has Boosted Credit to Private Sector and Money Supply



Source: CBI and World Bank staff calculations.

accelerated in 6M-20/21 to 17.1 percent as the banking sector claims on the government and non-public sectors grew by 31 percent and 18.1 percent, respectively. This in part reflects the increase in bank deposit rates which has reduced the negative real interest rates as well as COVID-19 response measures including temporary reductions in reserve requirements for providing emergency COVID-19 loans. However, high liquidity growth has been an ongoing challenge that the banking sector has faced in recent years (Figure 14). The sector faces deeper structural issues such as banking sector undercapitalization and other imbalances of banks' balance sheets. The non-performing loans (NPL) ratio climbed back over 10 percent in Q1-20/21 as COVID-19 contributed to a 26 percent increase in NPLs compared to the previous quarter (Jan–Mar 2020).

Government budget financing operations increased in the Tehran Stock Exchange (TSE) while the main index underwent a large expansion followed by a sharp correction in 2020/21. The TSE main index (TEDPIX) experienced two distinct periods in 2020/21 (Figure 15). The first stage was a rapid increase (345 percent growth in the index in Apr–Jul 2020) following the depreciation of the currency and a number of TSE initiatives by the Government. The latter included a number of initial public offerings (IPOs) of state-owned enterprises (SOEs) shares and exchange traded funds (ETFs). In addition, the GoI proceeded with removal of trade restrictions of "Justice Shares"[8] which contributed to trading volatility. These measures along with lower banking deposit rates and curbs on FX sales led to a large influx of liquidity to the market. The market bullish trend reversed in Jul–Oct 2020 after an increase in banking deposit rates and delays in the rolling out of a second ETF (consisting of petrochemical sector SOE shares) led to a large correction in the TEDPIX. In November 2020, IRR10 trillion (US$238 million at the official ER) from the National Development Fund (NDFI) of Iran was officially allocated to a TSE stabilization fund.

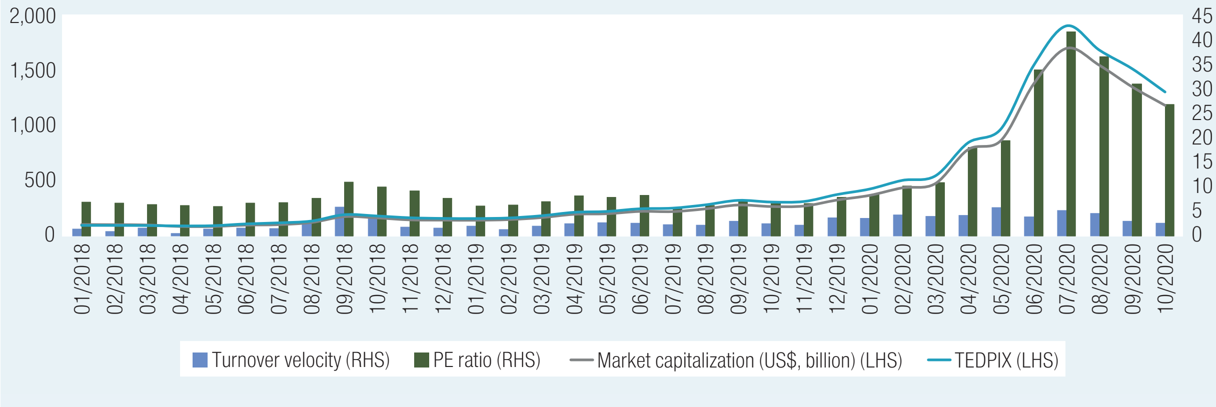
Public Sector Finance

The decline in oil export revenues and subdued economic activity placed unprecedented pressures on government finances.[9] The fiscal deficit-to-GDP ratio more than doubled to 3.7 percent

8 A quasi social assistance program initiated in 2006 based on which the government transferred shares of a basket of SOEs' equity to the bottom deciles. The shares were managed by the government on the shareholders' behalf and dividends were paid out on only a few occasions. As of mid-2020, around 50 million Iranians were reported to own Justice Shares and with recent policy, were able to trade part of their shares directly on TSE if they opted to do so.

9 The GoI has stopped publishing government finances data through public databases since 2018/19, though some information on fiscal aggregates is occasionally shared via the media.

FIGURE 15 • Large Liquidity Inflows Led TSE to Undergo a Rapid Boom and Bust in 2020

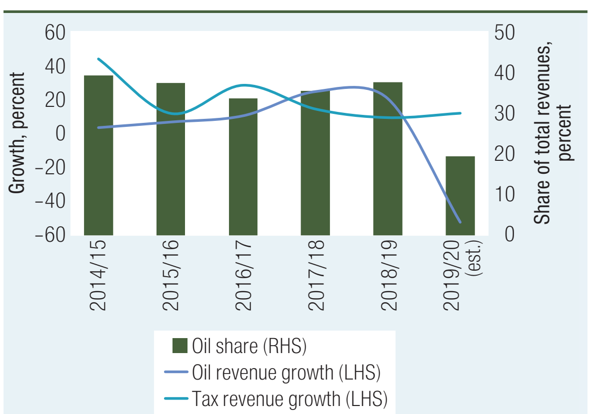


Source: TSE, CEIC and World Bank staff calculations.

in 2019/20, as revenues falling to 11 percent of GDP in 2019/20 (4.2 pp decline). Oil revenues fell by more than 50 percent to reach 2.2 percent of GDP while tax revenues shrank in real terms. Oil revenues share in the budget fell to the lowest amount in recorded history in 2019/20 (19 percent, previous low was 25 percent during the Iran-Iraq). Revenue pressures further mounted in 2020/21. According to the Plan and Budget Organization (PBO), only 6 percent of planned oil revenues were realized in Apr–Jul 2020, however, in the same period more than 75 percent of budgeted tax revenues for 2020/21 were realized. Tax revenue growth, despite the economic contraction and narrowing of the tax base, reflects better collection and the impact of high inflation and sharp rial depreciation (e.g., in the form of higher rial denominated customs tax revenues).

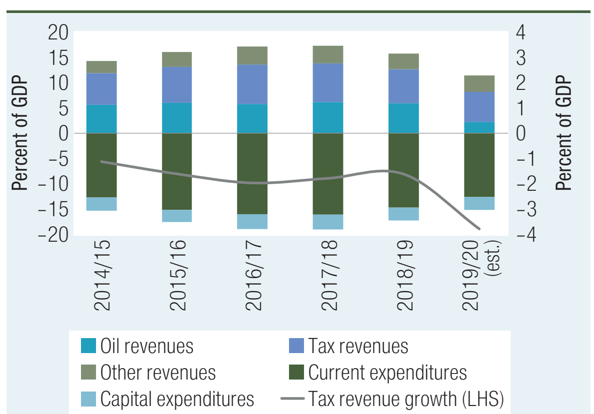
Adjustments to recurrent spending and COVID-19 related expenditures have led to a sharp increase in the fiscal deficit. Slower current expenditures growth (10 percent) relative to a high GDP deflator growth (37 percent) lead total expenditures to fall to 15 percent of GDP in 2019/20, despite stronger capital expenditures growth (23 percent). Expenditures grew faster in 2020/21 due to wage bill and pension payment adjustments as well as new transfers to counter the negative impact of high inflation and recession. Public sector wages and pensions for

FIGURE 16 • Oil Revenues Have Fallen to Historic Lows while Taxes Grew Modestly…



Source: CBI, PBO and World Bank staff calculations.

FIGURE 17 • …leading to a Widening Fiscal Deficit



Source: CBI, PBO and World Bank staff calculations.

2020/21 were increased by 15 percent and 20 percent, respectively. In response to the pandemic, GoI rolled out a number of new cash transfers and low interest loan packages to protect households and businesses (Box 2). As a result of a combination of higher costs and lower revenues, the fiscal deficit is estimated to widen to over 6 percent of GDP in 2020/21.

The Government resorted to wide scale bond issuance, sales of assets and withdrawals from strategic reserves to meet rising financing needs. Disposal of financial assets (mainly bond issuance) increased by 90 percent in 2019/20 following amendments to the budget law. In 2020/21, GoI started selling SOE shares via the stock market and issued bonds through CBI auctions. Financing through the TSE—a combination of bond issuance and sales of SOE shares—in 6M-20/21 was 23 percent larger than that of the entire 2019/20. Other financing

BOX 2. GoI COVID-19 SOCIAL PROTECTION MEASURES

After the COVID-19 outbreak, the GoI introduced multiple financial support measures to mitigate the negative impact of the crisis on households and businesses. In addition the health sector and the unemployment insurance fund also received emergency funds from the initial (IRR1000 trillion or US$24 billion) support package.

Households

The first stage of household measures consisted of two major components:

1. Four rounds of **cash transfers** of between IRR2 million to IRR6 million per household (depending on household size) in each round which covered 3 million vulnerable Iranians. Eligible households were those which neither the head of the family or other members had an income source over the year prior to COVID-19.
2. A single round of **consumption loans** to around 21 million households. The low-interest loan amount was IRR10 million per household and repayments would be taken from future non-COVID-19 cash transfers. Initial studies suggest that the loans had a sizable impact on non-durable goods consumption.[a]

A third indirect mitigation measure after the first COVID-19 peak came with the authorities relaxing previous restriction on trading of Justice Shares in TSE (see footnote 5) which potentially acted as a new savings source for those in need.

These measures were better targeted than past transfer programs thanks to a recently operationalized welfare database by the Ministry of Cooperatives, Labor and Social Welfare (MoCLSW). The *Welfare Information Platform of Iranians* is an intragovernmental data platform managed by MoCLSW that provides economic and welfare indicators for all Iranians. Data is consolidated from 46 different sub-platforms shared by various ministries and public sector entities including Ministry of Finance, Ministry of Education, Ministry of Health, CBI, Social Security Organization, other pension funds, Chamber of Commerce, Civil Registry, Deeds and Properties Registry and Law Enforcement Force.

In November 2020, two new plans were unveiled by the GoI and the Parliament after a new surge in COVID-19 cases was followed by a new round of stricter mitigation measures.

- The **GoI** plan offers four new monthly cash transfers of IRR1 million per individual for the lowest income deciles (covering 30 million people). In addition, eligible households without a stable source of income (covering around 10 million Iranians) qualify for another round of IRR10 million (per household) consumption loans.
- The **Parliament** proposed plan is in the form of 6 monthly transfers of IRR1.2 million per individual to the bottom three deciles (20 million people) and IRR0.6 million per individual for 60 million other Iranians according to the income deciles. The total cost of the plan is IRR300 trillion (US$7.1 billion).

Businesses

The GoI earmarked funds of the total initial rescue package to support businesses and protect jobs. Based on the measure impacted businesses were at low interest rate loans. The size of loan to businesses was determined by the sector of activity and number of employees and was conditional on employees retention. Details on the uptake and the impact of these loans have remained limited.

The GoI COVID-19 response packages complement existing social protection programs including the Targeted Subsidy Reform Plan cash transfers (since 2010), Livelihood Support cash transfers (since the November 2019 gasoline price increase), occasional transfers (e.g., for Ramadhan) as well as other public social assistance plans of Behzisti Organization and Komite Emdad which focus on the most vulnerable households and people with disabilities.

[a] https://voxeu.org/article/emergency-loans-and-consumption-evidence-covid-19-iran.

TABLE 1 • GoI Proposed an Expansionary Budget for 2020/21

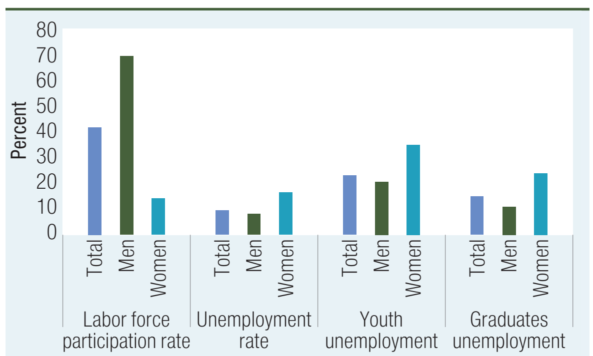
	2020/21 Budget Law (IRR billion)	2021/22 Budget Bill (IRR billion)	2021/22 Budget Bill (US$ billion*)	Growth (%) (relative to 2020/21 Budget Law)
Total Revenues	**3,962,886**	**5,428,678**	**47.2**	**37.0**
Current Revenues	**2,887,991**	**3,175,958**	**27.6**	**10.0**
Tax Revenues	2,038,535	2,479,450	21.6	21.6
Direct Taxes	871,006	1,309,445	11.4	50.3
Indirect Taxes	1,167,530	1,170,005	10.2	0.2
Other Revenues	849,456	696,508	6.1	−18.0
Disposal of Non-Financial Assets	**1,074,895**	**2,252,720**	**19.6**	**109.6**
Oil	569,436	1,992,720	17.3	249.9
Others	505,459	260,000	2.3	−48.6
Total Expenditures	**5,240,136**	**7,410,428**	**64.4**	**41.4**
Current Expenditures	**4,360,316**	**6,370,117**	**55.4**	**46.1**
Development Expenditures	**879,821**	**1,040,311**	**9.0**	**18.2**
Budget Balance	**-1,277,250**	**-1,981,750**	**-17.2**	**55.2**
Disposal of Financial Assets	**1,747,250**	**2,984,750**	**26.0**	**70.8**
Acquisition of Financial Assets	**470,000**	**1,003,000**	**8.7**	**113.4**
Net Disposal of Financial Assets	**1,277,250**	**1,981,750**	**17.2**	**55.2**
Government General Resources	**5,710,136**	**8,413,428**	**73.2**	**47.3**

Source: PBO and World Bank staff calculations.
Notes: * Based on the budget proposal's implicit ER of 115,000 IRR/USD.

sources included sales of new discounted justice shares and withdrawals from the NDFI for COVID-19 social assistance packages. The GoI explored new financing plans including securitization of future oil revenues; the latter was not approved by the Supreme Economic Council[10] for implementation in 2020/21.

The GoI submitted the 2021/22 Budget Bill to the Parliament for approval and proposes important reforms including to the budget structure. The 2021/22 bill proposes an expansionary budget which will be 47.3 percent larger relative to the 2020 Budget Law (Table 1). The bill is based on a

FIGURE 18 • Labor Market Gender Gaps Remain High (Q2-20/21)



Source: SCI.

[10] The Council consists of senior officials including heads of three main branches of power (Executive, the Parliament and the Judiciary) and was established in 2018/19 in response to the economic impact of US sanctions' return.

lower oil price of US$40/bbl and oil sales of 2.3 mbpd (around 0.3 mbpd above the mid-2020/21 production level). The implicit ER assumed in the Bill is 110,000 IRR/USD, substantially higher than the current official ER of 42,000 IRR/USD. The GoI proposes the removal of the top three income deciles from receiving cash transfers while public sector wages and pensions are to increase by 25 percent. The government proposes a smaller allocation of US$8 billion (down from US$9 billion in 2020/21) at the subsidized rate of 42,000 IRR/USD for the importation of essential goods and medicine. However, as part of the draft budget the government requested discretion for scrapping the allocated ER subsidy in 2021/22 if needed and allocate the resources to further social protection measures and capital expenditures. According to the PBO authorities, the bill incorporates some of the elements of a more comprehensive budget reform plan and its execution including performance-based allocation of budgets to increase expenditure efficiency.

Labor Market and Jobs

The worsening economic situation led to a deterioration of employment and labor force participation. Employment increased by 1.8 percent to reach 24.3 million in 2019/20 but fell by 1.5 million (y-o-y) in Q1-20/21 as COVID-19 led to a decline across all major sectors. This trend continued in Q2-20/21 (Jul-Sep 2020) albeit at a slightly lower amount of 1.2 million lower employed (y-o-y). Labor force participation declined by 0.4 pp in 2019/20 to 44.1 percent and in Q2 2020/21 the labor force shrank by 1.6 million (y-o-y). As a result, the unemployment rate in 2019/20 and Q2-20/21 fell to 10.7 percent and 9.5 percent, respectively. Youth unemployment (15–24 years old) remained high in Q2-20/21 at 23.1 percent and total underemployment increased to 9.3 percent from 8.8 percent in Q2-19/21.

The decline in the unemployment rate masks the impact of COVID-19 and the past two years of economic contraction. Since the return of US sanctions and the start of economic contraction in Iran, many jobseekers have either not entered the job market or have exited as they lose hope for finding jobs. The large cohort of Iranians born in 1980s, following a spike in fertility in the period, had postponed entry through continued education and training. Despite this demographic wave, the active population only grew by 25 thousand in 2019/20 and in Q2-20/21 was 5 percent lower than the same period in 2018/19. While part of this could be explained by structural issues such as skills mismatch, it mainly reflects the slow pace of job creation over the last two decades which has led to potential jobseekers' not entering the market. The opportunity cost of this weak activation and employment trend is especially significant for Iran considering the relatively high Human Capital Index in Iran (see Box 3)

The economic recession and COVID-19 has had a disproportionate gender impact in the labor market. The Iranian labor market indicators show the persistence of a large difference between males and females over the years (Figure 18). However, the gender gap has been exacerbated by the economic recessions. Female labor force participation in Q2-20/21 is now 5 times smaller than males compared to a ratio of 1 to 4 in Q2-18/19. In 2019/20, only 14 percent of working age women were working which was down 0.6 pp compared to the previous year. The female employment to population ratio in Q2-20/21 also fell to 11.8 percent, registering a sharper y-o-y contraction compared with males (–2.6 versus –2.2 percent, respectively).

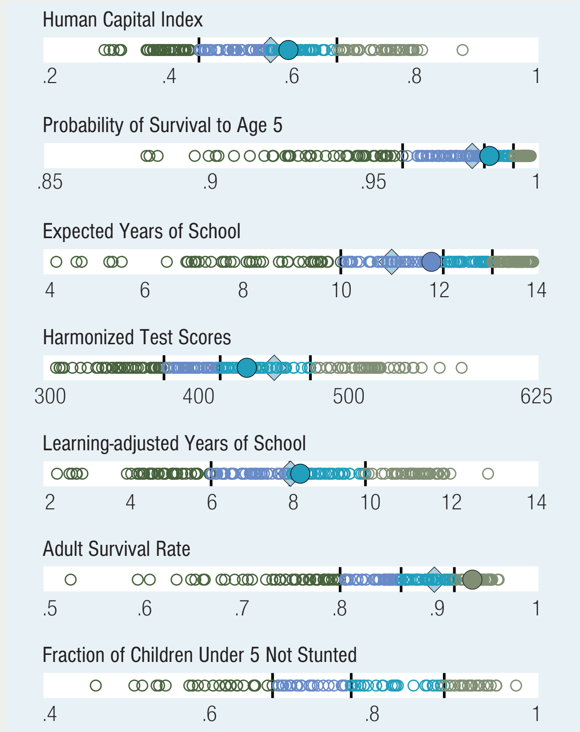
BOX 3. THE HUMAN CAPITAL INDEX IN IRAN

According to the latest edition of the Human Capital Index (HCI) report published by the World Bank in September 2020, a child born in Iran today will reach, on average, only 59 percent of his or her potential productivity when he or she grows up.

First launched in 2018, the HCI estimates the expected productivity of a child born today as a future worker relative to a benchmark of complete education and full health. Using the latest data on education and health outcomes through March 2020, the 2020 index provides a snapshot of the state of human capital in 174 countries before the COVID-19 pandemic and a baseline to track the pandemic's impacts on human capital over time. Figure B3.1 HCI and Components

The HCI is composed of five components (see Figure B3.1):[a]

Probability of Survival to Age 5. 99 out of 100 children born in Iran survive to age 5.
Expected Years of School. In Iran, a child who starts school at age 4 can expect to complete 11.8 years of school by her 18th birthday.
Harmonized Test Scores. Students in Iran score 432 on a scale where 625 represents advanced attainment (300 represents minimum attainment).
Adult Survival Rate. Across Iran, 93 percent of 15-year olds will survive until age 60. This statistic is a proxy for the range of health risks that a child born today would experience as an adult under current conditions.
Healthy Growth (Not Stunted Rate). Data on stunting are not available for Iran.



Note:
- Large circle represents Iran, Islamic Rep. in 2020
- Diamond represents Iran, Islamic Rep. in 2010
- Small circles represent other countries
- Lines and color of circles indicate quartiles of the distribution

Component	Boys	Girls	Overall
HCI	0.58	0.61	0.59
Survival to Age 5	0.98	0.99	0.99
Expected Years of School	11.9	11.8	11.8
Harmonized Test Scores	420	446	432
Learning-adjusted Years of School	8.0	8.4	8.2
Adult Survival Rate	0.92	0.95	0.93

Iran's HCI value of 59 percent is above the averages for the MENA region (57 percent) and upper-middle income countries (56 percent). Between 2010 and 2020, the HCI value for Iran increased from 0.56 to 0.59.

In Iran, the HCI for girls is higher than for boys. Girls measure higher on all components except the expected years of schooling which closely follows boys.

Iran's education outcomes indicators underperform relative to its HCI health indicators. Based on current enrollment rates, an Iranian child can expect to complete only 11.8 years of school placing Iran in the bottom half of the list of countries in the world despite the progress made on this indicator since 2010. When taking into account the quality of learning that actually takes place, this child will achieve only 8.2 learning-adjusted years of school. As a result, more than 30 percent of the time spent in school by an average Iranian child is "wasted" and fails to translate into productive skills when this child enters the workforce. Furthermore, harmonized test scores of Iranian students (especially for boys) has regressed since 2010 highlighting the need for measures and investments to improve education quality.

Sources:
World Bank. Human Capital Project. https://www.worldbank.org/en/publication/human-capital.
World Bank. 2020. ***The Human Capital Index 2020 Update: Human Capital in the Time of COVID-19.*** World Bank, Washington, DC. https://openknowledge.worldbank.org/handle/10986/34432.
[a] *Learning-adjusted Years of School is a product of two HCI components*: Expected Years of School and Harmonized Test Scores.

2

OUTLOOK AND RISKS

Outlook

Iran's economic outlook remains highly uncertain, especially given the COVID-19 evolution and the continuation of US sanctions. Iran's GDP in 2020/21 is estimated to contract by 3.7 percent due to a dual contraction of the non-oil and oil sectors. The growth forecast remains moderate compared to regional comparators due to a shorter initial period of domestic containment measures and neighbor countries move to more growth focused mitigation strategies. Oil production is projected to remain close to the Q1-20/21 level (2 mbpd). Overall economic contraction is projected to intensify in the second half of 2020/21 (Oct 2020–Mar 2021) as stricter health measures are enforced due to a resurgence of cases in the colder season. In the absence of a vaccine widely adopted in the country until end-2021, recovery in 2021–2022 is projected to be weak and be driven primarily by the non-oil sector.

On the external side, Iran's current account balance is projected to remain at low levels as exports slowly recover. The 2020/21 CAB is estimated to register a small deficit for the first time in 15 years due to a decline in exports. The magnitude of the external deficit is partly mitigated by the simultaneous sharp decline in imports as access to international reserves remain limited. As exports begin to recover the CAB is projected to remain at a small surplus in 2021–2022. In the absence of other sources of external financing (e.g., foreign direct investment and remittances) and a rebound in oil prices external pressures are expected to continue.

Fiscal pressures are forecast to increase due to higher financing costs and lower revenue growth. Government revenues are projected to reach a trough in 2020/21 as economic activity contracts before improving in the outer years with the moderate economic recovery and gradual pick up in oil revenues. COVID-19 healthcare cost and social assistance transfers are forecast to add to government expenditure growth which will be dominated by subsidies and labor compensation in 2020/21 and beyond. Extensive bond issuance in 2020/21 is forecast to continue and the higher interest payments is projected to lead to a growing overall fiscal deficit in the medium term while the primary fiscal deficit GDP ratio marginally declines.

Inflation is forecast to remain elevated in the medium term while job creation remains weak

especially as labor force participation increases. Despite the government's refraining from direct monetization of the fiscal deficit inflation is estimated to increase to 39 percent in 2020/21. Notwithstanding the large output gap in the economy, inflationary pressures are expected to remain high due to the scope of economic uncertainties and high liquidity growth as external account pressures continue. Iran's current economic structure undermines the private sector's role as the main engine of job creation and as such jobs prospects even under a modest rebound in 2021–22 will remain insufficient to meet the growing labor supply in absolute terms.

The COVID-19 outbreak will impact households' welfare through reduced labor market incomes and high inflation. The fall in labor market incomes is estimated to increase poverty in the short-term significantly, with households in more affected parts of the country and working self-employed in services sectors being more severely affected. Government cash transfers partly help compensate for the shock, but their mitigation impact is hindered by high inflation continuing to erode their value in real terms. Fiscal constraints may limit the scope for a wider response, but better targeting of cash transfers can help reduce the fiscal cost of mitigation measures. The Special Focus chapter of this issue of the IEM examines the disaggregated impact of COVID-19 and inflation.

Risks and Opportunities

Risks to Iran's economic outlook relate to the evolution of COVID-19 pandemic and geopolitical developments. The economic outlook is subject to significant risks if large resurgences of COVID-19 outbreak force stringent lockdown measures or a reliable vaccine is not distributed in 2021. Economic recovery in the longer term could be weaker if the pandemic leads to a permanent reduction of Iran's productive capacity. Higher government reliance on debt issuance and stock market sales of assets increases financial contagion risks and could place additional stress on the undercapitalized banking sector. External balances could worsen if further trade restrictions are imposed (e.g., on exports to Iraq) or demand in China and other main export partners do not recover in the medium term. With the economy operating at a lower base and below potential output, recovery in the outer years could be stronger. Limited integration of Iran's economy with the rest of the world reduces the magnitude of exposures to external shocks. Upside risks to Iran's economic prospects include a stronger recovery in the oil market which could help Iran's exports through both volume and price channels. The lifting of a significant part of US sanctions would have a large positive impact, as it did following the Joint Comprehensive Plan of Action in 2015.

The multitude of crises facing Iran's economy raises the urgency for further social protection mitigation strategies that are complemented with deeper economic reforms. The recent multiple years of recession has severely undermined the welfare of the Iranians and put unprecedented strain on the most vulnerable which raises the urgency of reforms more than before. Mitigation measures have managed to offset part of the pressures in the past but have largely been ad-hoc and unsustainable due to lack of accurate targeting mechanisms. The newly piloted Welfare Information Platform of Iranians could be a crucial tool in the implementation of future interventions and social protection strategies. Sustainability of such measures and overall economic recovery will ultimately depend on a package of deeper economic reforms such aimed at further economic diversification and private sector promotion.

TABLE 2 • Iran: Selected Economic and Financial Indicators, 2017/18--2022/23

	2017/18 Act.	2018/19 Act.	2019/20 Act.	2020/21 Proj.	2021/22 Proj.	2022/23 Proj.
Real sector		**(annual percentage change, unless otherwise specified)**				
Real GDP at factor cost	3.7	−5.4	−6.5	−3.7	1.5	1.7
Total crude oil production (million barrels/day)	3.8	3.6	2.4	2.0	2.1	2.2
Crude oil, average price (US$)	52.8	68.3	61.4	40.0	42.0	48.0
Money and prices		**(annual percentage change, unless otherwise specified)**				
CPI Inflation (p.a)	9.6	31.2	41.2	39.1	28.3	24.5
Investment & saving		**(percent of GDP, unless otherwise specified)**				
Gross Capital Formation	34.7	34.7	41.3	40.7	41.0	41.3
Gross National Savings	38.3	40.6	42.1	40.1	41.6	41.9
Government finance		**(percent of GDP, unless otherwise specified)**				
Total revenues	17.0	15.4	11.2	9.3	9.5	9.8
Tax Revenues	7.6	6.7	5.9	5.6	5.8	6.0
Direct Taxes	3.5	3.4	3.4	3.1	3.2	3.3
Indirect Taxes	4.1	3.3	2.5	2.5	2.6	2.7
Total expenditures	18.7	17.0	14.9	15.9	16.2	16.7
Current	15.9	14.5	12.5	12.9	12.4	12.3
Net lending/borrowing (overall balance)	−1.8	−1.6	−3.7	−6.6	−6.7	−6.9
Government Debt (% of GDP)	36.1	41.8	42.9	45.1	47.0	49.4
External sector		**(percent of GDP, unless otherwise specified)**				
Current Account	3.5	5.9	0.9	−0.6	0.5	0.7
Net Exports	3.3	5.5	0.7	−0.7	−0.1	0.0
Export of Goods and Services	24.2	22.7	16.0	12.3	12.8	13.4
Import of Goods and Services	21.0	17.1	15.3	13.0	12.9	13.4
Memorandum Items:						
Nominal GDP (Billion IRR*)	15,316,534	19,128,863	24,412,595	31,773,326	42,055,915	53,516,185

Source: Iranian authorities and World Bank staff estimates and projections

SPECIAL FOCUS: WELFARE IMPACTS OF INFLATION AND THE COVID-19 OUTBREAK IN IRAN[11]

This chapter presents the most recent estimates of poverty and inequality in Iran. It also continues and updates the analysis on the welfare and poverty impacts of the COVID-19 pandemic in Iran undertaken in the previous issue of the Iran Economic Monitor. It extends the analysis by assessing the impact of high inflation in the country and the potential mitigation effect of social assistance response measures to the pandemic. Poverty is measured using the international poverty line of USD 5.5 (2011 purchasing power parity (PPP), using the latest revision to PPP estimates). Our analysis shows that the COVID-19 pandemic and continued high inflation heightened already strained household incomes resulting in a substantial increase in poverty. Social protection responses can partly help to mitigate these impacts but can be better targeted.

Introduction

Iran entered its third year of economic contraction following the reintroduction of US sanctions in 2018 and the COVID-19 crisis in 2020. Meanwhile, the depreciation of the Rial continued to fuel inflation. The growth rate in GDP per capita was –7.0 percent in 2018/19,[12] –7.7 percent in 2019/20 and is expected to be –5.4 percent in 2020. Inflation, which had started to come down from the 2017 spike, resurged in 2019/20 as the Rial sharply depreciated. The exchange rate passed IRR 220,000 per USD in the parallel market and the depreciation rate in Apr–Jun 2020 was equal to that of the entire previous year. The Consumer Price Index (CPI) increased by 10 percentage points to 41.2 percent in 2019/20 and inflation has continued to accelerate in 2020 through the pandemic, reaching the highest month-to-month increase in almost 2 years in October 2020.

These macroeconomic trends and the economic shock from the pandemic raise concerns about the welfare of Iranians. The main channels through which the COVID-19 outbreak has impacted household welfare are through reductions in income and through cost of living increases.

[11] This section is a product of the Poverty and Equity Global Practice of the World Bank. It has been written by Laura Rodriguez (lrodrigueztak@worldbank.org).

[12] As in the rest of the report, numbers on Iran in this note are based on Persian calendar which bridges two years in Gregorian calendar starting and ending in March.

Incomes for self-employed workers in the services and high-intensity contact sectors that are difficult to do from home have been the most hardly hit.[13] Inflation, especially rising prices for food and other basic commodities have further deteriorated the living standards of households. Ongoing government cash transfers help compensate for the income shocks, but their mitigation impact is reduced by high inflation which erodes the real value of the transfers. This note examines in detail these impacts.

Recent Poverty and Inequality Trends in Iran

The poverty measurement in this note follows the methodology of previous Iran Economic Monitor reports and well-established international standards. In the absence of an official poverty line, the poverty threshold is the international upper middle-class poverty line of USD 5.5 PPP per day. Measuring poverty requires firstly to define an indicator to measure welfare or living standards. The note uses both household consumption and household income (expressed per person), following standard procedures to construct the aggregates and implementing price adjustments to ensure comparability within survey years and across them (Deaton and Zaidi, 2002; Haughton and Khandker, 2009).[14] For the poverty line—the minimum level below which a person is considered to be poor—we use the international upper middle-class line[15] of USD 5.50 expressed in Purchasing Power Parity (PPP) terms (Jolliffe and Prydz, 2016).[16] Figures from 2016/17 onwards are updated using the May 2020 revision to PPP rates[17] and thus differ from previous estimates;[18] trends and within-country patterns discussed in previous works (Kazemi et al., 2020; Hayati et al. 2018) remain valid.

Poverty reduction in Iran stalled in recent years, and inequality is on the rise. Three special focuses in the Iran Economic Monitor (Hayati et al., 2018; Kazemi et al., 2020) reported recent poverty and inequality trends and their determinants. During a period of poverty reduction between 2009/10 and 2012/13 poverty fell by almost four percentage points; a remarkable performance which was driven by the universal cash transfer program introduced in 2011. Declining values of the transfers in real terms could not sustain this poverty reduction, leading to a gradual increase in poverty in the following years until 2016/17**.** The national poverty rate fell slightly from 11.6 in 2016/17 to 10.8 in 2017/18 (Figure 19), mostly due to increases in labor incomes (Kazemi et al., 2020). Poverty rose again to 12.3 in the most recent estimate for 2018/19, a change that was again related to the erosion of cash transfers and labor incomes in real terms (ibid). Urban and rural poverty have followed similar trends, although rural poverty is considerably higher, standing at 24.2 percent in 2018/19 (compared to 8.3 in urban areas). Inequality measured by the Gini index has increased continuously since 2016/17 (Figure 20). Inequality within urban areas also saw a continued increase in the period, but that within rural areas did not rise in 2018/19.

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13 Skills surveys from 53 countries reveal that workers in hotels and restaurants, construction, agriculture, and commerce are less likely to be able to work from home (Hatayama et al., 2020). Phone surveys conducted by the World Bank across developing countries have revealed that women and lower educated workers have been more likely to lose their jobs, especially in industry and services sectors (Sanchez-Paramo and Narayan, 2020). Similar findings have been echoed in the US, UK and Germany (Adams et al., 2020).

14 The consumption aggregate excludes expenditure on health and durables and is inter-temporally and spatially deflated to account for changes in prices during the survey period and spatial variation in prices. The CPI rates used to convert figures to 2011 values come from the Statistical Center of Iran (SCI).

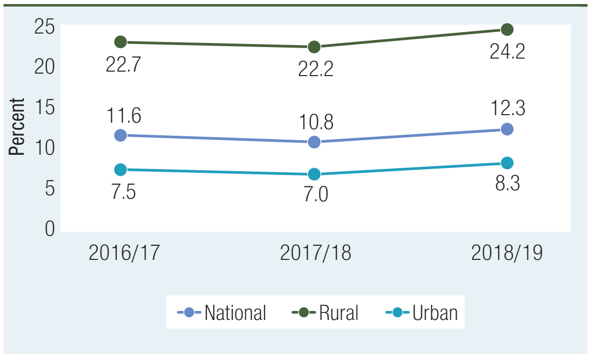
15 Because extreme poverty is almost nonexistent in Iran, we do not use the most common USD 1.9 poverty line.

16 The levels of poverty are slightly different than those reported by the World Bank for global poverty monitoring (in World Development Indicators and PovcalNet). The main difference comes from the way welfare aggregate is created.

17 https://www.worldbank.org/en/programs/icp#6.

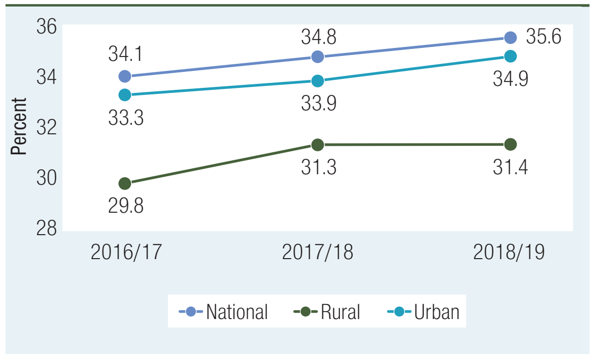
18 As in many other countries and the global estimates, poverty increased with the revised 2011 PPP figures (Atamanov et al., 2020a).

FIGURE 19 • Headcount Poverty Rates (consumption per capita) at USD 5.5 2011 PPP National and by Rural/Urban Areas, 2016/17-2018/19



Source: Author's calculations based on HIES 2016/17–2018/19.

FIGURE 20 • Gini Index (consumption per capita) National and by Rural/Urban Areas, 2016/17-2018/19



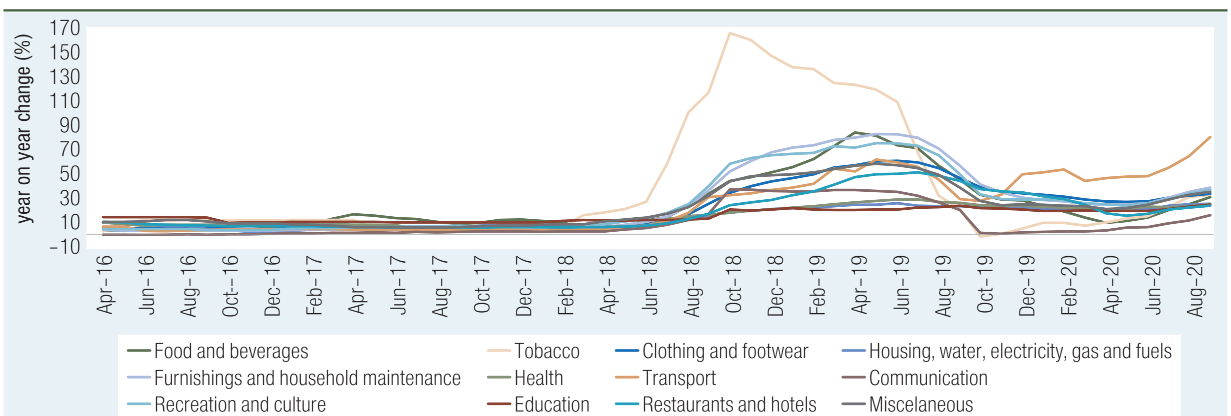
Source: Author's calculations based on HIES 2016/17–2018/19.

The Impact of COVID-19 and Inflation on Household Welfare and Poverty

High inflation returned to Iran in 2020. Food prices have spiked, with particularly worrisome implications for the cost of living of the poor and vulnerable. After price increases in 2018, the continued depreciation of the Rial and the COVID-19 pandemic heightened inflation again in 2020. The sharp depreciation of the exchange rate increased import prices, which in turn pushed the domestic price of imported goods. Among the top 5 imported products in Iran are maize, rice and soybeans; vegetables are 15 percent of total imports.[19] As many key staples are imported, food prices are especially exposed. The COVID-19 pandemic—which reached Iran early in 2020—heightened these pressures. Problems with supply chains, restrictions to labor mobility and lower global demand through the pandemic have been reflected in rises in agriculture prices and food price inflation in many countries. The highest increases in CPI in Iran have been for food, beverages and tobacco (Figure 21). Prices for many other items, such as furnishings and household equipment, recreation and culture and transportation have also been high.

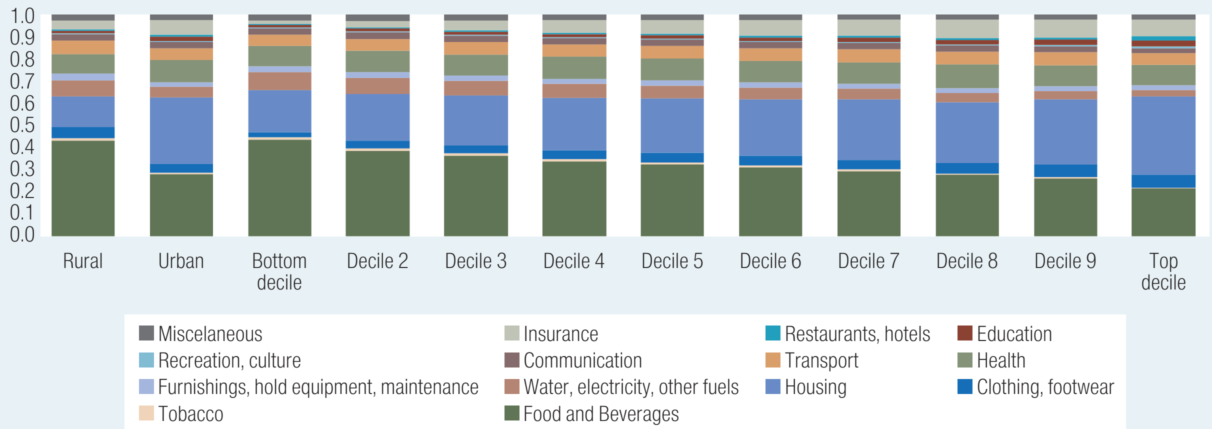
[19] Data for 2017 from the World Integrated Trade Solution (WITS) https://wits.worldbank.org/.

FIGURE 21 • National CPI by Type of Goods and Services (% change y-o-y)



Source: Author's calculations based on SCI.

FIGURE 22 • Expenditure Shares by Type of Goods and Services (%) (by rural/urban and welfare decile)



Source: Author's calculations based on HIES 2016/17.

Rising living costs are strongly connected to declining socio-economic wellbeing, but not everyone is equally affected. The degree to which purchasing power declines with inflation depends on the items consumed as well as spatial variations in price increases. For instance, tobacco expenditures are only 1 percent of the total household budget, so a large price increase would be minimally felt by most. Rising food costs have deeper implications, especially for the poor. Food shares are as high as 43 percent of the household budget[20] in rural areas and for households in the lowest welfare decile (Figure 22). Rent inflation affects more heavily the middle-class and even the more affluent urban households as housing costs shares are large in urban areas (30 percent of total expenditure) and in the top decile (35 percent). Transport costs represent around 5–6 percent of expenditure without much variation across the distribution.

Combining data on inflation with different expenditure baskets for households in different regions and across the welfare distribution, we calculate group-specific price indices. Methodologically, the estimation follows Cravino and Levchenko (2017), who estimate the impact of the 1994 Mexican hyperinflation for household living standards across the income distribution.[21] Unlike a generic price index, which weights price increases for different goods and services using a common basket for the whole country, a group-specific price index instead accounts for variations in consumption baskets, incorporating, for instance, the higher share of expenditures on food by poorer households, or higher rent expenses by urban ones. Unlike the CPI reported by the Statistical Center of Iran (SCI), which exists for deciles and by provinces separately, group-specific indices here are further disaggregated for intersections of those groups (e.g. rural areas in a specific province) allowing a more detailed analysis. Further, they are adapted to the welfare aggregate used for the poverty measurement, excluding durable items and health expenditures.

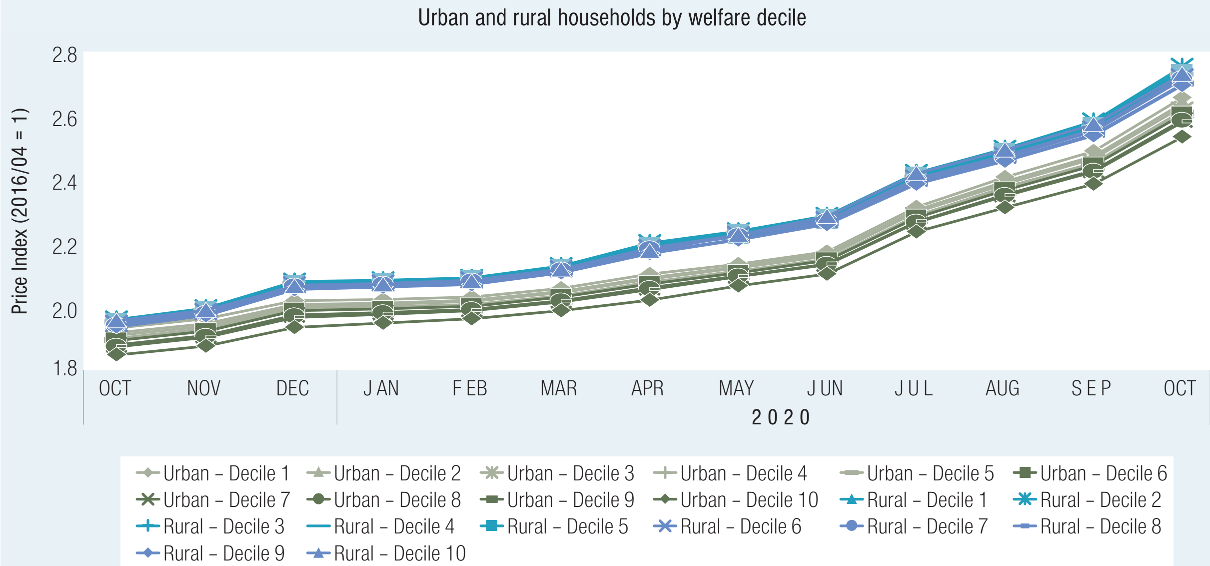
There is clear variation in inflation between different groups, with poor rural households and households in rural Zagros[22] being most affected. On average nationally, by October 2020, the consumption basket was 2.6 times more expensive compared to April 2016. Rural households across the distribution saw the highest rise in the price of their consumption basket (Figure 23). The

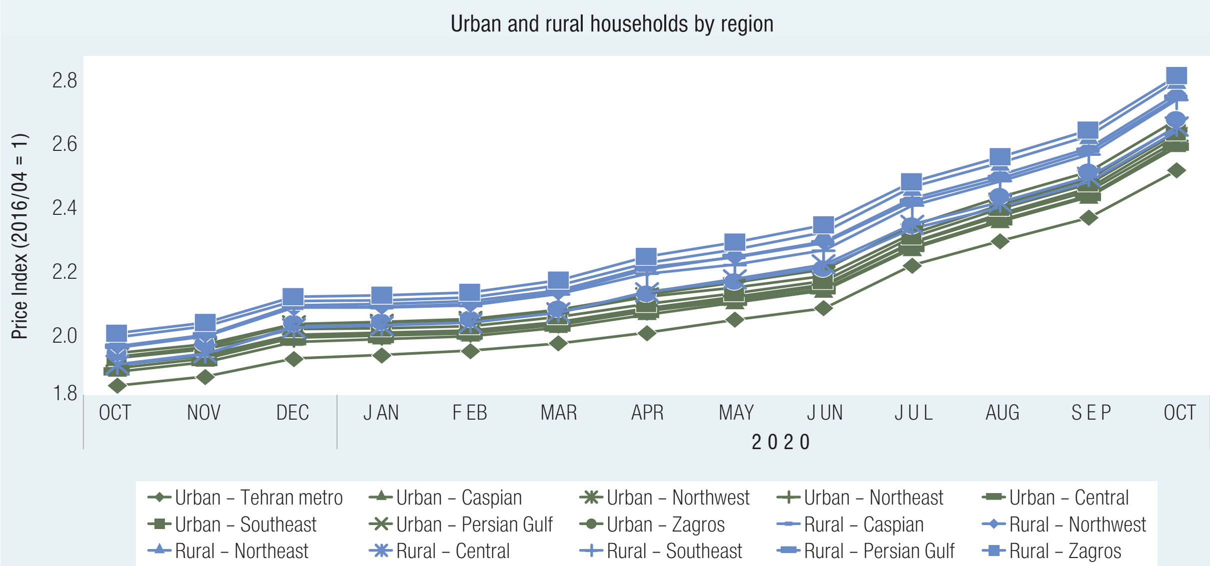
20 Because households may change the composition of their budgets as a response to high inflation, budget shares are calculated for 2016/17 before the inflationary pressures began in Iran.

21 Although we are only able to identify the changes in welfare attributed to the variation of prices for households that consume different types of goods (across variation) but not that owing to the within variation.

22 Provinces are grouped in regions. See note in Figure 5.

FIGURE 23 • Group-Specific Price Index (April 2016 = 1).





Source: Author's calculations based on HIES 2016/17 and CPI from SCI.
Note: Provinces are grouped in the following regions: Tehran metro (Urban parts of Tehran and Alborz); Caspian (Golestan, Gilan, Mazandaran); Northwest (East and West Azarbaijan, Zanjan, Ardebil); Nortеast (Khorasan Razavi, Semnan, North and South Khorasan); Central (Rural parts of Tehran and Alborz, Qom, Qazvin, Markazi, Fars, Isfahan); Southeast (Kerman, Sistan, Yazd); Persian Gulf (Khuzestan, Bushehr, Hormozgan); Zagros (Kermanshah, Kurdestan, Hamadan, Bakhtiari, Lorestan, Ilam, Kohkiloyeh).

rural poor experienced the highest increase—2.8 times by October 2020. The cost of living increase for urban households was overall smaller, but with variations across the welfare distribution; a 2.7 time increase for urban households in the poorest welfare decile and a 2.5 times increase for the richest urban households, the lowest cost of living increase for any group and lower than the national average. Some parts of the country were also more heavily affected. Households in rural Zagros (Kermanshah, Kurdestan, Hamadan, Bakhtiari, Lorestan, Ilam and Kohkiloyeh) experienced the largest price increases (2.8 times increase), and households in the urban parts of the region also felt high inflation (2.7 times). Households

TABLE 3 • Parameters by Type of Income and Economic Sector of Occupation

Income Source	Scenario Parameters
	% of initial income (months without income)
Self-employment general	0.80 (2.4 months)
Self-employment selected sectors*	0.50 (6 months)
Salary – public sector	1 (no change)
Salary – private sector general	0.90 (1.2 months)
Salary – private sector selected sectors*	0.70 (3.6 months)
Household transfers (remittances)	0.95 (1 month)
Pensions	1 (no change)
Social assistance (pre-COVID)	1 (no change)

Note: *Selected sectors are construction; retail; transport; hotels and restaurants; communications; real estate; administrative and support activities; entertainment and art; other services.

in Tehran metropolitan area saw the lowest price rise in their consumption basket (2.5 times increase). Among urban households, those in the Persian Gulf (2.6 times) and the Southeast (2.6 times) parts of the country saw relatively high inflation compared to those in other regions.

We extend estimations of the welfare impacts of the pandemic economic shock developed in Kazemi et al. (2020) to assess the added impact of the high inflation in the country. This follows a partial-equilibrium analysis to simulate the first-order effects of the shock on various sources of household income using micro-level data from the 2018/19 Household Income and Expenditure Survey (HIES). The income change is then applied to the welfare aggregates (consumption per capita and income per capita) to calculate the increase in the poverty rate. In a second step of the simulation, using the group-specific price indices we add the impact of inflation, that is, an estimate of how much households could now afford given the new prices. As a baseline, the welfare aggregates from HIES 2018/19 are nowcasted to 2020 by applying nominal private consumption per capita growth, and the poverty line is updated using the changes the group-specific price indices to obtain its value in the same baseline year. The baseline poverty rates are 15.2 percent (consumption per capita poverty) and 20.4 percent (income per capita poverty).

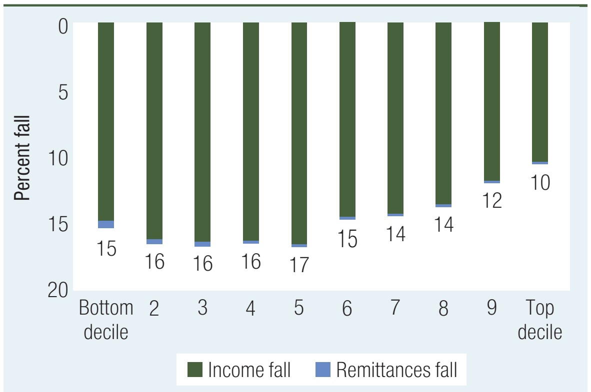
The income effects vary for wage and self-employment income and by sector of employment. Table 3 displays the parameters, with 1 indicating no change in income after the shock. For instance, self-employment income is assumed to decline to 80% of the pre-shock annual level. We could think of this as a fall in this type of income for two-and-a-half months of the year. Labor income changes are adjusted by province of residence to account for some regions of the country being more heavily affected by the disease than others.[23] There is an additional small shock to private household transfers (domestic and international remittances), which have fallen through the pandemic.[24]

The resulting fall in total incomes is larger for the poorest half of households who mostly work in sectors highly affected by the pandemic. These income losses are estimated to increase poverty by 10 percentage points. Under the simulation, the labor income and remittances shocks result in an average reduction of 14.5 percent in total household income. Households in the bottom half of the welfare distribution face a loss ranging from 15 to 17 percent, while the total income loss for those in the top 50 percent ranges from 10 to 14 percent (Figure 24). The larger falls for poorer households are associated with their greater reliance on self-employment and being in sectors such as construction, retail, transport and hotels and restaurants, which are the most affected by the economic shock and the restrictions imposed to curve the pandemic. As a result of these income losses, poverty rises by 10 percentage points from the baseline when measured with the consumption aggregate and by a similar magnitude when measured with the income aggregate (Figure 25).

[23] The province-specific parameters vary slightly from that in Kazemi et al. (2020) to account for the evolution of the virus spread across provinces since then.

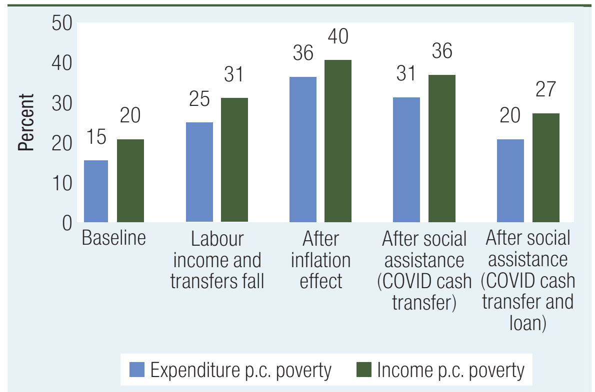
[24] Ratha et al. (2020) estimate a 5 percent fall in international remittance inflows to Iran in 2020 compared to 2019. We are unable to distinguish domestic from international remittances in HIES.

FIGURE 24 • Income Reduction across Consumption Per Capita Deciles (% change)



Source: Author's calculations based on HIES 2018/19.

FIGURE 25 • Simulated Poverty Impacts. Headcount Poverty Rates at USD 5.5 2011 PPP



Source: Author's calculations based on HIES 2018/19.

The fall in incomes through the pandemic is exacerbated by high inflation, which reduces how much households can afford. The increase in the cost of the household consumption basket increases poverty by another 11 percentage points. Because inflation reduces how much households can afford with a given income, accounting for the rise in the cost of living further increases poverty: by 11 percentage points in the case of the consumption poverty measure and by 9 points using the income poverty measure.

Despite a tight fiscal space, the GoI has adopted a series of measures to mitigate those impacts. A cash transfer aimed at informal poor workers has a small impact on aggregate poverty figures; a broader targeted consumption loan has potentially larger mitigating effects across the distribution. Two social assistance measures have been adopted in Iran so far to respond to the crisis: a cash transfer to 3 million poor households[25] without a formal income before the pandemic, and a low or no-interest loan to about 21 million households across the country.[26] We simulate these responses to assess their potential impact (Table 4). Despite being a relatively small program, the first measure can mitigate about 5 percentage points or about a quarter of the increase in consumption poverty because of its narrower targeting at the bottom of the distribution.[27] The consumption loan adds 10 percentage points of mitigation, bringing poverty closer to the pre-COVID

25 Distributed in 4 rounds between April and June 2020.

26 The loan was available for households who were receiving the existing energy subsidy reform compensation transfer. Of the eligible households, about 21 million households applied for it.

27 It can mitigate almost a fifth of the increase in income poverty.

TABLE 4 • COVID-19 Social Assistance Response Scenarios

Social Assistance	Scenario Parameters	
	Recipient allocation in survey	Amount (IRR per household/ year)
COVID cash transfer (4 rounds)	Approx. 3 million households without formal wage, pension or property income and in the bottom 7 deciles of the household consumption distribution.	IRR 2 million plus IRR 1 million for each additional household member up to IRR 6 million for households with 5 or more members.
Consumption loan	Approx. 21 million households receiving existing social assistance transfers excluding those in the top decile of the household consumption distribution.	IRR 10 million. No interest repayments.

baseline. Since the loan is intended to be repaid as lower future subsidy reform cash handouts, its mitigation impact might be somewhat reversed if the crisis is prolonged.

As the COVID-19 pandemic continues to unfold in a harsh economic environment, protecting households from further deterioration of their economic wellbeing is paramount. In late November 2020 the parliament approved an additional, broadly targeted social assistance transfer to further help mitigate the economic impact of the pandemic on households. At an estimated cost of IRR 300 trillion (USD 7.1 billion), it is intended to reach 60 million Iranians.[28] Nonetheless, as with previous cash transfers in Iran, its impact will be limited if cost of living increases continue to deteriorate its real value.

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[28] Details are yet to be implemented but the expectation is of a smaller transfer per household (IRR 1.2 million for households in the bottom three deciles and IRR 600 thousand for those in middle deciles).

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